Indemnities and guarantees have an important role in commercial leases, particularly in the current financial climate. If a landlord is not convinced that the tenant will be able to pay the rent and cover the costs of repairs and other covenants over the term of a new lease, it may still grant one on the condition that a third party of sufficient financial strength guarantees the tenant’s obligations.

Parties rarely stop to consider whether they should be seeking a guarantee or a guarantee and indemnity, or even realise there is a distinction between the two. In fact, there are significant differences, in particular, differences in principle; how they are created; the effect of variations of the lease; and the discharge of the obligations.

**Basic distinctions**
Modern leases tend to include two separate covenants: (i) a guarantee; and (ii) an indemnity covenant. This benefits the landlord because it makes it more difficult for a party to argue that the obligation created is just a guarantee in case of tenant failure, rather than a primary obligation. However, disputes could still arise over the nature of the obligation. The distinction is one of substance, which will not be decided on language alone.

An indemnity is a primary obligation. It is an express requirement to compensate someone for loss or damage, independent of the obligations of the party whose covenants are being reinforced. A guarantee is a secondary obligation; a guarantor will be liable only if the party whose obligations have been guaranteed has failed to perform its primary obligations. An indemnity has advantages over a guarantee for reasons that will become clear below.

**Indemnities and guarantees are primary obligations, while guarantees are secondary ones**

**The existence of the former will dictate who is liable when a tenant defaults on its payments**

In order for a guarantee to be valid it must meet certain requirements. It must be:
- in writing or evidenced in writing (Actionstrength Ltd (t/a Vital Resources) v International Glass Engineering INGL EN SpA [2003] UKHL 17; [2003] 2 AC 541); and
- signed by the guarantor (section 4 of the Statute of Frauds 1677).

There are no formal requirements for creating a valid indemnity, so it could be oral or in writing and not signed. However, an indemnity would still have to meet the requirements for a valid contract. Therefore, there must be an offer and acceptance, and consideration. In addition, the parties must have intended to enter into a legal relationship with one another.

Since the agreement by the guarantor or indemnifier is generally contained in the lease and commercial leases are executed as deeds, problems about whether a guarantee and/or indemnity has been validly created rarely arise in practice (but see the recent case of Beardsley Theobalds Retirement Benefit Scheme Trustees v Yardley [2011] EWHC 1380 (QB), in which the court found that even if the lease was unenforceable as a deed, it would still have been enforceable as a contract in writing if the landlord could show the contract was supported by consideration).

Similarly, the question of whether the guarantee or indemnity complies with the basic contractual requirements is answered by their being created by a deed.

As such, the issue of whether there is a valid guarantee in a commercial landlord and tenant situation is more likely to arise where a tenant is in occupation without having executed a lease, for example, if a landlord has allowed a tenant to occupy before a lease has been executed, possibly...
Variations to the terms of a lease
A guarantor's liability is linked with the underlying obligations of the tenant. This means that care must be taken if the terms of the lease vary. A guarantee will be discharged if there has been any substantial variation without the consent of the guarantor. Therefore, consent in writing should always be obtained. This principle does not apply to an indemnity, since this is a primary liability. The variation of a lease will not discharge the obligations of the indemnifier. Nevertheless, it would be prudent to obtain consent for the variation. If the guarantor has given an indemnity covenant and consented in writing to the variation, no further agreement is required.

Guarantors have been released from liability if the landlord:

- granted the tenant a revocable licence to widen the permitted use of the property (Howard de Walden Estates v Pasta Place Ltd [1995] 1 EGLR 79);
- agreed with the tenant to a surrender of part of the premises comprised in a lease without the guarantor's consent (Holme v Brunskill [1878] LR 3 QBD 495).

If a landlord allows a tenant to pay rent late without obtaining written and signed consent from the guarantor, this may be seen as "giving time" to the tenant, which may operate to discharge the guarantee (although the position may be different if the lease states that the guarantee will not be affected by time given by the landlord to the tenant to make payments).

However, a variation that is not substantial (that is, one that does not affect the terms of the principal obligations and is self-evidently beneficial to the guarantor) will not affect the guarantor's secondary contract: Metropolitan Property Co (Regis) Ltd v Bartholomew [1995] 1 EGLR 65; [1995] 14 EG 143.

From a litigator's point of view, variation of the terms of a lease is one of the first things to consider when advising a landlord or guarantor, because this can provide a good defence to a guarantor. However, if the guarantor also gave an indemnity, it would not have a defence to a claim under the indemnity on the grounds of variation.

Discharge of obligations
In general terms, if the tenant is discharged from performance of its covenants by the landlord, the liability of the guarantor will also be discharged. This is not the case with an indemnity.

Bankruptcy or insolvency
The situation in the case of a tenant's insolvency is of particular interest in the current economic climate. To summarise the position, neither the bankruptcy of a tenant who is an individual nor the liquidation of a tenant company will release a guarantor.

If a liquidator disclaims the lease, the House of Lords has confirmed in the case of Hindcastle Ltd v Barbara Attenborough Associates Ltd [1997] AC 70 that a disclaimer operates in relation to the liability of the company to which it relates, that is, the tenant, and does not affect the liability of any third party. Therefore guarantors or indemnifiers remain liable.

For these reasons, the inclusion of an express indemnity covenant in a lease has teeth in certain situations. Guarantors should be advised of the implications of giving a guarantee and indemnity and landlords should be warned not to agree variations of lease terms without obtaining guarantors' written and signed consent.

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Further reading
Chitty on Contracts
Beale H (ed), (volume 2, chapter 44)
Sweet & Maxwell

Why this matters
In poor market conditions, a landlord may want to have the benefit of the extra security provided by a guarantor of the tenant's obligations under a lease. In commercial leases, the guarantor will often be a parent company, which may be able to offer a better covenant strength.

While the differences between an indemnity and a guarantee can be summarised easily by stating that the former creates a primary obligation and the latter, a secondary one, the importance of the distinction only comes to the fore when a landlord is seeking to obtain payment from a guarantor once a tenant has defaulted.

At this point, a landlord may discover that a guarantor has a good defence against paying on the basis that there has been a substantial variation to the lease that releases it from liability. However, if the guarantor also gave an express indemnity covenant, its obligation would not be affected by a variation of the lease and would remain enforceable.

Care should, therefore, be taken when drafting a lease on behalf of a landlord to include a separate indemnity covenant as well as a guarantee, so that the landlord has the benefit of both and there is no difficulty of interpretation or argument as to the nature of the obligations created.

Practitioners should also check whether there is a guarantee before agreeing or documenting any variation of the lease on behalf of the landlord and, if so, obtain the written and signed consent of the guarantor to the variation.

In practice, solicitors acting for tenants often also negotiate and advise on the terms of a guarantee on behalf of the guarantor, because the tenant and guarantor are frequently related companies. In this situation, solicitors should consider whether there is any conflict of interest and whether they need to advise the guarantor to obtain separate representation.

When advising a guarantor, it would clearly be appropriate to seek to exclude any indemnity covenants and to oblige the landlord to notify the guarantor of any default, so that the guarantor can bring pressure to bear on the tenant at an early stage.

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