

How wide is your indemnity liability? August 2014

In the case of *Durley House Ltd v Firmdale Hotels plc* [2014] EWHC 2608 (Ch), the English High Court has provided a useful review of the liability of an indemnifier under a contract of indemnity, where the indemnified person has not itself made a payment to the "creditor".

In response to the defendant / indemnifier's argument that the indemnified party could not claim for damages where he himself had not made any payment to the "creditor", the High Court held that prior payment was not required and that equitable principles require the defendant to directly pay the creditor under the indemnity - unless the indemnity agreement contained express provision that prior payment by the indemnified was a condition precedent to the indemnifier's liability.

This case is a timely reminder to consider the inclusion of express provisions dealing with whether liability is conditional upon actual payment by the indemnified party, among other details, when entering into indemnity agreements.

The facts

In this case, the Plaintiff was under an obligation to pay rent to the Lessor (i.e. the creditor) under a tenancy agreement ("**Lease**"). The Plaintiff subsequently entered into a management agreement with the Defendant ("**Management Agreement**") under which the Defendant agreed to pay the rent due under the Lease directly to the Lessor and, also, to indemnify the Plaintiff against "*all liability, damage or loss resulting from*" the Defendant's breach of the Management Agreement.

The Defendant failed to pay the rent due under the Lease and defaulted under the Management Agreement. As the Lessor did not have a contractual relationship with the Defendant, the Lessor claimed against the Plaintiff, who in turn, brought proceedings against the Defendant, for payment of the unpaid rent.

During the course of the Plaintiff's proceedings against the Defendant, the Plaintiff entered into a settlement agreement with the Lessor ("**Settlement Agreement**")

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whereby the Plaintiff agreed to pay the Lessor the net proceeds of its claims against the Defendant ("**Net Proceeds**") in consideration for a discharge of the Plaintiff's liabilities to the Lessor under the Lease. Pursuant to the Settlement Agreement, the Plaintiff was not under an obligation to pay the Lessor until it received payment from the Defendant under the proceedings. In defence, the Defendant claimed that:

1. the effect of the Settlement Agreement was that the Plaintiff has been discharged from its liability under the Lease and, therefore, the Plaintiff has no rental liability against which it required to be indemnified by the Defendant; and
2. since the Plaintiff has not paid the rent to the Lessor, as a matter of law, it cannot claim damages from the Defendant for breach of the contract of indemnity.

Judgment

The High Court held that as a matter of construction, the Settlement Agreement had not released or discharged the Plaintiff from liability under the Lease, as any discharge was conditional upon the Plaintiff paying the Net Proceeds to the Lessor. This construction was consistent with business common sense and was the obvious intention of the parties to the Settlement Agreement. As such, the Plaintiff was still liable to the Lessor for the rent due under the Lease.

With regards to the indemnity provided by the Defendant, the High Court held that prior payment of the rent by the Plaintiff was not a pre-condition to establishing the Defendant's liability under the indemnity. Under the equitable principles of specific performance, the Court may require the Defendant to directly pay the Lessor the rent due under the Lease, and in doing so, hold the Plaintiff harmless against "*all liability, damage or loss resulting from*" the Defendant's breach of the Management Agreement. However, if the indemnity had expressly provided that prior payment by the Plaintiff was a condition precedent to the Defendant's liability under the indemnity, equity will not override the intention of the parties.

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Therefore, it is recommended for a party proposing to give an indemnity against another party's liabilities to carefully consider including an express provision dealing with whether its liability is conditional upon actual payment by the indemnified party to the "creditor", and specifying the person, the amount, and the time for payment under the indemnity.

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