

UPDATE

Royal Court issues guidance on bank's contractual indemnity

Update prepared by Sandra Duerden and Iona Mitchell (Guernsey)

The Royal Court of Guernsey has issued guidance on a bank's ability to recover its costs from a customer pursuant to a contractual indemnity.

The decision is important as it limits the circumstances in which a bank, or other beneficiary of a contractual indemnity, may exercise its indemnity in respect of the costs of Court proceedings¹.

Background

Mourant successfully defended injunction proceedings brought by a customer against a local bank (the **Bank**) seeking to prevent the Bank from exercising its contractual entitlement to call in a loan facility. Relying on a contractual indemnity and right of set-off in its terms and conditions, the Bank deducted its legal fees incurred in connection with successfully defending the proceedings (the **Legal Fees**) from the customer's account.

Two years later, the customer brought Court proceedings against the Bank seeking, amongst other things, repayment of the Legal Fees.

Scope of the contractual indemnity

One of the issues in the case was whether the relevant clause of the Bank's terms and conditions providing that the customer would pay the Bank's costs in connection with the loan facility covered the Legal Fees of the injunction proceedings.

This was a question of construction of the terms and conditions. The relevant clause was fairly standard, and provided that:

'The [customer] will be responsible for all costs, charges, fees and expenses (including legal and professional fees, VAT etc.) arising at any time in connection with the Facility whether the matter proceeds to completion or not and the [customer] agrees to reimburse the Bank on a full indemnity basis all and any of such as have been incurred by the Bank...By signing the [agreement] the [customer] authorises the Bank to debit the [customer]'s account with any amount due to the Bank under the [agreement]'.

The Royal Court found that resisting the injunction proceedings could properly be said to be something arising in connection with the Facility. It was 'inarguable' that the parties had agreed that the customer would be responsible for these costs.

Court order as to costs

Importantly, the Court found that the amount to be indemnified, and deducted from the customer's account, could only be known once it has crystallised. In the context of costs associated with legal

¹ The decision is likely to be the subject of an appeal in respect of which Mourant is acting. Accordingly, this update only provides a summary of the decision and does not comment on its correctness.

proceedings, this means that there should be a costs order by the Court. In that manner, the paying party can request the receiving party's bill of costs to be taxed if the costs cannot be agreed.

Otherwise, the receiving party would be able to unilaterally decide what is required to be paid. The Court observed that this would be contrary to the earlier Royal Court decision of *Guernsey Home Loans Limited v Le Couvey* (unreported, 28 May 2015). In that case, it was held that:

- Regardless of any contractual agreement between the parties, the Royal Court always retains oversight over costs incurred in legal proceedings.
- Where there is a contractual right to the costs, the Court's discretion should ordinarily be exercised so as to reflect that contractual right.
- The bank's contractual right of indemnity extends to all costs other than those which have been unreasonably incurred or which were unreasonable in amount.

Mourant acted in both cases. In the present case, the Royal Court noted that where there is a contractual indemnity, the 'default order' is that the court will order indemnity costs, and it did so. However, there needs to be some ability for another body to scrutinise the costs falling within the indemnity, to ascertain that they are reasonably incurred and reasonable in amount.

What this means in practice

Banks and others relying on a contractual indemnity should note that, following this decision:

- Regardless of any contractual agreement between the parties, the Royal Court always retains oversight over costs incurred in legal proceedings.
- Where there are Court proceedings, the bank should obtain a costs order at the conclusion of the proceedings, even it has a contractual indemnity.
- The default order in this scenario is still that the Court would order indemnity costs in the bank's favour.
- After obtaining the costs order, the bank should provide a Bill of Costs to the paying party, providing a breakdown of the costs incurred. If the paying party does not request a taxation within one month, the bank can enforce the Bill of Costs.
- If the paying party objects, the matter will proceed to taxation for the court to determine whether the bank's costs were reasonably incurred and reasonable in amount.
- At taxation, any doubt as to the reasonableness of the costs is resolved in favour of the bank.
- It is not always in a paying party's interests to go to taxation (they may be liable for the costs of doing so) and so it may be that, on obtaining a costs order, the bank and the paying party are able to agree a commercial settlement of the costs without the need for a Bill of Costs and taxation

The Court did not expressly exclude the possibility that a suitably drafted set of terms and conditions could give the power to:

- deduct the costs of court proceedings without recourse to a court order, and/or
- rely on a contractual indemnity to 'top up' any costs awarded at taxation to the amount of costs actually incurred.

However, even though the terms in question were drafted widely, the Court found that they did not go so far as to grant either of these powers.

Conclusion

It is recommended that banks and others benefitting from a contractual indemnity consider their terms and conditions in light of the decision. Obtain legal advice at any early stage, particularly where dealing with the costs associated with a dispute.

The decision is likely to be the subject of an appeal and so it is expected that this will not be the final word on the matter – watch this space.

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