



Guarantee or Indemnity?

The distinction between the two types of suretyship



GUARANTEE OR INDEMNITY?

In this briefing note we consider the essential differences between a guarantee and an indemnity and why the financier needs to be aware of them?

Two types of suretyship

O'Donovan and Phillip define a guarantee as,

"In essence, ... a binding promise of one person to be answerable for a present or future debt or obligation of another if that other defaults. An indemnity, by contrast, is usually defined as an agreement to hold another harmless against loss".

What is the difference? Generally speaking, a guarantee provides for a liability co-extensive with that of the principal. In other words, the guarantor cannot be liable for anything more than the client. The document will be construed as a guarantee if, on its true construction, the obligations of the surety are to "stand behind" the principal and only come to the fore once an obligation has been breached as between the principal and the financier. The obligation is a secondary one, reflexive in character.

An indemnity, by contrast, provides for con-

current liability with the principal throughout and there is no need to "look first" to the principal. In essence it is an agreement that the surety will hold the financier harmless against all losses arising from the contract between the principal and the financier.

The relevance for enforcement

When considering whether, and how, to enforce the suretyship obligation, the first consideration is whether the contract is one of guarantee or indemnity. This is for two principal reasons:

A guarantee must be in writing or evidenced in writing; an indemnity can be purely oral. A guarantee cannot be given orally, there must be an agreement or a note or memorandum of the guarantee signed by the guarantor before he can be liable – see section 4 of the Statute of Frauds 1677 and the recent "ITV Digital" case – *Carlton Communications v Granada* [2002] EWHC 1650 (Comm).

The continued operation of the Statute of Frauds means that a guarantor cannot be estopped from relying on the absence of writing. Similarly, the requirement for writing means that there is no question that guarantees can be given by implication; *Silverburn Finance v Salt* [2001] Lloyds Rep Bank 119. By contrast, an indemnity can be purely oral.



There is usually need for a default and (often) a demand on the principal debtor before a guarantor is liable. By contrast, an indemnifier usually is a principal debtor and (subject to the terms of the indemnity) no demand on him is necessary. We deal in other briefing notes with how and when demand should be made before proceedings are commenced. It is sufficient to note at this point that the question of whether valid demands have in fact been served is pregnant with dispute.

Subject to the inclusion of a “*principal debtor*” clause (see below), as a matter of construction it is normally a condition precedent to a guarantor’s liability that there be some kind of demand either upon the principal, or the guarantor, or sometimes both before can be liable; see *Esso Petroleum v Alstonbridge* [1975] 1 WLR 1474. By contrast, where the obligation is to indemnify (that is, to hold harmless against loss) often the need for such a demand can be dispensed with – the gist of the action on an indemnity is the loss, not the demand to make that loss good.

Which is it?

It can be both. It is entirely possible for someone both to guarantee the debts of a company and also agree to hold the financier harmless against loss resulting from the agreement with the principal debtor.

Whether the security document is a guarantee or an indemnity (or both) is a matter of construction. There is a mass of (rather arid) case law on the distinction, but ultimately it comes down to the document in question.

Relevant considerations are:

- The words used; the fact that one label or another is used is not determinative but it may demonstrate what the parties were attempting to achieve.
- Whether the document purports to make the surety liable for a greater sum than could be demanded under the principal contract, in which case the inference is that he is undertaking an obligation to indemnify.
- Whether a demand upon the principal debtor is defined as a condition precedent to proceeding against the surety – in which case the document may well best be read as a guarantee.

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