The interpretation of warranties, indemnities and representations in commercial contracts governed by the laws of England and Wales, South Africa or the United Arab Emirates

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Warranties, indemnities and representations are familiar concepts to commercial lawyers and form the legal backbone of many commercial agreements. This article examines their interpretation under the laws of England and Wales (shortened to ‘England’), South Africa and the United Arab Emirates.

1. WARRANTIES

1.1 Common to all three jurisdictions

Warranties are recognised as legal constructs in all three jurisdictions and predominantly function to elicit disclosure, as A should not give a warranty if it is untrue, and to provide B with a contractual remedy in relation to the content of an untrue warranty. Warranties are statements of truth made at the time the contract is entered into, and can either be agreed between the parties and expressly included in the contract or implied by law.

As statements of present fact warranties can be contrasted with undertakings, which are promises to do (or not to do) something in the future. Alongside this legal classification, the word ‘undertakings’ is also used in a wider sense to describe all obligations agreed under the contract.

If it later transpires that a warranty given by A is untrue, B has a contractual claim for damages to cover loss he suffered as a result of that untruthfulness. The damages are unliquidated, that is to say calculated by the court, and aim to put B in the position that he would have been in had A’s warranty been true.

1.2 England and South Africa

Under English and South African law this calculation is subject to the normal limitations on the recovery of damages: B must actually have suffered loss that is not too remote from A’s breach of the warranty, and he is under a duty to mitigate that loss. The parties can agree limitations on the recovery of damages in the contract, for example through a cap on liability. In addition or in the alternative the English and South African courts have a discretion to order specific performance, namely to require that A performs the obligations under the contract that he has breached.

Some contractual terms are considered so fundamental to the contract that a breach by A will entitle B to terminate the contract, that is to extinguish all future rights and obligations, as well as to seek damages. These terms are called ‘conditions’ and, in the commercial contracts context, have generally been identified on a piecemeal basis in case law. As they do not provide B with certainty over the remedies available to him on A’s breach it is advisable for the parties to expressly identify in the contract the breaches that will give rise to termination rights.

1.3 United Arab Emirates

In the United Arab Emirates damages are calculated on a case-by-case basis, with actual loss, loss of profit, moral damages and loss of opportunity all recoverable in theory; the court will investigate the
foreseeability of the damages at the time the parties entered into the contract and the certainty of their occurrence. In the United Arab Emirates B can also seek specific performance of the contract following a breach of warranty by A.

2. INDEMNITIES

2.1 Common to all three jurisdictions

In all three jurisdictions indemnities are recognised as promises by A to pay money to B if certain specified circumstances arise. B’s claim is automatic: it is treated more like a debt claim than an action for damages, and B should be able to recover the money on a pound-for-pound basis if he can establish that his situation falls within the indemnity wording set out in the contract. Unlike under a warranty, B is not under a duty to mitigate his losses. In addition to the indemnities usually included in a commercial contract, for example protecting B against loss caused by A’s breach of third party intellectual property rights or of applicable law, indemnities may be used by the parties to apportion risk in advance where a liability or potential liability is known.

The quantum of recovery will depend on the specific wording of the indemnity, in particular the circumstances it envisages and the losses, damages or other costs it specifies. Generally, however, B should ensure when negotiating the clause that the loss is capable of being quantified without the need for evidence; otherwise the quantum must be proved in a similar manner to a damages claim, and the benefits of having an indemnity over an ordinary contractual term are reduced. Indemnities will be caught by any caps on liability elsewhere in the contract, and therefore express wording to exclude them from these caps must be included if the parties intend A to have unlimited liability in particular circumstances.

At first glance indemnities may appear to bear similarities to other contractual terms, but they can offer B unique rights. Indemnities differ from guarantees as they are a primary obligation on A, not a secondary obligation that A takes on only when C breaches his obligation. And while a clause for liquidated damages also commits A to pay B in the event of a specified breach of the contract by A, the automatic nature of a claim for payment under an indemnity is an important benefit from B’s perspective.

Indemnities must therefore be carefully drafted to ensure that they are unambiguous, as use of the word ‘indemnity’ in the clause does not ensure that it will in fact be given effect by a court as an indemnity. They are usually interpreted against the party seeking to rely on them. A should ensure that the indemnity clause is not so wide as to encompass risk that he is not prepared to bear, for example loss arising from deliberate action by B.

2.2 England and South Africa

Unlike in US commercial contracts, contracts governed by English and South African law do not generally contain an overarching indemnity for any breach of the contract by A, a term that could potentially provide B with both a contractual claim for damages and an indemnity claim for the same action by A. It is not certain that the English courts would exclude the rules on remoteness and mitigation in the case of such an overarching indemnity, in which case it would have no additional benefits over a normal damages claim.

2.3 United Arab Emirates

In the United Arab Emirates courts have been known to reduce the amount agreed by the parties in an indemnity clause if the quantum of loss suffered by B is less than the indemnity provides for – a practice not adopted by the English or South African courts, which in the absence of extraordinary circumstances such as duress generally implement the terms of a contract to reflect the agreement of the parties.
3. REPRESENTATIONS

3.1 Common to all three jurisdictions

Representations are oral or written statements that induce a party to enter into the contract (often simply referred to as ‘misrepresentations’, because they become worrisome when proved to be false). Representations can either be pre-contractual or contained in the contract itself.

3.2 England

Under English law A can breach a representation both deliberately and inadvertently, but in either case the element of inducement must be present. If A inadvertently makes a false statement – perhaps as opinion, intention or sales talk – on the strength of which B is induced to enter into the contract B is likely to have a claim for misrepresentation; but if B regards A’s statement as A’s personal view he will be unlikely to establish a misrepresentation claim if A’s prediction is later proved incorrect. In English law it is an assessment of the parties’ intentions in the context in which the statement was made that determines where the line between those two situations falls. Where a statement is true at the time that A makes it and subsequently ceases to be true, A’s failure to inform B that it is no longer true will also amount to a misrepresentation.

The remedies available to B under English law are rescission, that is the unwinding of the contract ab initio so as to restore the parties to the position as though it had never been entered into, and damages. The particular applicability of these remedies depends on whether A’s misrepresentation was fraudulent, negligent or wholly innocent:

- **Fraudulent misrepresentations**, where A has no honest belief in the truth of his statements, entitle B to rescind the contract and/or claim damages from A, and may also give rise to criminal liability. The measure of damages is to place B in the position he would have been in had A not made the representation, and in many cases this will be that B would not have entered into the contract.

- **Negligent misrepresentations**, made carelessly by A or without reasonable belief in their truth, also give rise to a damages claim if B could have recovered damages had the misrepresentation been fraudulent. The measure of damages is the same. In addition to this, B does have a right to rescind the contract but, unlike for fraudulent misrepresentations, this is subject to the court’s discretion to refuse the right to rescind and award damages instead.

- **Wholly innocent misrepresentations** only attract an action for damages if they are contained in the contract itself. However, B’s right to rescind the contract following a pre-contractual misrepresentation is subject to the court’s discretion as for negligent misrepresentations above, and therefore B may receive damages in lieu of rescission.

Therefore if a pre-contractual representation later becomes a term of the contract, for example as a warranty, rescission remains available as a remedy to B.

Where A has partly performed services under a contract that B rescinds for misrepresentation, it is generally thought that B must make an allowance for services received. Nevertheless it is very difficult to return parties to the positions they would have been in had they never concluded the contract, particularly in the case of large-scale services contracts, and this remedy will therefore be of limited value to B.

Generally A will seek to exclude any claims by B for pre-contractual misrepresentations by means of an entire agreement clause, which is effective provided that it is reasonable and does not seek to exclude liability for any fraudulent misrepresentation.

3.3 South Africa

South African law places the same emphasis on inducement as English law and draws the same distinction between statements of opinion on the one hand and representations that give rise to a claim if they are “wrongful” (false) on the other. B’s remedies for fraudulent and negligent
misrepresentations by A are also rescission and/or damages, and there is no judicial discretion in the award of one over the other. Recourse for wholly innocent misrepresentations is less developed than under English law, although the courts have previously allowed rescission in these circumstances.

As under English law A will seek to negotiate the inclusion of an entire agreement clause in the contract, although exclusion clauses have not been enforced by the South African courts where this would go against the public interest.

3.4 United Arab Emirates

In contrast to the other two jurisdictions, the law of the United Arab Emirates requires a representation to be fraudulent before it will be classified as a misrepresentation and remedies are available for its breach – indeed the Civil Code requires both a misrepresentation and “a gross cheat” before enabling a remedy, setting a high threshold for the existence of a misrepresentation. The deceit by A can be through words, actions or deliberate omission. If B can establish that (i) he was deceived by A’s misrepresentation and (ii) A intended to deceive him, B can terminate the contract thereby extinguishing all future rights and obligations. B must be careful not to consent to the misrepresentation once he knows about it, and not to continue performing the contract, as this is likely to prevent him from seeking termination.

This difference in the law of misrepresentation ties in with the statutory requirement in the United Arab Emirates that parties perform contracts in good faith. There is no equivalent obligation under English or South African law.

4. COMBINATIONS

Commercial contracts sometimes contain the wording “represents and warrants”, or even “represents, warrants and undertakes”, thereby seeking to provide B with both contractual and non-contractual remedies for a breach by A of whatever facts or circumstances follows those words. However, while express agreements between the parties will generally be upheld the courts will if necessary look to the substance of each term rather than its label, and enforce it in that light.

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