

**PROBLEMS WITH  
CONTRACTUAL  
INDEMNITIES  
(AND HOW TO AVOID THEM)**

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## **PROBLEMS WITH CONTRACTUAL INDEMNITIES (and how to avoid them)**

1. A contract of indemnity is one which provides that if one party (the indemnified party) incurs a liability to a third party to the contract as a result of the performance of the contract, the indemnified party is entitled to be indemnified by the other party to the contract (the indemnifier) against that liability. More simply put, it is a contract by one party to keep the other “harmless” against loss (a term I will return to later in this paper).<sup>1</sup>
2. The expression “indemnity clause” in practice generally refers to a clause in a commercial contract (other than an insurance contract) which attempts to shift the responsibility for an adverse event from one party to the other.
3. Indemnity clauses can be found in many different types of commercial contracts, for example, leases, sale of goods, construction contracts, manufacturing contracts and service agreements.

## **DAMAGES FOR BREACH OF CONTRACT**

4. A breach by one party of an obligation under a contract may entitle the other party to monetary compensation by way of an award of damages. The purpose of an award of damages for breach of contract is to put the injured party in the same position as if the contract had performed. However, damages can be limited (in whole or in part) by a variety of factors including causation, remoteness and mitigation.
5. The plaintiff must show that:
  - (a) the loss was caused by the defendant’s breach, that is to say there must be a causal link. The concept is closely related to that of remoteness;
  - (b) the loss was not too remote, namely that the defendant’s breach was the effective cause of his loss and which was within the reasonable contemplation of the parties or naturally arising from the breach of contract; and
  - (c) the plaintiff has taken reasonable steps to mitigate (or minimise) his loss and is not entitled to recover from the defendant any losses which the exercise of reasonable care on his part would have prevented from arising.
6. Contractual indemnities provide, in theory at least, the parties with an opportunity to allocate risk and to (perhaps) avoid the limitations of causation, remoteness and mitigation for breaches of contract.

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<sup>1</sup> *Sunbird Plaza Pty Ltd v Maloney* (1988) 166 CLR 245 at 254 per Mason CJ; *Yeoman Credit Limited v Latter* [1961] 1 WLR 828 at 830-831; *Total Oil Products (Aust) Pty Ltd v Robinson* [1970] 1 NSWLR 701; *Argo Caribbean Group Limited v Lewis* [1976] 2 Lloyd’s Rep 289 at 296.

7. It is for that reason, amongst others, that indemnity clauses are often included in contracts. However, they are not entirely straight forward and give rise to other issues and complications.

### **THE NATURE OF A CONTRACTUAL INDEMNITY**

8. A number of propositions can be stated as to the nature of a contractual indemnity as follows:
- (a) an indemnity against “loss” may apply to financial damage or loss of or damage to physical property. Under certain contracts, the indemnity may be referable to loss suffered as a consequence of a third party making a claim against the beneficiary of the indemnity;
  - (b) liability pursuant to an indemnity will only exist in respect of an ascertained amount, but an action may be brought under an indemnity prior to the ascertainment of liability.<sup>2</sup> Accordingly the obligation to indemnify may arise prior to any loss or damage has been suffered by the beneficiary;<sup>3</sup>
  - (c) indemnities are contractual in nature and must therefore be supported by consideration, unless contained in the form of a deed;<sup>4</sup>
  - (d) historically, contractual indemnities were treated differently in law than in equity. The distinction appears no longer relevant. Brandon LJ in *The Fanti* commented on the different treatment of indemnity clauses in law on the one hand, and in equity on the other as follows:<sup>5</sup>

*“There is no doubt that before the passing of the Supreme Court of Judicature Acts 1873 and 1875, there was a difference between the remedies available to enforce an ordinary contract of indemnity at law on the one hand and in equity on the other. At law the party to be indemnified had to discharge the liability himself first and then sue the indemnifier for damages for breach of contract. In equity an ordinary contract of indemnity could be directed to be specifically performed by ordering that the indemnifier should pay the amount concerned directly to the third party to whom the liability was owed or in some cases to the party to be indemnified. There*

<sup>2</sup> *County and District Properties Ltd v C. Jenner & Son Ltd* [1976] 2 Lloyd’s Rep 728 at 734-738 per Swanwick J.

<sup>3</sup> *In re: Richardson; ex parte Governors of St Thomas’ Hospital* [1911] 2 KB 705 at 709-710 per Cozens-Hardy MR.

<sup>4</sup> *Com-A1 Windows Pty Ltd v Silent Vector Pty Ltd* [2008] WASCA 99.

<sup>5</sup> At 28.

*is further no doubt that since the passing of the Supreme Court of Judicature Acts 1873 and 1875 the equitable remedy has prevailed over the remedy at law.*"

(emphasis added).

- (e) an indemnity agreement may be in respect of illegal matters or those contrary to public policy however, in these circumstances, it will not be enforceable. In *Brown Jenkinson & Co Ltd v Percy Dalton (London) Ltd*<sup>6</sup> the majority of the Court of Appeal considered an indemnity clause in respect of conditions which were (adjudged to be) illegal and unenforceable, was also unenforceable. Morris LJ (Pearce LJ concurring and Evershed MR dissenting) said:<sup>7</sup>

*"Can A, who does what B asks him to do, enforce against B a promise made in the following terms: 'If you will at my request make a statement which you know to be false and which you know will be relied upon by others and which may cause them loss, then, if they hold you liable, I will indemnify you?' In my judgment, the assistance of the courts should not be given to enforce such a promise."*

- (f) as to limitation of liability issues, if the indemnity is an indemnity against liability the cause of action will come into existence when A incurs a liability to B. If, however, the indemnity is a general indemnity then time will not begin to run against A for the purpose of pursuing his indemnity against C until A's liability to B has been established and ascertained.<sup>8</sup>

### Debt or damages

9. An issue which has arisen is whether a claim for an indemnity gives rise to a right to claim in debt or in damages. The authorities are divergent. In *Jervis v Harris*,<sup>9</sup> Millett LJ analysed the nature of a repairing covenant in a commercial lease. In doing so he commented on the nature of indemnity clauses in commercial contracts more generally and said:

*"a tenant's liability to reimburse the landlord for his expenditure on repairs is not a liability in damages for breach of his repairing covenant at all. The landlord's claim sounds in debt not damages; and it is not a claim for compensation for breach of the tenant's covenant to repair, but for reimbursement of sums actually spent by the landlord in carrying out the repairs himself."*

<sup>6</sup> [1957] 2 QB 621, CA.

<sup>7</sup> At 635.

<sup>8</sup> *Telfair Shipping Corp v Intersea Carriers SA* [1985] 1 WLR 553; per Neill J at 566.

<sup>9</sup> [1996] Ch 196.

*(emphasis added).*

10. It seems tolerably clear, therefore, that Millett LJ's view is that an indemnity is a contractual right of reimbursement which requires evidence of expenditure. Further, it is a contractual right of recoupment which requires proof that some kind of liability has been discharged. Millett LJ went on to say:

*“The law of contract draws a clear distinction between a claim for payment of a debt and a claim for damages for breach of contracts... a debt is a definite sum of money fixed by the agreement of the parties as payable by one party to the other in return for the performance of a specified event or condition; whereas damages may be claimed from a party who has broken his primary contractual obligation in some way other than by failure to pay such a debt.”*

11. However, it should be noted that the House of Lords, in an insurance context, considered that the nature of indemnity is founded in damages not in debt.<sup>10</sup> In that case, Goff LJ said:<sup>11</sup>

*“I accept that, at common law, a contract of indemnity gives rise to an action for unliquidated damages, arising from the failure of the indemnifier to prevent the indemnified person from suffering damage, for example, by having to pay a third party. I also accept that, at common law, the cause of action does not (unless the contract provides otherwise) arise until the indemnified person can show actual loss ...*

*This is, as I understand it, because a promise of indemnity is simply a promise to hold the indemnified person harmless against a specified loss or expense. On this basis, no debt can arise before the loss is suffered or the expense incurred; however, once the loss is suffered or the expense incurred, the indemnifier is in breach of contract for having failed to hold the indemnified person harmless against the relevant loss or expense. There is no condition of prior payment; but the remedies available at law (assumpsit for damages, or possibly in certain circumstances the common count for money paid) were not efficacious to give full effect to the contract of indemnity. It is for this reason that equity felt that it could, and should, intervene. If there had been a clear implied condition of prior payment, operable in the relevant circumstances, equity would not have intervened to enforce the contract in a manner inconsistent with that term. Equity does not mend men's bargains; but it may grant specific performance of a contract, consistently with its terms, where the remedies at law are inadequate. This is*

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<sup>10</sup> *“The Fanti and the Cadre Islands” Firma C-Trade SA v Newcastle Protection and Indemnity Association* [1991] 2 AC 1.

<sup>11</sup> At 35-36.

*what has happened in the case of contracts of indemnity. As a general rule, ‘Indemnity requires that the party to be indemnified shall never be called upon to pay’ ...; and it is to give effect to that underlying purpose of the contract that equity intervenes, the common law remedies being incapable of achieving that result.’*  
(emphasis added).

12. Further, in the “*Piper Alpha*” case,<sup>12</sup> Hoffman LJ concluded that an action for recovery pursuant to a contractual indemnity is (usually) not a claim based in breach of contract. It is a claim for an indemnity for a liability incurred.
13. On balance the better view is that an indemnity is a right of reimbursement and not subject to issues relevant to damages. The bargain between the parties is that the party be indemnified. It is different from an obligation not to cause any loss. In those circumstances a party claiming an indemnity should not be obliged to mitigate loss, or be subject to causation or remoteness issues. To do so would be to undermine the very bargain struck by the parties. The claim is therefore more in the nature of a debt, albeit unquantified at the time of entry into the contract.

#### **The benefits of indemnity clauses**

14. The benefits of an indemnity clause as a mechanism for a negotiated compensation include the following:
  - (a) the measure of compensation is indemnification which may be greater than damages for breach of contract;
  - (b) proof of damages may be more difficult than proving “out of pocket” losses and expenses for indemnification;
  - (c) mitigation of loss probably does not apply;
  - (d) remoteness of damage issues ought not apply. Although the view that indemnities were not subject to remoteness issues was put in doubt by the United Kingdom Court of Appeal in *Total Transport Corp v Arcadia Petroleum Ltd*;<sup>13</sup> and
  - (e) risk can be transferred.

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<sup>12</sup> *Caledonia North Sea Ltd v British Telecommunications Plc* [2002] UKHL 4; see [100].

<sup>13</sup> (*The Euros*) [1998] 1 Lloyd’s Rep 351.

## Types of indemnity clauses

15. There are an infinite variety of circumstances and manner of expression of an indemnity, however, there have been several types of indemnities identified:<sup>14</sup>
- (a) “bare” indemnities: i.e. Party A indemnifies Party B against all liabilities or losses incurred in connection with given events or circumstances, but without setting out any specific limitations. In particular, such indemnities will be silent as to whether they indemnify losses arising out of B’s own acts and/or omissions (and so *could*, in theory, operate as a “reverse” or “reflexive” indemnity).
  - (b) “reverse” or “reflexive” indemnities: i.e. Party A indemnifies Party B against losses incurred as a result of Party B’s own acts and/or omissions (e.g. negligence).
  - (c) “proportionate” indemnities: these are the opposite of “reverse” indemnities, i.e. Party A indemnifies Party B against losses *except* those incurred as a result of Party B’s own acts and/or omissions.
  - (d) “third party” indemnities: i.e. Party A indemnifies Party B against liabilities to or claims by Party C.
  - (e) “financing” indemnities: i.e. Party A indemnifies Party B against losses incurred if Party C fails to repay financial accommodation to Party B. These indemnities are usually coupled with a guarantee in financing arrangements.
  - (f) “party/party” indemnities: i.e. each party to a contract indemnifies the other(s) for losses occasioned by them by the indemnifier’s breach of the contract.

## THE DISTINCTION BETWEEN INDEMNITY, GUARANTEE, INSURANCE AND WARRANTY:

16. An indemnity can, unless carefully drafted, amount to either a guarantee, an obligation of insurance, or a warranty. Each are quite different legal concepts which have quite different legal outcomes. It is important to understand the difference between each.

### Indemnity and guarantee

17. The central characteristic of an indemnity clause is that the indemnifier assumes a primary responsibility for the adverse event covered by the clause and undertakes to hold the indemnified party “harmless” against the consequences

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<sup>14</sup> See “*The indemnities: it’s all in the drafting*”, D’Angelo (2007) 35 ABLR 93 at 95-96.

of that event. It is to be distinguished from the liability of a guarantor or surety which is a secondary or derivative to the liability of the principal debtor. If the surety pays the creditor he may still have recourse against the principal debtor by way of indemnity or subrogation. Conversely an indemnifying party bears the ultimate loss. This distinction is often blurred by use of the expression “guarantee and indemnity” in modern drafting.

18. Therefore it is important to recall the basic distinctions:
- (a) an indemnity gives rise to a primary obligation. This is to be contrasted to a guarantee;
  - (b) a guarantee is a contract to another for the debt default or miscarriage of another who is to be primarily responsible for the promise;<sup>15</sup> and
  - (c) a guarantee gives rise to a security obligation which is dependent on the default of the primary obligation.<sup>16</sup>
19. The distinction may be important for several other reasons. First, it is a statutory requirement<sup>17</sup> that a guarantee must be in writing. Section 126(1) of the *Instruments Act 1958* (Vic) provides that:
- “126 Certain agreements to be in writing**  
**(1) An action must not be brought to charge a person upon a special promise<sup>18</sup> to answer for the debt, default or miscarriage of another person or upon a contract for the sale or other disposition of an interest in land unless the agreement on which the action is brought, or a memorandum or note of the agreement, is in writing signed by the person to be charged or by a person lawfully authorised in writing by that person to sign such an agreement, memorandum or note.”**
- (emphasis added).
20. Promises to answer for the debt of “another person” are in the nature of a guarantee and must be evidenced in writing.<sup>19</sup> This does not apply to apply to an indemnity. Accordingly an indemnity need not be in writing.

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<sup>15</sup> *Yeoman Credit* at 830.

<sup>16</sup> *Argo* at 296.

<sup>17</sup> Originally contained in the *Statute of Frauds* 1677, 29 Car. 2, c. 3, s. 4 and now a requirement of the *Instruments Act*.

<sup>18</sup> A “special” promise is a reference to a promise supported by consideration (see *Saunders v Wakefield* (1821) 106 ER 1054 at 1056). This requirement was displaced by s. 129 of the *Instruments Act* which provides that a contract of guarantee shall not be invalid by reason only of fact that the consideration does not appear on the face of the instrument.

<sup>19</sup> *Harvey v Edwards, Dunlop & Co. Limited* (1927) 39 CLR 302 at 311; *Marginson v Ian Potter & Co.* (1976) 136 CLR 161 at 168-169.

21. Secondly, a guarantor's liability is derivative and only crystallises upon the liability of the principal debtor. Further, the guarantor's liability will also be dependent upon whether the original contract is void or unenforceable. However an indemnifier's liability is independent of the status of the debt which is to be indemnified.
22. Thirdly, a guarantor may be discharged as a result of certain conduct by the creditor, whereas this is less likely in the case of an indemnity.
23. Fourthly, an indemnity clause is subject to the same rules of construction as an exclusion clause. The rationale of the Courts is that it is inherently improbable that one party to a contract would wish to absolve the other from liability for breach of contract, especially when such breach is attributable to that other's negligence.<sup>20</sup> In *Smith v South Wales Switchgear Ltd*<sup>21</sup>, Dilhorne LJ said:

*“when considering the meaning of such a clause one must, I think, regard it as even more inherently improbable that one party should agree to discharge the liability of the other party for acts for which he is responsible.”*

24. In the same case, Kinkell LJ, having referred to the guidelines laid down in *Canada Steamship Lines Ltd v R*<sup>22</sup>, said:

*“While they apply to the construction both of a clause relied on as exempting from certain liabilities a party who has undertaken to carry out contractual work and of a clause whereby such a party has agreed to indemnify the other party against liabilities which would ordinarily fall on him, they apply a fortiori in the latter case, since it represents a less usual and more extreme situation.”*

25. Accordingly, indemnity clauses will be construed against the person seeking to enforce such a clause.<sup>23</sup> Whereas, the *contra proferentem* rule of construction probably does not apply to guarantees.<sup>24</sup>

### **Indemnity and insurance**

26. In a contract of insurance, the insurer (or underwriter) agrees to pay money upon the occurrence of a certain event.<sup>25</sup> It is a direct positive contract and is in many ways very similar to a contract of indemnity. However there are several important differences.

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<sup>20</sup> *Smith v South Wales Switchgear Co. Ltd* [1978] 1 WLR 165 at 167-168.

<sup>21</sup> *Smith v South Wales Switchgear Co. Ltd.*

<sup>22</sup> [1952] A.C. 192.

<sup>23</sup> *Canada Steamship Lines Ltd v The King* [1952] A.C. 192.

<sup>24</sup> *Andar Transport Pty Ltd v Brambles* [2004] HCA 28 at [67], [71] per Kirby J.

<sup>25</sup> *Dane v Mortgage Insurance Ltd* [1894] 1 QB 54 at 61.

27. First, the insurer makes an assessment of risk and requires that the insured disclose all material facts. The law imposes an obligation upon the insured to disclose such material facts and the contract is one of the utmost good faith.<sup>26</sup>
28. Secondly, the contract of insurance usually requires the insurer to pay up to a certain amount, this may not be the case for an indemnity.
29. Thirdly, an insured cannot make a profit from insurance, so that if the actual value of that which was insured is less than the figure for which it was insured, the insurer is only liable for the actual value.<sup>27</sup>
30. Finally, the *contra proferentem* rule of construction does not apply to contracts of insurance.<sup>28</sup>

### **Indemnity and warranty**

31. A warranty is generally a description of the characteristics of the subject matter of the contract. A breach of such a statement will ordinarily entitle the promisee to recover damages but not to treat the contract as repudiated.<sup>29</sup> However, the warrantor makes no promises as to the recovery or extent of loss (indemnification or otherwise), in contrast to a contract of indemnity.

### **PRACTICAL ISSUES OF CONSTRUCTION AND DRAFTING:**

32. Indemnity clauses can effect a significant change in the (usual) contractual allocation of risk. It is for that reason that Courts have generally treated indemnity clauses extremely strictly and subjected them to “specially exacting standards”. The reason for imposing such standards on those clauses is the “inherent probability” that the other party to a contract including such a clause intended to release the other from a liability that it would otherwise accrue to that party.<sup>30</sup> Some observations which may be useful regarding drafting of indemnity clauses are to be found in the attitude of Courts to construction.

### **Construction of indemnity clauses**

33. The approach of Courts when construing indemnity clauses was conveniently summarised in a recent decision of the Supreme Court of Queensland as follows:<sup>31</sup>

<sup>26</sup> *Distillers Co. Bio-Chemicals (Aust) Pty Ltd v Ajax Insurance Co. Ltd* (1974) 130 CLR 1 at 27-31.

<sup>27</sup> *Bennett v Tugwell* [1971] 2 QB 267.

<sup>28</sup> *Botany Fork & Crane Hire Pty Ltd v New Zealand Insurance Co. Ltd* (1993) 116 ALR 473; *McCann v Switzerland Insurance Australia Ltd* (2000) 176 ALR 711 at 726.

<sup>29</sup> *Hong Kong Fir Shipping Co. Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26 at 70.

<sup>30</sup> *Ailsa Craig Fishing Co. Ltd v Malvern Fishing Ltd* [1983] 1 WLR 964, (HL) as per Fraser LJ at 970 and Wilberforce LJ at 966.

<sup>31</sup> *Samways v Workcover Queensland* [2010] QSC 127 at [66]-[71].

- (a) an indemnity clause falls to be construed strictly, and any doubt as to the construction should be resolved in favour of the indemnifier.<sup>32</sup> The doubt may arise not only from the uncertain meaning of a particular expression but from its apparent width of possible application;<sup>33</sup>
- (b) the authorities that require ambiguity to be resolved in favour of the indemnifier do not require that ambiguity be detected where the natural and ordinary meaning of the language, taken in its contractual context, requires no such conclusion.<sup>34</sup> Absent statutory authority, a court has no mandate to rewrite a provision to avoid what it retrospectively perceives as commercial unfairness or lack of balance;<sup>35</sup>
- (c) the clause should be construed in its contractual context which allocates risks of different kinds between the parties;
- (d) effect should be given to the ordinary meaning of the language used (absent use of technical expressions or terms of art) so as to provide certainty as to where responsibility may lie, against which insurance may be obtained;<sup>36</sup>
- (e) the fact that the contract requires a party to take out insurance against the indemnified liability may be taken into account in concluding that the indemnity applies to that liability, whether or not insurance is in fact taken out;<sup>37</sup>
- (f) the absence of a provision for insurance against the liability may also be taken into account.<sup>38</sup> However, the fact that the indemnifier is not required by the contract to take out insurance, and chooses not to take out insurance should not affect the construction of an indemnity that unambiguously allocates responsibility for the liability against the indemnifier;
- (g) the outcomes of other cases involving different contractual arrangements and different clauses do not dictate the outcome of a particular case. However, the principles of construction established in those cases should be followed;<sup>39</sup> and
- (h) one line of authority construes contracts of indemnity for a party's own negligence on the assumption that it is inherently improbable that a party

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<sup>32</sup> *Andar Transport Pty Ltd v Brambles Ltd* (2004) 217 CLR 424 at [17] – [23].

<sup>33</sup> *Bofinger v Kingsway Group Ltd* (2009) 239 CLR 269 at 292 [53]; [2009] HCA 44.

<sup>34</sup> *Erect Safe Scaffolding (Australia) Pty Ltd v Sutton* (2008) 72 NSWLR 1 at 21 [87].

<sup>35</sup> *Ibid* at [88].

<sup>36</sup> *Ibid*.

<sup>37</sup> *Ibid*.

<sup>38</sup> *Ellington v Heinrich Constructions Pty Ltd* (supra) at [23].

<sup>39</sup> *Erect Safe Scaffolding (Australia) Pty Ltd v Sutton* (supra) at [89], [166].

would contract to absolve the other party against claims based on the other party's own negligence.<sup>40</sup> The competing view is that at least a principal purpose for obtaining such an indemnity is to protect a party against liability for its own fault.<sup>41</sup>

34. A number of observations regarding the drafting of indemnity clauses by those intending to rely on them can be made:
- (a) draft it as a deed and avoid issues of consideration;
  - (b) they should be drafted carefully having regard to an assumption that the Court will construe them against the person seeking to rely on the indemnity;
  - (c) a *contra proferentem* approach will only be appropriate if there is an ambiguity. Accordingly care should be taken to avoid any ambiguity;
  - (d) the nature of an indemnity clause means that the drafter has an opportunity to exclude time limits, causation, remoteness, foreseeability and mitigation;
  - (e) the drafter may extend the indemnity clause to include claims by other parties to which the indemnitee may or will be liable;
  - (f) Courts are reluctant to rewrite a contract, even if they are perceived as being unfair;
  - (g) clauses are to be read in context and the drafting will assist in that regard;
  - (h) if the indemnity is to include the indemnitor's own negligence then it must be made very clear by the drafter;
  - (i) care should be taken to not use the words of guarantees. It does not require much to be considered to be a guarantee. This may not be what was intended by the author and may have adverse results;
  - (j) avoid the blurring of distinctions between guarantee and indemnity. They are very different legal concepts and there should be no excuse for characterising an obligation as both "guarantee" and "indemnity" especially in the same contractual clauses;

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<sup>40</sup> *Davis v Commissioner for Main Roads* (1968) 117 CLR 529 at 534 per Kitto J (Windeyer J agreeing); *Westina Corporation Pty Ltd v BGC Contracting Pty Ltd* [2009] WASCA 213 at [64] – [65].

<sup>41</sup> *Davis v Commissioner for Main Roads* (supra) at 537 per Menzies J (Barwick CJ and McTiernan J agreeing); *Erect Safe Scaffolding (Australia) Pty Ltd v Sutton* (supra) per Basten JA.

- (k) similarly, avoid the language of warranty. The obligation is either in the nature of indemnity or it is something else. A warranty is a different “thing” at law and may not be what is intended; and
  - (l) the same can be said of insurance. Be careful in the language to avoid an insurance obligation;
  - (m) try and avoid the clause being characterised as a right to damages. Draft the indemnity as an obligation to pay money to compensate the indemnified party for a loss once it has been sustained;
  - (n) careful drafting can attempt to minimise issues of or the requirement to establish causation. The clause could provide that the indemnified party only establish loss and that an indemnifying event occurred;
  - (o) similarly, the obligation to attempt mitigation of loss should be expressly excluded if so desired;
  - (p) if the indemnity extends or is likely to extend to legal costs it should be made clear that they are out of pocket expenses and not the usual party-party (standard) costs;
  - (q) consider the relevant proportionate liability legislation and whether it can be excluded or modified as part of an indemnity. Although s. 24AH of the *Wrongs Act* 1958 (Vic) provides that a defendant whom judgment is given under Part IVAA of the *Wrongs Act* as a concurrent wrongdoer in relation to an apportionable claim cannot be required to indemnify another concurrent wrongdoer in the same proceeding for the apportionable claim;
  - (r) is it intended to include consequential or pure economic losses? If so, that should be dealt with expressly; and
  - (s) contractual indemnity may purport to extend to cover the losses of a third party (i.e. stranger) to the contract. These losses would not be enforceable pursuant to ordinary contract principles because there would be no consideration and no privity of contract. In order to avoid problems the third party could be made a party to the contract or by creating a trust or by use of a deed. The solution will vary depending on the circumstances.
35. In every instance, the drafter must ask the following questions:
- (a) Who is providing the indemnity?
  - (b) Who is the beneficiary?
  - (c) What enlivens the obligation to indemnify?

- (d) What is the extent of indemnity?
  - (e) How long does the indemnity last?
36. Care should be taken to avoid phrases which are likely to be the subject of confusion or ambiguity. For example:
- (a) care should be taken in using the term “*arising out of*”. In *Samways*, Applegarth J said:<sup>42</sup>

*“The words ‘arising out of’ are wide. The relevant relationship should not be remote, but one of substance albeit less than required by words such as ‘caused by’ or ‘as a result of’.<sup>43</sup> The phrase connotes a weak causal relationship.<sup>44</sup> However, more is required than the mere existence of connecting links.<sup>45</sup> The words require the existence of a causal or consequential relationship between, in this case, the use of the plant and the injury.<sup>46</sup>”*

- (b) similarly in *Samways*, Applegarth J commented on the use of the expression “*in connection with*” as follows:

*“The expression ‘in connection with’ is capable of having a wide meaning, but its meaning must be derived from the context in which it is used.<sup>47</sup> The words ‘in connection with’ have been accepted as capable of describing a spectrum of relationships between things, one of which is bound up with or involved in another. The question that remains in a particular case is what kind of relationship will suffice to establish the connection contemplated by the contract.<sup>48</sup> In the present context there must be a sufficient nexus between the use of the plant and the injury.”*

- (c) indemnity clauses often use the phrase “*save harmless*” and whilst this is common phraseology in indemnity clauses and to which the Courts have

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<sup>42</sup> At 72.

<sup>43</sup> *Erect Safe Scaffolding (Australia) Pty Ltd v Sutton* (supra) at [11].

<sup>44</sup> *Ibid* at [97].

<sup>45</sup> *F & D Normoyle Pty Ltd v Transfield Pty Ltd* (2005) 63 NSWLR 502 AT 515 [90].

<sup>46</sup> *Westina Corporation Pty Ltd v BGC Contracting Pty Ltd* (supra) at [61].

<sup>47</sup> *Fraser v The Irish Restaurant and Bar Co Pty Ltd* [2008] QCA 270 at [40].

<sup>48</sup> *Ibid* at [42]-[43] citing *R v Orcher* (1999) 48 NSWLR 273 at 279.

attributed the meaning of indemnity,<sup>49</sup> it is preferable to use plain English language rather than what might be ambiguous even if a term of art.

37. On the other hand, some observations can be made for those acting for persons giving such an indemnity:
- (a) indemnity clauses without a monetary limit can expose the indemnifier to an unknown and possibly unquantifiable liability;
  - (b) indemnity clauses without limitation as to the source of the loss also expose the indemnifier to unquantifiable liabilities. The clause can be limited to certain types of loss, or losses caused by certain classes of persons;
  - (c) losses may be caused or contributed to by the other contracting party. Such loss could be excluded or limited, or give rise to a proportionate or prorated reduction in liability;
  - (d) if possible the source of losses should be identified expressly. Further, the losses could be limited by reference to losses which are reasonably foreseeable at the time of entry into the contract as a general provision;
  - (e) the losses could be, unless limited, ongoing. Consideration should be given to imposing an obligation of mitigation of loss and of indemnification for reasonable losses or for those incurred reasonably;
  - (f) pure economic and consequential losses may, unless limited or excluded, be part of any liability to indemnify. These may be unquantifiable and unexpected. Accordingly, consideration should be given to excluding, limiting or reducing such an exposure.

## CONCLUSION

38. Contractual indemnities are a very useful method of transferring risk for a defined event from one contracting party to another. They offer them opportunity to extend the time for a claim, to avoid issues of causation, remoteness and mitigation. However they are treated strictly by the Courts and will be construed against the interest of the person claiming the right of indemnity.

**March 2015**

**P J BOOTH**

**Victorian Bar**

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<sup>49</sup> See *Sunbird Plaza* at 256 per Mason CJ; *Yeoman Credit v Latter* [1961] 1 WLR 828, especially at 831 (per Holroyd Pearce LJ) for example.