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**Indemnities against Breach of Contract**

## **Indemnities against Breach of Contract**

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### **Introduction**

#### **Background**

I have been asked to explain the operation of one particular type of indemnity, namely, an indemnity against breach of contract. An example of such a clause would read:

A must indemnify B against any breach of this agreement by A.

As explained below, the task of explaining the operation of such an indemnity is not an easy one.

Clauses under which one party to a contract agrees to indemnify the other against its own breach of contract are undoubtedly in general use. Normally with respect to contract provisions which are in general use, such as entire agreement clauses, liquidated damages provisions, exclusion clauses, termination clauses and so on, it is possible to find a line of modern authority to debate. Strangely, there is no such line of authority either in Australia or England in relation to an indemnity clause of this type. To say the least, from a legal as well as a commercial perspective, it is a rather alarming state of affairs that a provision which is found in many modern contracts is more or less untested in the courts. Of course, the conclusion might be drawn from the absence of authority that the operation of such clauses is well understood. If only that were the position.

Where there is no authoritative line of authority, it is usually appropriate to go back to first principles. However, we are blocked there as well. As recent discussions in the literature illustrate very clearly,<sup>105</sup> in relation to contractual indemnities it is

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105 See Rafal Zakrzewski, 'The Nature of a Claim on an Indemnity' (2006) 22 *JCL* 54; Nuncio D'Angelo, 'The Indemnity: It's All in the Drafting' (2007) 35 *ABLR* 93.

difficult to identify a common ground for such first principles. Different conclusions may therefore be reached. The overall result is a surprising level of uncertainty at the most basic level. There are, I think, two main reasons for this. The first is that any discussion tends to search for a set of characteristics common to all indemnities. There is an assumption that an indemnity is a particular animal. Although common characteristics may exist, they are not easy to isolate. Arguably, that is simply a reflection of the fact that, as explained below, indemnities come in all shapes and sizes.

Second, in so far as a set of characteristics common to all indemnities does exist, it is not clear which of these apply to an indemnity against breach of contract.

### **Categories of indemnity**

The indemnity commonly found in contracts under which A agrees to indemnify B against A's breach of contract is an express indemnity. The closest analogy, somewhat surprisingly, is the indemnity provided by a liability insurer.

However, an indemnity need not be express. It may also be implied. But, except in unusual circumstances a general indemnity against breach of contract will not be implied. An implied indemnity against breach may be found in a contract under which a person undertakes fiduciary responsibilities.<sup>106</sup> However, the basis for the implication is the fiduciary duty. Since not every breach of contract will also be a breach of fiduciary duty, it would be incorrect to say — even in this context — that a court may imply an indemnity against breach of contract. Indemnities are often implied in favour of a person who acts on behalf of another. A specific illustration is where a charterer impliedly agrees to indemnify a shipowner against the consequences of complying with its orders in relation to the vessel.<sup>107</sup> A more general one is that a principal impliedly agrees to indemnify his or her agent in relation to authorised acts.<sup>108</sup>

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<sup>106</sup> See, eg *Eastern Shipping Co Ltd v Quah Beng Kee* [1924] AC 177.

<sup>107</sup> See *Sig Bergesen DY & Co v Mobil Shipping and Transportation Co (The Berge Sund)* [1993] 2 Lloyd's Rep 453 at 462; *Action Navigation Inc v Bottiglieri di Navigazione SpA (The Kitsa)* [2005] 1 Lloyd's Rep 432 at 437; [2005] EWHC 177 (Comm) at [15]. In some standard forms of charterparty the indemnity is express.

<sup>108</sup> *Birmingham and District Land Co v London and North Western Railway* (1886) 34 Ch D 261 at 275. See also *Lane v Bushby* (2000) 50 NSWLR 404 (entitlement of partner under partnership legislation).

Indemnities may arise independently of contract. For example, even if an agency relationship is not contractual, the agent will have an implied right of indemnity from the principal, at least in relation to expenses. Again, an indemnity may arise under statute.<sup>109</sup> Again, a trustee is entitled to be indemnified out of trust assets where it acts in accordance with its powers. That is a different kind of indemnity again. Indemnities may also arise as an incident of a remedy. For example, in making orders to achieve restitutio in integrum a court may order that the plaintiff be indemnified by the defendant in relation to liabilities.<sup>110</sup>

### Definition

Given the diversity of bases and contexts for indemnities, there is an obvious difficulty in defining an indemnity. In *Sunbird Plaza Pty Ltd v Maloney*<sup>111</sup> Mason CJ said:

An indemnity is a promise by the promisor that he will keep the promisee harmless against loss as a result of entering into a transaction with a third party ...

However, that definition cannot possibly be accepted as a general definition. That is obvious, not only because an indemnity need not be contractual in nature but also because not all contractual indemnities relate to ‘loss as a result of entering into a transaction with a third party’. The statement must therefore be seen (as it was intended to be seen) as a definition of a particular type of indemnity. Alternatively, and probably more accurately, it is simply a statement of a particular kind of promise.

In *Victorian Workcover Authority v Esso Australia Ltd*<sup>112</sup> Gleeson CJ, Gummow, Hayne and Callinan JJ defined an indemnity as an ‘obligation imposed by contract or by the relation of the parties to save and keep harmless from loss’. This definition is more easily adapted to the range of circumstances in which indemnities may be found. It is also a useful starting point for the type of indemnity with which this paper is concerned.

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<sup>109</sup> See, eg Trade Practices Act 1974 (Cth), s 74H (manufacturer must indemnify seller).

<sup>110</sup> See *Newbigging v Adam* (1886) 34 Ch D 582, affirmed sub nom *Adam v Newbigging* (1888) 13 App Cas 308 (indemnity in respect of partnership liabilities).

<sup>111</sup> (1988) 166 CLR 245 at 254; 77 ALR 205. Deane, Dawson and Toohey JJ agreed. See also *Andar Transport Pty Ltd v Brambles Ltd* (2004) 217 CLR 424 at 437; 206 ALR 387; [2004] HCA 28 at [23] per Gleeson CJ, McHugh, Gummow, Hayne and Heydon JJ (both guarantees and indemnities ‘are designed to satisfy a liability owed by someone other than the guarantor or indemnifier to a third person’).

<sup>112</sup> (2001) 207 CLR 520 at 528; 182 ALR 321; [2001] HCA 53 at [16].

## Categories of Contractual Indemnity

### General

Merely defining a concept does not tell us the characteristics of the concept. Thus, the statement that the obligation of an indemnifier is to 'save and keep harmless from loss' does not explain how that is done, or what 'harmless' means. Moreover, given the range of situations in which indemnities operate, it must be difficult to identify common characteristics of indemnities. Indeed, it would seem self-evident that indemnities cannot all share the same characteristics. Logically, the most that can be said is that certain characteristics are common to particular kinds of indemnity. Since the present concern with a particular type of contractual indemnity, it is appropriate to identify the categories of contractual indemnity in common use.

Contractual indemnities are agreements, that is, promises of indemnity. They can nearly always be reduced to the form:

A promises to indemnify B against [X].

A is the promisor (indemnifier) and B is the promisee (indemnified party). In this generalised form, the indemnity is *against* the occurrence of an agreed event. 'X' is that agreed event. Therefore, to draft a contractual indemnity all we need to do is to replace X with the particular event against the occurrence of which A promises to indemnify B.

Consider for a moment a typical contract for the sale of goods. If a seller promises to sell goods to a buyer, and the buyer promises to accept the goods and pay the agreed price, two things may be noticed. First, the promises relate to events which the parties desire to occur. Second, the law regards the agreed return for each promise as equivalent. In other words, although in fact the seller may have made a good (or a bad) bargain, that is irrelevant to the validity of the contract terms.<sup>113</sup> The position is simply that *for the parties* the agreed return for each promise is equivalent to the agreed return of the other. That necessarily holds true, at least in the commercial context, if only one of the parties provides an indemnity against breach of contract.

If A promises to indemnify B 'against' the occurrence of an event (such as a breach of contract), the event is not something which either A or B desires to occur.

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<sup>113</sup> Cf Nick Sage, 'Should Contract Law Demand Equality in Exchange? Reflections on Substance, Procedure and Modus Vivendi' (2008) 24 *JCL* 28.

Such indemnities deal with *fortuitous* events. Indemnity promises are therefore examples of aleatory promises. That is why the classic example of a contractual indemnity is the indemnity promised by a liability insurer. Since litigation in relation to insurance is common, there is a vast body of law on indemnities under insurance contracts. In that context, the feature common to all bilateral contracts — equivalence of the agreed return for each promise — needs some explanation. If an insurer promises to indemnify an insured for the insured's negligence, and the insured pays a premium of, say, \$10,000, the parties understand not only that the insurer may never come under an obligation to pay anything, but also that the insurer's liability on the indemnity may far exceed the premium paid by the insured. It is the element of risk — the risk that the event insured against will occur — which makes the payment of \$10,000 'equivalent' to the insurer's promise to pay.

However, relying on insurance law as a guide to general principles immediately creates a problem for most lawyers. Insurance contracts are not like standard bilateral contracts. The features of insurance contracts are not replicated in contracts in general. The differences give rise to a quite specific philosophy in contract drafting. Insurance law is a specialised area. In fact, in many areas only those with an intimate knowledge of the type of insurance (and the relevant market) will have a full understanding of the legal effect of the contract and its exclusions and limitations. An indemnity against breach in a contract for the provision of services is simply one term of the contract. Under a contract for liability insurance, the indemnity is the contract.

There are, however, three common features:

- (1) neither the indemnifier nor the indemnified party desires the relevant event to occur;
- (2) neither the indemnifier nor the indemnified party promises that the relevant event will occur; and
- (3) the scope of the indemnity may be the subject of express provision.

An analysis of indemnities against breach of contract must therefore pay some attention to the approach to promises of indemnity insurance. But it must equally be borne in mind that the case law in relation to indemnity insurance is not the general law of contract. For that, and other reasons, it is dangerous to generalise from the cases on insurance contracts to indemnities against breach of contract.

### **Four categories of contractual indemnity**

Just as an insurer takes on a risk, so also does a contracting party who provides an indemnity against the occurrence of an event. Indeed, it seems to me quite correct to say that where A contracts to indemnify B against the occurrence of an event, A is acting as B's 'insurer' in relation to the risk that the event will occur.<sup>114</sup> And, just as there are various categories of indemnity insurance, so also are there various categories of contractual indemnity.

If the analysis of contractual indemnities is limited to indemnities against the occurrence of events, it is possible to identify four important categories of contractual indemnity. The first is the indemnity against breach of contract with which I am primarily concerned. This may be described as a 'party-party indemnity'.

The second category is the one most familiar to banking and finance lawyers, namely, that given by a guarantor. The relevant promise is the indemnity promise under a 'contract of guarantee and indemnity'. The promise relates to events arising under another contract, that is, between the creditor (promisee in relation to the indemnity promise) and the principal debtor. This may be termed a 'guarantor indemnity'.

Next there is the indemnity against claims by a third party. Although these are most commonly found in contexts such as software supply contracts, any commercial contract could include an indemnity against claims brought against the indemnified party by a 'third party', that is, a claim by anyone other than the indemnifier. This has been described as the 'primary meaning' of 'indemnity'.<sup>115</sup> I term it a 'third party claims indemnity'.

If A enters into a contract with B, the contract may require A to indemnify B in relation to B's liability to A. Because it is the reverse of a party-party indemnity, this fourth category may be termed a 'reverse indemnity'. It effectively operates as an exclusion of B's liability to A.<sup>116</sup> As recent decisions show,<sup>117</sup> such indemnities are

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<sup>114</sup> This is perhaps a fact that a client who is willing to give an indemnity might not actually appreciate.

<sup>115</sup> *Total Transport Corp v Arcadia Petroleum Ltd (The Eurus)* [1998] 1 Lloyd's Rep 351 at 358 per Staughton LJ (with whom Auld LJ agreed).

<sup>116</sup> The infamous rules on exclusion of liability for negligence were stated in *Canada SS Lines Ltd v R* [1952] AC 192 at 208 in the context of such an indemnity.

sometimes used. The scope of the indemnity may extend to events which do not involve any breach of duty. In that respect, the indemnity may include a ‘claims indemnity’ under which the claimant may be anyone, *including* the indemnifier.

### **What’s in a name?**

If a contract includes a promise described as an ‘indemnity’ it is natural to think that it will be so construed. However, even if the promise is so described, that is clearly not conclusive.<sup>118</sup> There is a long line of cases on the distinction between guarantee and indemnity in the context of Statute of Frauds provisions which clearly shows that whether a promise is an indemnity (or a guarantee) is a question of construction.<sup>119</sup> This question is not a linguistic one. The point at issue is the *legal effect* of the promise.<sup>120</sup>

The importance of this extends beyond the need to distinguish a guarantee from an indemnity. There are three points. First, the parties’ use of a word which has a particular legal significance, such as ‘licence’, ‘agent’ or ‘indemnity’ does not require a court to treat the clause as having the characteristics which might be thought to be inherent in the label. There may be a presumption that the parties have applied the right label to the promise, but the label itself cannot be conclusive. It is not uncommon for courts to speak of a right to damages as entitling a promisee to an ‘indemnity’ from the promisor.<sup>121</sup> The sense of the word is ‘compensation’. Therefore, if a contract says that A must ‘indemnify’ B against A’s breach of contract, the first question which must be asked is whether ‘indemnify’ simply means ‘pay common law damages to’.

The second point is that even if a promise is otherwise accurately described as an indemnity, the detail of the clause may indicate that it has a different legal effect. For example, assume that a clause says:

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<sup>117</sup> *Schenker & Co (Aust) Pty Ltd v Maplas Equipment and Services Pty Ltd* [1990] VR 834; *Andar Transport Pty Ltd v Brambles Ltd* (2004) 217 CLR 424; 206 ALR 387; [2004] HCA 28.

<sup>118</sup> The converse is also true, although more difficult to establish. See, eg *Mediterranean Freight Services Ltd v BP Oil International Ltd (The Fiona)* [1994] 2 Lloyd’s Rep 506 (Art IV, r 6 of the Hague-Visby Rules). Contrast *Commonwealth v Aurora Energy Pty Ltd* (2006) 235 ALR 644; [2006] FCAFC 148.

<sup>119</sup> J W Carter, *Carter on Contract*, LexisNexis Butterworths, Sydney, §09-070.

<sup>120</sup> *Yeoman Credit Ltd v Latter* [1961] 1 WLR 828.

<sup>121</sup> See, eg *Addis v Gramophone Co Ltd* [1909] AC 488 at 491; *Total Transport Corp v Arcadia Petroleum Ltd (The Eurus)* [1998] 1 Lloyd’s Rep 351 at 357.

A must indemnify B against any Loss (other than a Consequential Loss) caused by breach of this agreement by A.

It may be argued that the qualification (‘other than a Consequential Loss’) prevents the clause operating as an indemnity. That would depend on the definition of ‘Consequential Loss’. But the point is that if it is assumed that a promise has certain characteristics by reason of its status as an indemnity, drafting which is inconsistent with those characteristics will mean that the promise does not have the status of an indemnity. It will not therefore attract the attributes of an indemnity. I will return to this point later,<sup>122</sup> but it is appropriate to say that many clauses labelled as indemnities — and regarded as such by the parties and their lawyers — may not be indemnities at all.

The third point is also one which is discussed in more detail later. In *Moschi v Lep Air Services Ltd*<sup>123</sup> Lord Reid said:

I would not proceed by saying this is a contract of guarantee and there is a general rule applicable to all guarantees. Parties are free to make any agreement they like and we must I think determine just what this agreement means.

Lord Reid’s warning in relation to contracts of guarantee is equally applicable to indemnity promises. Ultimately, the legal characteristics of a promise of ‘indemnity’ is a matter of intention.

## **Objectives of Contractual Indemnities**

### **Introduction**

What are the objectives of a contractual indemnity? If the party-party indemnity is compared with other categories of contractual indemnity commonly found, one point which emerges is that the objective of a party-party indemnity is not nearly as clear as might generally be assumed.

It is, of course, trite to say that indemnities allocate risks. That is true of all contractual promises. However, as was noted above, where a contractual indemnity relates to a fortuitous event it allocates the risk of an undesired event occurring. A person who purchases liability insurance has the objective of allocating the

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<sup>122</sup> See below, text at n 63.

<sup>123</sup> [1973] AC 331 at 344. See also *Sunbird Plaza Pty Ltd v Maloney* (1988) 166 CLR 245 at 256, 270; 77 ALR 205.



(undesired) risk to the insurer who is prepared to undertake the risk because it has assessed the chance of the risk occurring, and decided that the risk is a 'good' one to bear. Simply expressed, the insurer has done its sums in relation to the risk. The whole contract is drafted to define and regulate the risk.

The guarantor indemnity in a contract of guarantee and indemnity also has a specific objective. It is, in essence, designed to deal with the situation where the guarantor is not liable in that capacity.<sup>124</sup> If, for example, the contract between the principal debtor and the creditor is not enforceable by reason of the debtor's lack of contractual capacity, the guarantor's promise of guarantee is (as a collateral promise) also not enforceable. But since the guarantor indemnity is enforceable, the creditor may recover its loss on the principal contract.<sup>125</sup>

It is easy to see the objective of the third party claims indemnity. If the indemnified party is sued, the indemnifier must pay any loss suffered by the indemnified party. Like insurance contracts, such indemnities may be the subject of detailed drafting. For example, the indemnified party may be required to permit the indemnifier to take over the defence of the claim, there may be provisions designed to protect the commercial reputation of the indemnified party, restrictions on settlements and so on.

On the other hand, where there is a reverse indemnity the objective is that one party to the contract must not sue the other. The effect is that if the indemnifier does sue the indemnified party the claim must be dismissed, because any judgment would be met by an equal judgment going the other way. A court must not permit circuity of action.<sup>126</sup>

### **Objectives of a party-party indemnity**

What, then, is the objective of the party-party indemnity? Since the indemnity is against breach of the agreement, the indemnifier would (as promisor under the agreement), even without the indemnity, be liable to the indemnified party (as promisee under the agreement). That liability is, of course, to pay common law

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<sup>124</sup> But it will not always be effective: *Citicorp Australia Ltd v Hendry* (1985) 4 NSWLR 1.

<sup>125</sup> *Yeoman Credit Ltd v Latter* [1961] 1 WLR 828.

<sup>126</sup> Of course, to the extent that the indemnity operates as an exclusion of liability, it may be invalid under provisions such as Trade Practices Act 1974 (Cth), s 68. Cf *Qantas Airways Ltd v Aravco Ltd* (1996) 185 CLR 43; 136 ALR 510. For an express provision to that effect see Fair Trading Act 1999 (Vic), s 32LA.

damages. Given that the cause of action for breach of contract will merge in any judgment for damages for breach of the agreement, there is (on the face of it) little point in having an indemnity against breach of the agreement.

From this apparent lack of utility three inferences concerning the intention of the parties may be drawn. First, it is noted that an indemnity is generally conceived of as a primary obligation. Therefore, the intention should be inferred that the reason for the indemnity is the creation of a *primary obligation* in addition to the secondary obligation which arises on breach of the agreement. There is, in other words, a parallel with a guarantor indemnity and the agreement creates a primary obligation to pay money in addition to the secondary obligation which arises on breach of the agreement by the promisor.

Second, as an alternative inference, the intention is to create two breaches of contract. The reason for the indemnity is the creation of a *secondary obligation* additional to that which arises on breach of the agreement and which arises at the same time. Since the breach of any primary obligation gives rise to a secondary obligation, if the indemnity promise is not performed there is an additional cause of action. This view has its attractions. The form of the indemnity promise suggests that the indemnifier is in breach of the indemnity promise from the moment that the agreement is breached.

The third inference is that the parties intend to create a liability having a *broader scope* than liability for contract damages. This may, perhaps, be combined with either of the first two inferences. Some support for this is found (superficially at least) in a contrast sometimes drawn in the context of claims for contract damages. Thus, in *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd*<sup>127</sup> Asquith LJ (for the English Court of Appeal) said:

It is well settled that the governing purpose of damages is to put the party whose rights have been violated in the same position, so far as money can do so, as if his rights had been observed: (*Wertheim v Chicoutimi Pulp Co* [1911] AC 301). This purpose, if relentlessly pursued, would provide him with a complete indemnity for all loss de facto resulting from a particular breach, however improbable, however unpredictable.

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<sup>127</sup> [1949] 2 KB 528 at 539.

Asquith LJ went on to relate the principles of remoteness of damage applied to claims for contract damages. It is the operation of those principles which prevents such a claim being a 'complete indemnity'.

Of course, each such inference of intention embodies one or more particular conclusions of law.

- (1) The conclusion of law under the first inference is that a party-party indemnity may be enforced by an action for a liquidated sum.
- (2) The conclusion of law under the second inference is that under a party-party indemnity the indemnifier is in breach of the indemnity when the agreement is breached.
- (3) The conclusion of law under the third inference is that the rules on remoteness of damage applicable to the breach of the agreement do not govern a claim on the indemnity.

These conclusions cannot all be correct. But it is difficult to find clear authority to support any of them in the cases.<sup>128</sup> There are, moreover, other possibilities to be considered. These include:

- that a party-party indemnity eliminates from consideration the rules on remoteness of damage in an action for breach of the agreement, that is, in relation to any breach to which the indemnity applies;
- that a party-party indemnity is an agreement on what damages are recoverable for breach of the agreement; and
- that a party-party indemnity provides the promisee with an additional cause of action (on the indemnity) which arises when breach of the agreement causes loss.

In one way or another, all such inferences of intention and conclusions of law rely on an assumption that there is something 'special' about an indemnity promise. That special feature (or features) must lie in the legal nature or characteristics of an indemnity.

## **Characteristics of a Party-party Indemnity**

### **Introduction**

It seems reasonable to say that where a party-party indemnity is inserted in a contract the parties assume that the promise has certain legal characteristics. Just what those

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<sup>128</sup> See *Total Transport Corp v Arcadia Petroleum Ltd (The Eurus)* [1998] 1 Lloyd's Rep 351 at 357 per Staughton LJ, with whom Auld LJ agreed ('precious little authority to support' a meaning under which the indemnifier is liable for all loss 'attributable to a specified cause, whether or not it was in the reasonable contemplation of the parties').

characteristics are is not usually articulated in the clause itself. However, there is little direct guidance on the legal characteristics in the case law.

One answer to this is to say that the legal effect of any promise in any contract is simply a question of construction — the point which Lord Reid made in relation to guarantees in *Moschi*. Unfortunately, that is not a complete answer. Assume that an indemnity is drafted in the form identified at the beginning of this paper:

A must indemnify B against any breach of this agreement by A.

What is there to construe? The clause does not state any legal effect. That work is assumed to be done by the word ‘indemnity’ — a mere label.

Such a ‘bare’ indemnity is not usually employed. More commonly, the indemnity is expressed as:

A must indemnify B against *any Loss caused by* breach of this agreement by A.

If the words in italics are included, there will be more to construe. A familiar definition of ‘Loss’ is ‘any loss, damage, expense or liability’. However, that does not really take us much further. The words ‘indemnify B against’ could easily be replaced with ‘pay B’. Would that change the legal effect of the clause?

Five questions may be raised in an attempt to identify the characteristics of a party-party indemnity:<sup>129</sup>

- (1) Is an action to enforce the promise an action in ‘debt’ or one for damages?
- (2) Is the promisee entitled to be put in funds prior to actual loss being suffered?
- (3) When does the cause of action on the promise arise?
- (4) Do the rules of contract damages on remoteness apply to a claim on the indemnity?
- (5) Does the indemnified party have the choice of suing on the indemnity or suing for breach of the agreement?

These are very important questions. But they are not easy to answer. In fact, so far as an indemnity against breach of contract is concerned, it is impossible to deduce clear answers from the cases. Logically, therefore, in order to settle these matters the indemnity should expressly state what legal effect the clause is intended to have.

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<sup>129</sup> Another characteristic which might be considered is an indemnifier’s right of subrogation.

### Debt or damages?

One thing that does seem to be clear from the cases is that an action on an indemnity is generally conceived as an action for damages.<sup>130</sup> For example, the conventional view is that an action on a policy of liability insurance is an action for damages.<sup>131</sup> However, that probably sounds absurd. A professional indemnity insurer does not promise that a solicitor will not be negligent. The promise is an indemnity in relation to a loss if the solicitor is negligent. That looks to be simply a promise to pay money. Thus, it is sometimes suggested that an action on an indemnity is a claim in 'debt' to recover the amount to which the indemnified party is entitled.<sup>132</sup>

To deal with this issue it is necessary to make a short diversion into legal history. The action in debt was abolished well over a hundred years ago. Prior to its abolition it would have been impossible to frame an action on an indemnity against breach of a simple contract as an action in debt because the form of action assumed an agreement or obligation to pay a sum certain. After the abolition of debt as a form of action, it became common to contrast claims for unliquidated damages with claims for debts or other liquidated sums. But in relation to simple contracts, all such actions were merely varieties of *assumpsit*. There were three varieties:

- (1) common *assumpsit*;
- (2) special *assumpsit*; and
- (3) *indebitatus assumpsit*.

In order to facilitate pleading of claims to recover debts or other liquidated sums, the common counts were employed.<sup>133</sup> These accommodated both contractual claims (for example, for the price of goods sold and delivered) and what we now regard as restitutionary claims (for example, a reasonable sum for work requested and accepted independently of contract). There was, however, no common count to recover 'money payable under any indemnity'. The only common count likely to have

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<sup>130</sup> See, eg *Wren v Mahony* (1972) 126 CLR 212 at 227.

<sup>131</sup> *Hobartville Stud Pty Ltd v Union Insurance Co Ltd* (1991) 25 NSWLR 358 at 361; *Ventouris v Mountain (The Italia Express) (No 3)* [1992] 2 Lloyd's Rep 281 at 285. But cf *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384 at 402; 141 ALR 618 (term used 'loosely').

<sup>132</sup> I do not subscribe to the view that whether a claim is for a debt or damages can be explained in terms of a distinction between redressing loss and preventing loss.

<sup>133</sup> These can still be found in the Uniform Civil Procedure Rules 2005 (NSW), r 14.12.

any general application was the count for money paid.<sup>134</sup> But that assumes that the indemnified party has paid a sum of money to a third party.<sup>135</sup> This all clearly suggests that, in most cases at least, an action on an indemnity was not regarded as a claim in the nature of (what we now refer to as) ‘debt’. Inevitably, therefore, the origin of a claim on an indemnity is common or special *assumpsit*, that is, a claim for damages.<sup>136</sup>

If there is a technical point to make it is that the failure to pay money due under a promise of indemnity is generally a failure to pay a damages liability. Of course, it seems pointless today to try to work out what the old common law regarded as a claim in debt. The more modern perspective — the use of expressions such as ‘debt or liquidated demand’ or ‘liquidated sum’ in rules of court and statutory provisions — does not depend on the characterisation of the claim under the old forms of action.<sup>137</sup> Equally, the relevance of the discussion is not entirely technical. From a more practical perspective the discussion shows that an indemnity promise has generally been conceived as a *non-monetary promise*.<sup>138</sup>

Equally, merely drafting a contractual promise as a promise to pay money does not of itself prevent a claim to enforce the promise being regarded as a claim for damages. Three examples may be given. First, where A and B contract that A will pay \$100 beneficially to C, failure by A to pay the \$100 to C provides B with a claim for damages, not a claim in debt.<sup>139</sup>

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<sup>134</sup> See *Victorian Workcover Authority v Esso Australia Ltd* (2001) 207 CLR 520 at 528; 182 ALR 321; [2001] HCA 53 at [16]. Of course, the ingenuity of pleaders was such that on occasions a claim on an indemnity might be squeezed into another category, such as a quantum meruit for work done or an account stated.

<sup>135</sup> The short description in the count was ‘money laid out (or paid) by the plaintiff to the use of the defendant’. See Keith Mason and J W Carter, *Restitution Law in Australia*, Butterworths, Sydney, 1995, §111. In the Uniform Civil Procedure Rules 2005 (NSW), r 14.12 it is expressed as ‘money paid by the plaintiff for the defendant at the defendant’s request’.

<sup>136</sup> Cf *Alexander v Ajax Insurance Co Ltd* [1956] VLR 436 at 443-6. See also *Rothenberger Australia Pty Ltd v Poulsen* (2003) 58 NSWLR 289 at 296-8; [2003] NSWSC 788 at [19]-[27].

<sup>137</sup> *Workman Clark & Co Ltd v Brazileño* [1908] 1 KB 968; *Victorian Workcover Authority v Esso Australia Ltd* (2001) 207 CLR 520 at 533; 182 ALR 321; [2001] HCA 53 at [29].

<sup>138</sup> Cf *Moschi v Lep Air Services Ltd* [1973] AC 331 at 347-8 (nature of guarantor’s liability where the guarantee relates to a debt).

<sup>139</sup> *Tradigrain SA v King Diamond Shipping SA (The Spiros C)* [2000] 2 Lloyd’s Rep 319 at 330-2. The fact that B may in some cases obtain specific performance of the contract (see *Coulls v Bagot’s Executor and Trustee Co Ltd* (1967) 119 CLR 460 at

Second, if A is (or may be) indebted to B, breach of a promise made by C to A, to pay the debt, generally sounds only in damages.<sup>140</sup>

Third, a liquidated damages provision, although it quantifies the promisee's claim for damages does not alter the nature of the claim. It remains one for the payment of damages.<sup>141</sup> In that context it may be noted that an action on a valued policy of marine insurance has been characterised as a claim for liquidated damages.<sup>142</sup>

Ultimately, the indemnified party will — as in a conventional action for damages — be entitled to recover a money sum. But the indemnified party's claim is no more a claim for a debt than a claim for damages for breach of warranty is a claim for a debt.<sup>143</sup> The only relevant amount must therefore be a 'loss'. Accordingly, where a contract provides:

A must indemnify B against any breach of this agreement by A

this will usually be interpreted as a statement:

A must indemnify B against *any loss caused by* breach of this agreement by A.

Now it might be said: 'So what, that is how any lawyer would interpret the clause.' But the point is that an indemnity cannot be said to relate to a loss while the amount is unliquidated or unascertained.<sup>144</sup> That means that if the parties define 'loss' to include a 'liability' the focus of the indemnity must, as a matter of construction, be the liability of the indemnified party *to a third party*. It cannot be the liability of the indemnifier to the indemnified party. Until quantified or ascertained, that 'liability' is, in money terms, an indeterminate amount and cannot amount either to a loss sustained by the indemnified party or a debt due from the indemnifier.

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478, 503; *Beswick v Beswick* [1968] AC 58) shows a parallel with the equitable approach to the enforcement of indemnities.

<sup>140</sup> *Wren v Mahony* (1972) 126 CLR 212 at 226.

<sup>141</sup> *President of India v Lips Maritime Corp* [1988] AC 395; *Hungerfords v Walker* (1989) 171 CLR 125 at 139; 84 ALR 119. Cf *Sempra Metals Ltd (formerly Metallgesellschaft Ltd) v Inland Revenue Commissioners* [2007] 3 WLR 354 at 381, 424; [2007] UKHL 34 at [88], [214].

<sup>142</sup> See *Ventouris v Mountain (The Italia Express) (No 3)* [1992] 2 Lloyd's Rep 281 at 286-92.

<sup>143</sup> Of course, success on the claim gives rise to a judgment debt.

<sup>144</sup> See *Telfair Shipping Corp v Inersea Carriers SA (The Caroline P)* [1985] 1 WLR 553 at 568, 569.

Applying this to a party-party indemnity, in order for the indemnifier (A) to be liable to pay a liquidated sum to the indemnified party (B), the amount of the loss must have crystallised. What is the loss in money terms? It cannot be whatever amount B says it has lost. Unless the contract itself quantifies the loss, the idea that B may sue for a liquidated sum must generally assume one of the following:

- that B has paid (or perhaps has become liable to pay) a particular sum to C;
- that A and B have agreed the amount of the loss; or
- that there has been a decision that A owes a particular sum to B.

**Is the promisee entitled to be put in funds immediately?**

The cases on the application of statutes of limitation suggest that another general characteristic of an indemnity is that the indemnity is not enforceable until a loss has been suffered by the indemnified party.<sup>145</sup> There is, in other words, no cause of action until the event against the occurrence of which the indemnity was provided has caused loss. It is that feature (a quantified loss) which tends to give the appearance that an action on an indemnity is an action in ‘debt’.

In recent years the view has gained currency that the indemnified party is entitled to be put in funds before a loss is suffered so as to ensure that the indemnified party never suffers the loss. Credence has been given to this view from two considerations.<sup>146</sup> The first is that the traditional language of indemnity promises includes the words ‘and hold harmless’. But that language is hardly ever used today. That must be because — probably correctly — the words are regarded as redundant. To indemnify *means* ‘to hold harmless’.

Second, prior to the fusion of law and equity it appears that a court of equity would intervene to prevent the indemnified party being out of pocket. Therefore, the position today (following fusion) is that the indemnified party is entitled to be put in funds prior to suffering any loss. This view may well be correct in some contexts. For example, a person who is entitled to be indemnified for expenses may be entitled to claim those expenses prior to paying a third party, and the beneficiary of a third party claims indemnity may be entitled to be put in funds prior to meeting a judgment

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<sup>145</sup> See further below, text at n 48.

<sup>146</sup> The leading modern authority is *Firma C-Trade SA v Newcastle Protection and Indemnity Association (The Fanti)* [1991] 2 AC 1 at 35, 42.



against it. However, the question is always one of construction,<sup>147</sup> and the ‘equitable approach’ may be excluded by agreement.<sup>148</sup>

If this approach is correct — and it does seem to be generally accepted<sup>149</sup> — it must at least confirm that an action on an indemnity is not an action to recover a debt. Courts of equity exercised no general discretion to order specific performance of an obligation to pay money: damages would be an adequate remedy. However, it would be wrong to say that the order must be for specific performance. The more usual relief is a declaration of an entitlement to be indemnified.<sup>150</sup> In any event, in the contractual context at least, it seems clear that an indemnity promise is regarded as a promise to do an act, not a promise to pay money. So it is relatively easy to understand the role of equity.

For present purposes it is unnecessary to resolve this issue. Whatever may be the position in relation to indemnities in general, it is difficult to see how the idea of putting the beneficiary of an indemnity in funds prior to the suffering of a loss can have any general relevance to a party-party indemnity. The basis for a claim on such an indemnity is that breach of the agreement has caused the indemnified party to suffer a loss, not an expense. The loss is the loss of a promised benefit, and the amount of the loss is at large. Moreover, since a promisee cannot pay itself, logically the issue of being put in funds is likely to arise only if there is an obligation to pay money to a third party or the amount of a loss (or a liability)<sup>151</sup> has been agreed or determined by action. Moreover, to treat relief by way of specific performance or declaration as generally available under a party-party indemnity would seem to imply

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<sup>147</sup> *Wren v Mahony* (1972) 126 CLR 212 at 227.

<sup>148</sup> That was the position in *Firma C-Trade SA v Newcastle Protection and Indemnity Association (The Fanti)* [1991] 2 AC 1 (indemnity drafted as ‘pay to be paid’ indemnity).

<sup>149</sup> See *Ventouris v Mountain (The Italia Express) (No 3)* [1992] 2 Lloyd’s Rep 281 at 291-2; *Thanh v Hoang* (1994) 63 SASR 276 at 284; *Yorkshire Water Services Ltd v Sun Alliance and London Insurance Plc* [1997] 2 Lloyd’s Rep 21 at 29; *Callaghan v Dominion Insurance Co Ltd* [1997] 2 Lloyd’s Rep 541 at 543-4; *Victorian Workcover Authority v Esso Australia Ltd* (2001) 207 CLR 520 at 529; 182 ALR 321; [2001] HCA 53 at [17]; *C Inc Plc v L* [2001] 2 Lloyd’s Rep 459 at 464.

<sup>150</sup> *Rankin v Palmer* (1912) 16 CLR 285; *R & H Green & Silley Weir Ltd v British Railways Board* (1980) [1985] 1 WLR 570n at 573; *Thanh v Hoang* (1994) 63 SASR 276; *Victorian Workcover Authority v Esso Australia Ltd* (2001) 207 CLR 520 at 529; 182 ALR 321; [2001] HCA 53 at [17].

<sup>151</sup> Cf *C Inc Plc v L* [2001] 2 Lloyd’s Rep 459 at 464, 474. But see *Total Liban SA v Vitol Energy SA* [2001] QB 643 (damages claim).

a general right to specific performance (or analogous relief) in relation to *the agreement*.

**When does the cause of action arise?**

The normal rule in relation to breach of contract is that because suffering loss or damage is not an element of the cause of action, a breach of contract gives rise to an immediate right to sue. However, the discussion above suggests, as a general characteristic of indemnities, that the cause of action does not accrue immediately on the occurrence of the event to which the indemnity refers. It must follow that the mere occurrence of the event cannot be a breach of the indemnity promise. Rather, unless the parties have agreed otherwise, the breach occurs when the indemnified party suffers loss.<sup>152</sup>

This conclusion is not in every respect an obvious one. If an indemnity is drafted in the form ‘A must indemnify B against X’, the occurrence of the event (X) looks to activate the indemnity. Moreover, it seems clear that the commercial perspective on an indemnity against breach of contract is that the occurrence of a breach of the agreement immediately activates the indemnity even if the contract does not expressly say so.

The common law approach must, it seems, be rationalised on the basis that an indemnity drafted in the form ‘A must indemnify B against X’ is to be interpreted as meaning ‘A must indemnify B against *loss caused by X*’. Therefore, the cause of action is not complete when X occurs, it is only complete when B sustains some quantifiable loss.<sup>153</sup> In other words, the promise is not that the event will not occur, the promise is that the indemnified party will not suffer loss by reason of the occurrence of the event. It follows that the equitable approach to an indemnity involves relief on a quia timet basis, so that the equitable right is not a ‘debt’.<sup>154</sup>

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<sup>152</sup> See, eg *County and District Properties Ltd v C Jenner & Son Ltd* [1976] 2 Lloyd’s Rep 728 at 734, 735-6; *Telfair Shipping Corp v Intersea Carriers SA* [1985] 1 WLR 553 at 565, 567; *R & H Green & Silley Weir Ltd v British Railways Board* (1980) [1985] 1 WLR 570n at 572; *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514; 109 ALR 247. See also *Law Society v Sephton & Co (a firm)* [2005] QB 1013; [2004] EWCA Civ 1627 at [146] (affirmed [2006] 2 AC 543; [2006] UKHL 22).

<sup>153</sup> See also *Heath Lambert v Sociedad de Corretaje de Seguros* [2004] 1 WLR 2820 (position where indemnity is in respect of a payment deemed to be made).

<sup>154</sup> *R & H Green & Silley Weir Ltd v British Railways Board* (1980) [1985] 1 WLR 570n at 572.

This does help to explain the treatment of liability insurance. Where an insurer agrees to indemnify an insured against fire, it is obvious that the insurer is not promising that fire will not occur. Thus, the occurrence of a fire does not amount to a breach of contract. Rather, the promise of the insurer is to indemnify against loss caused by fire. It is, therefore, the suffering of a loss which puts the insurer in breach of contract.<sup>155</sup> It would therefore seem correct to say that breach of the indemnity promise occurs when the loss is suffered, rather than when the indemnifier refuses to pay the loss.

### **Do the remoteness rules apply?**

If an action on an indemnity is an action for contract damages it is logically subject to the rules on remoteness of damage. However, actions against liability insurers have never been approached (overtly at least) from the perspective of the rule in *Hadley v Baxendale*. Indeed, there is precious little discussion of the remoteness issue in the cases. That is perhaps easily explained in the insurance context because the amount of the indemnity is closely defined, either in terms of an amount or the characteristics of a loss or liability. Thus, the need for consideration of remoteness of damage does not logically arise until the insurer fails to pay the loss. However, at that stage there is a legal obstacle to a consideration of remoteness, namely, that there is no such thing as a cause of action in damages (including to recover interest) for a failure to pay damages.<sup>156</sup>

Where remoteness might be seen as having a genuine role — that is, outside the context of insurance — the most that can be said is that in some cases it has been *assumed* that the remoteness rules do not apply to an action on the indemnity.<sup>157</sup> If

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<sup>155</sup> An alternative view is that the insurer has a reasonable time to pay, and is not in breach until that period has expired.

<sup>156</sup> *Hungerfords v Walker* (1989) 171 CLR 125; 84 ALR 119. For application of the rule in the marine insurance context see *Ventouris v Mountain (The Italia Express) (No 3)* [1992] 2 Lloyd's Rep 281 at 292; *Bank of America National Trust and Savings Association v Christmas (The Kyriaki)* [1993] 1 Lloyd's Rep 137 at 150-1. But note Insurance Contracts Act 1984 (Cth), s 57 (interest on claims — general insurance). Cf *Sempra Metals Ltd (formerly Metallgesellschaft Ltd) v Inland Revenue Commissioners* [2007] 1 AC 558; [2007] 3 WLR 354; [2007] UKHL 34 (see Chris Nicoll, (2008) 124 LQR 199; Malcolm Clarke, [2008] JBL 291).

<sup>157</sup> As in *Total Transport Corp v Arcadia Petroleum Ltd (The Eurys)* [1998] 1 Lloyd's Rep 351.

that assumption is correct then the basic criterion for liability is causation.<sup>158</sup> That seems to be the thinking behind Asquith LJ's statement in *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd*.<sup>159</sup> However, Asquith LJ's perspective was the breach of contract, *not* the breach of an indemnity promise. He was simply saying that, but for the rules on remoteness, a promisor would be liable for all loss caused by its breach of contract, no matter how 'improbable' or 'unpredictable'. There is, in other words, a distinction between whether damages should be assessed on an indemnity basis and whether the remoteness rules apply to an action on an indemnity. Although the distinction sounds subtle, it is important.

In terms of perception, if there is one thing which is clear about party-party indemnities it is that an action on an indemnity promise is perceived as *more valuable* than a common law action for damages for breach of contract. In contract negotiations, an indemnity against breach is sought (and challenged) on the basis that it states a liability which is more extensive than a liability to pay common law damages in respect of the breach. The only (obvious) reason for including the indemnity is that the promisee (also the indemnified party) desires perfect or complete compensation untrammelled by considerations such as the rule in *Hadley v Baxendale*. Still at the level of perception, there is nevertheless ambiguity as to why an indemnity is preferred. There are three views:

- (1) An indemnity is preferable because it permits the recovery of damages for breach of the agreement, determined in accordance with the remoteness principle, under an independent (primary) promise of indemnity.
- (2) An indemnity is preferable because it prevents the application of remoteness rules to any breach which activates the indemnity.
- (3) An indemnity is preferable because remoteness principles do not apply to an action on an indemnity promise.

Where A agrees to indemnify B against breach of contract, the first view suggests that the purpose of a party-party indemnity is simply to provide a specific means of recovering (perhaps as a liquidated sum) a loss which is otherwise recoverable under damages principles.

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<sup>158</sup> See *Mediterranean Freight Services Ltd v BP Oil International Ltd (The Fiona)* [1994] 2 Lloyd's Rep 506 at 522.

<sup>159</sup> [1949] 2 KB 528 at 539 (see above, text at n 23).

The second view suggests that the indemnity is designed to quantify loss. Accordingly, if a party-party indemnity is stated in clause 2 of an agreement and clause 1 is breached, the promisee's claim is for breach of clause 1 and the function of clause 2 is to state the basis on which loss must be quantified. The indemnity functions as a separate promise only for the purpose of giving effect to the parties' agreement about how damages for breach of the agreement must be assessed.

Under the third view, the indemnity is a second promise activated when breach of the agreement occurs or causes loss. On this approach it is irrelevant to ask whether the remoteness rules apply. It is irrelevant either because it is difficult to see how any loss could be said to be too remote where such a promise is breached or because (an action on an indemnity being an action for damages) the law does not permit an action for damages for the failure to pay damages.

At present the cases do not provide a basis for choosing between these views. Similarly, they do not rule out other views. However, three points may be made. First, although I think that most contract lawyers would not have the first or the second view in mind when they draft indemnities, the way in which qualifications to indemnities are expressed suggests otherwise.<sup>160</sup>

Second, the third view is consistent with the cases which treat an action on an indemnity as an action for damages and (unless the cause of action is regarded as arising when the agreement is breached) it is also consistent with the general approach of treating the cause of action as arising when the promisee sustains loss.<sup>161</sup>

Third, the issue need not arise. If the drafter of a party-party indemnity has the courage of his or her convictions, the drafting should make plain how the indemnity is to be applied. For example, the indemnity might read:

A must indemnify B against any loss caused by breach of this agreement by A whether or not such loss was a foreseeable consequence of the breach of the agreement or a foreseeable consequence of A's failure to indemnify B.

#### **Does the indemnified party have a choice?**

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<sup>160</sup> See below, text at n 63.

<sup>161</sup> Cf *County and District Properties Ltd v C Jenner & Son Ltd* [1976] 2 Lloyd's Rep 728 at 737.

A party-party indemnity looks to assume the existence of a distinct promise. For example, if A warrants in favour of B that goods are fit for their purpose, and also promises to indemnify B against breach of the warranty, there are clearly two promises. Since there are two promises, there is an obvious potential for A to be subject to two bases for liability.

In the cases in which the question has arisen whether the contract is one of guarantee or indemnity, the contrast has often been between an accessory liability (to compensate the creditor) and a primary liability (to indemnify). Conventionally,<sup>162</sup> this has been seen as a difference between a promise (guarantee) that someone else (the principal debtor) will do something (perform the principal contract) and a promise (indemnity) that the promisor will do something (keep the promisee harmless against loss). Although the conception of a guarantee of a monetary obligation as a promise that the principal debtor will do something has been questioned in recent years,<sup>163</sup> this distinction may be accepted for the purpose of considering whether breach of a party-party indemnity creates a separate cause of action.

In one sense it might seem obvious that a party-party indemnity creates two causes of action. Normally, if there are two promises each may be breached by the same act. For example, if A warrants in favour of B that goods are fit for their purpose, and also warrants that the goods are of good quality, goods delivered by A may be both unfit for their purpose and not of good quality. There are then two causes of action. Therefore, where A agrees to indemnify B against breach of the agreement, and B suffers loss as a result of A's breach of contract, B looks to have two claims against A.

Whether a party-party indemnity provides an additional cause of action may be very important. For example, the contract may limit A's liability for breach of warranty but not limit A's liability on an indemnity. (The converse may also be true.) If it is correct to say that breach of a party-party indemnity provides an additional

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<sup>162</sup> See, eg *Moschi v Lep Air Services Ltd* [1973] AC 331 at 348; *Marubeni Hong Kong & South China Ltd v Mongolia* [2005] 1 WLR 2497 at 2504; [2005] EWCA Civ 395 at [20].

<sup>163</sup> See *Sunbird Plaza Pty Ltd v Maloney* (1988) 166 CLR 245; 77 ALR 205.

cause of action, the indemnifier must ensure that limitations of liability in the contract apply both to breach of the agreement and any action on the indemnity.<sup>164</sup>

Again, the cases do not resolve this issue. However, it is more consistent with the cases to say that a promise of indemnity is breached when a loss crystallises rather than when the agreement is breached. Where a breach of the agreement occurs this may not immediately crystallise a loss. It is, however, actionable immediately and the promisee is entitled to have damages assessed in the normal way. And, as the beneficiary of an indemnity, the promisee is entitled to wait for the loss to crystallise and to bring a claim on the indemnity because, until the loss crystallises, there is no cause of action.

Notwithstanding the inherent logic in the above approach, and notwithstanding that many people may think it correct on the authorities, in my view it is wrong both at the level of principle and at the level of practice. At the level of principle, where there is a party-party indemnity the action for breach of the agreement is subsumed in the action on the indemnity.<sup>165</sup> In other words, the parties have agreed to accept the indemnity as the measure of compensation for breach of the agreement.<sup>166</sup> The only questions are what that measure is and how the indemnity promise operates.

At the level of practice, the approach to drafting qualifications to indemnities virtually ensures either that the only cause of action is for breach of the agreement or that the only cause of action is on the indemnity. Therefore, if the issue is looked at from the perspective of the parties' intention, this will usually be disclosed by the agreed qualifications on the right of 'indemnity'.

### **'Clean' and Qualified Indemnities**

It seems uncommon for a party-party indemnity to be a 'clean' indemnity, that is, an unconditional and unqualified indemnity. Many indemnities are qualified (these are usually termed 'carve-outs'). A simple (and very common) qualification is for

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<sup>164</sup> Cf *Caledonia North Sea Ltd v British Telecommunications Plc* [2002] 1 Lloyd's Rep 553 at 572-3; [2002] UKHL 4 at [99]-[101].

<sup>165</sup> Cf *Telfair Shipping Corp v Inersea Carriers SA (The Caroline P)* [1985] 1 WLR 553 at 568 (position where indemnity is implied).

<sup>166</sup> *Burkard & Co Ltd v Wahlen* (1928) 41 CLR 508 (indemnity provision in contract for sale of quantity of tin clippings displaced action for common law damages).

‘consequential loss’ — whatever that means.<sup>167</sup> Another common carve-out is for loss of profit. It is also reasonably common for the indemnity to be limited in amount, for claims to be enforceable only if they exceed a certain threshold and for claims to be restricted to particular categories of breach or the breach of particular terms.

I have already hinted at two points which may be made in relation to qualifications such as these. The first is that their presence may deprive the promise of one or more of the characteristics which the parties may have assumed to be implied from invocation of the indemnity concept. If that is the case then all the theorising about the nature of indemnities and their essential characteristics may be set at naught. That may come as a surprise, but it is in my view inherently inconsistent with the idea of ‘indemnity’ for breach of an agreement for the promise of indemnity to be limited to losses which cannot be described as ‘consequential’. If is, of course, a truism that the extent of any indemnity may be defined. An insurer rarely undertakes an unqualified and unlimited indemnity. We have no difficulty in such a case in saying that there is an indemnity. However, an indemnity against breach is different. The promise is to compensate for a loss caused by breach. But that breach is already the subject of a measure of damages, which may well include liability for ‘consequential loss’. If an indemnity is a promise to hold a person harmless, how can a promise be regarded as an indemnity if the promisor’s liability is narrower in scope than the liability it would have but for the ‘indemnity’? If, as Asquith LJ said in *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd*, an action for contract damages is a claim for something less than an indemnity, how can a claim for something less than an action for contract damages be called ‘an indemnity’?

The second is that the way in which the qualifications are framed may settle the question of whether the rules on remoteness of damage apply, and also their reference point. Assume that the indemnity takes the form:

A must indemnify B against any Loss (other than a Consequential Loss) caused by breach of this agreement by A.

The reference point for the concept of Consequential Loss looks to be breach of the agreement, not breach of the promise of indemnity. Since the concept of Consequential Loss is applied to ‘breach of this agreement’, it seems clear that it is

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<sup>167</sup> It is unnecessary for present purposes to analyse the meaning of the expression. But note *Environmental Systems Pty Ltd v Peerless Holdings Pty Ltd* [2008] VSCA 26.



loss caused by breach of the agreement, not breach of the indemnity promise, which must be the basis for any claim by B.

These points may be said to reinforce each other. Since the presence of qualifications may disclose that the reference point for determining loss is breach of the agreement rather than breach of the indemnity, it is logical to say that the indemnity is no more than an agreement about how contract damages must be assessed. The 'indemnity' is then an agreement about compensation for breach of the agreement. The one and only cause of action is for breach of the agreement. If the qualifications are significant, the word 'indemnity' may simply mean 'pay such damages as are recoverable at common law but subject to the limitations set out in this clause'.

The third point is that the qualifications may make it very difficult to determine the precise scope of the indemnity. And it follows that the (so-called) indemnity may provide for payment of a sum of money which is in fact less than the loss which would have been recoverable for common law damages. The message is clear. A party who is forced to give an indemnity should do its best to undermine the clause by insisting on qualifications. But it must be hard for a lawyer to face his or her client by saying 'you have an indemnity, but I don't know whether it is worth having or whether the \$300,000 you spent in the negotiation of the indemnity was money down the drain'.

## **Conclusions**

The discussion above suggests that there is very little which can be regarded as settled law in relation to indemnities against breach of contract. The burden of the discussion is that even if correct decisions can be made in relation to the operation of such an indemnity, these are likely to apply only to 'clean' indemnities.

Although when I agreed to present this paper I said that I would not be expressing any conclusions about how indemnities against breach operate, I would venture the following suggestions as being logical deductions from the authorities. First, a claim on a party-party indemnity is a claim for damages for breach of contract. A failure to indemnify does not give rise to a separate claim for damages because the law does not (at present) recognise a cause of action for the late payment of damages.

Second, unless it is clear that the parties have agreed otherwise, the cause of action on the indemnity arises when loss is suffered by reason of occurrence of the event referred to in the indemnity. Therefore, under an indemnity against breach of contract, the cause of action arises when the indemnified party suffers loss because of the indemnifier's breach of the agreement.

Third, while it may be true to say that the beneficiary of an indemnity is in some cases entitled to be put in funds immediately, so as to prevent loss arising, that idea has little relevance to a party-party indemnity for breach of an agreement.

Fourth, the objective of an indemnity is to express agreement on how damages for breach of the agreement are to be assessed. The concept of remoteness of damage is not applicable because the parties have contracted out of that rule.

Fifth, the means by which the parties contract out of the concept of remoteness of damage is by the insertion of a promise of indemnity. The only right of action enjoyed by the promisee for breach of the agreement is therefore to sue on the indemnity.

For what they are worth, the suggestions above express the essential characteristics of an indemnity where the promise is unqualified. It is impossible to explain the impact of qualifications to the indemnity without knowing what those qualifications are. However, on one view, once it is clear that there is no promise to hold the indemnified party harmless, for example, because the indemnity is stated not to apply to 'consequential loss', the promise is not an indemnity at all. Whether the characteristics which indemnity promises generally have are applicable depends on construction of the contract. Reliance on the label may be misplaced. Personally, I doubt whether this matters a great deal. Even if it is correct to say that there is no separate promise — so that the only cause of action available to the promisee is for breach of the agreement — content can still be given to the 'indemnity' as an agreement on how damages must be assessed. The position is simply that the only cause of action available to the promisee is an action for breach of the promise which activates the 'indemnity'.

Near the beginning of the paper I made the point that construction is the process by which the meaning and legal effect of any promise — including an indemnity promise — is determined. It necessarily follows that it is always open to

the parties to put back in those characteristics of an indemnity which have otherwise been lost by reason of qualifications. For example, whatever view a court comes to on whether a so-called 'indemnity' is in law an indemnity, it is open to the parties to agree that it is unnecessary for the promisee to incur a loss or expense prior to claiming on the indemnity. Similarly, they may agree that no cause of action arises until loss is suffered.

Assuming the suggestions made above are correct, what is the nature of an indemnity against breach of contract? To answer that question we might ask, 'What type of contractual promise has the following characteristics?':

- (1) an action on the promise is an action for damages;
- (2) an action on the promise is not available unless another promise in the agreement has been breached;
- (3) an action on the promise may lead to recovery of a money sum which is greater than that which would have been recovered as damages for breach of the other promise; and
- (4) the right of action on the promise replaces the right of action which would otherwise have been available in relation to the other promise.