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Le Mans Enters the Racy World of Indemnities

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> So…Johnny Scribe the lawyer can choose between the thrills of drafting a beautifully honed indemnity clause….or he can race at Le Mans in a Ferrari, Lamborghini, or a Porsche. No brainer: drafting the indemnity clause is excitement-plus for Johnny. (Johnny's client might wonder what the fuss is about though as she listens to the lawyers haggle over these arcane things).
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> But a clash involving indemnities, Le Mans, and those car makers, means this tough call is no longer. Le Mans fans can thrill to the excitement of indemnity clauses. Heaven.
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> This recent English judgment[1] is one of the few on contractual indemnities. The facts are a mirror of what happens with other IP indemnities such as for software.

What happened?

Automobile Club de L'Ouest (ACO) runs the famous 24 hour Le Mans and other races.
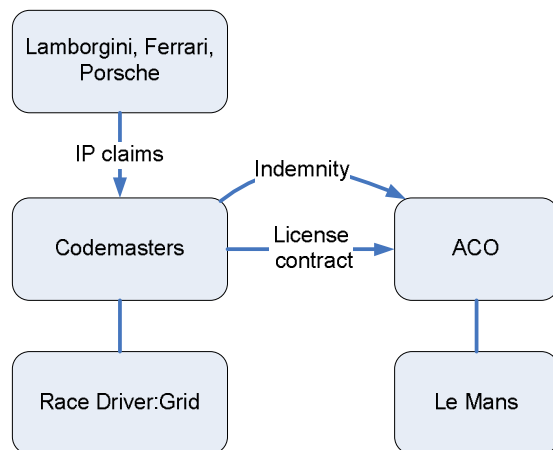
Codemasters Software sells a great computer car racing game called Race Driver:Grid. Crash your Ferrari and it can break up into up to 70 pieces on a very realistic race track.

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[1] *Codemasters v Automobile de L'Ouest* [2009] EWHC 2361 (Pat).

Codemasters agreed with ACO the rights to use Le Mans and other ACO races in the game. This included the rights to use the cars racing on the track, such as Ferrari, Lamborghini and Porsche. That meant that ACO was required to get licence rights from the three car manufacturers to enable use of their car names, marks and designs, to be able to pass on licence rights to Codemasters.

Codemasters claims ACO failed to do this.   All three manufacturers came knocking on their door (one with a writ issued in the Paris Commercial Court). Codemasters has settled with Lamborghini and Ferrari, by entering licence agreements (and they hope to settle in the same way with Porsche).

The Codemasters/ACO contract contains a relatively typical style of indemnity seen in many contracts involving intellectual property. Codemasters is seeking an indemnity from ACO in relation to the car makers' claims. It wants ACO to pay what it has shelled out to the car makers.

While the clause was not optimally drafted, it is the type of clause that many lawyers would approve…until seeing what happened here.

Codemaster got confirmation from the Court that the clause worked for them, but not without some turbulence on the way.

The case is a good illustration of what happens in IP contracts. Taking software agreements as an example, ACO is like a software licensor and the car makers are like third party owners of software incorporated in the ACO software. Software almost always contains third party components, so indemnities can be significant.

Indemnities 101

Contracts involving IP (such as software agreements) usually include indemnities. This is in addition to "normal" contract terms by which the supplier confirms it will do certain things or what is supplied will meet specified requirements (i.e. contract terms and warranties). If those things don't happen, the customer can sue for breach of contract, and seek damages, among other options.

Indemnities overlap with that, but take a different path. Typically, an indemnity sets out an event. If that event occurs (in particular, there is a claim by a third party against the customer), the supplier must indemnify the customer. For example, if the event is that there is a judgment that the customer must pay a third party (such as the true owner of the IP) a sum of money, the supplier must in turn pay that sum to the customer (often with legal costs reimbursed as well).

Where a supplier failed to get IP rights to supply the customer, the customer will often have a claim for breach of contract as well as under the IP indemnity. Further the breach of contract will often be the event that triggers the indemnity.

Of course the indemnity can also be granted by the customer to the supplier (usually as a mutual indemnity).

Indemnities can set out a detailed regime. For example, they may articulate a basis on which the supplier takes over defence of the claim against the customer.

A key question in this case was whether ACO had to reimburse (indemnify) Codemasters for what Codemasters paid out under the settlement agreements.

The general rule is that settlements are encouraged. If the indemnity applies, and subject of course to the specific wording, the indemnifier is liable to indemnify for the value of the settlement with the third party. This is so if both (a) the indemnified party was acting reasonably in reaching the compromise and (b) the amount of the compromise was reasonable. The indemnified party has to prove these two points. The claim by the third party must be of sufficient strength to justify the settlement and the amount paid must be reasonable having regard to the strength of the claim. In short, the settlements must be reasonable.[2]

The indemnity in the Le Mans case

The clause a short one, using the sorts of words seen in many jurisdictions:

> Each party (the 'Indemnifying Party') will **indemnify, defend and hold harmless** the other party …from any and all claims, causes of action, suits, damages or demands whatsoever, arising out of **any breach or alleged breach of any agreement or warranty** made by the indemnifying Party **pursuant to** this Agreement. [Bold added to highlight key points]

As will be seen below, this clause is capable of two interpretations. So the Court used the "matrix of facts" approach which takes into account the facts at the time when interpreting the clause. Additionally, it worked from the principle that the more unreasonable the outcome of an interpretation, the more unlikely it is that the parties intended it. If the parties intend that unreasonable outcome, it is necessary to make that intention abundantly clear.[3]

First interpretation question

Codemasters argued that the indemnity clause is an indemnity against claims by third parties such as the claims by the car makers in respect of which it seeks to recover from ACO.

But ACO, in its main argument in the case, said that the indemnity only applies in respect of claims under separate agreements, not under the agreement itself, which contains the indemnity.

ACO's point revolves around "pursuant to", highlighted in the indemnity quoted above.

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[2] See Codemasters at Paras 16-21.
[3] The Judge cited the leading House of Lords decision, Investors Compensation v West Bromwich [1998] WLR 896

Codemasters say that "pursuant to" means "in". ACO claim that it means "separate from and in consequence of".

The Judge said that "pursuant to", as pure language, could have either meaning. So it was necessary to stand back and consider the purpose of the clause and its commercial effect.

In doing this, the purpose becomes reasonably clear, in favour of Codemasters. The purpose is to grant an indemnity in relation to claims against Codemasters arising out of its exploitation of the rights granted under the contract. This is in accordance with common practice in IP-related contracts. There are good reasons why parties use such indemnities. The licensor is in a better position to assess whether exploitation will infringe third party IP rights. Commercially, it is more acceptable for the licensor to take the risk.[4]

So the commercially sensible option was accepted by the Court.

The judge said that the clause was "not felicitously drafted". However, while many lawyers would be surprised that there would even be an argument over the "pursuant to" point, it does show how seemingly clear words in contracts can lead to debate.

Second point

Next up is the meaning of "breach or alleged breach of any agreement or warranty". The claims were for breach of their IP rights, not for "breach or alleged breach of any agreement or warranty". However the Court held that the breach was of the warranty by ACO, in favour of Codemasters, that it had all IP rights to on-license to Codemasters. The clause was not ideally worded but that interpretation makes sense in context.

Third point

ACO also raised the obligation on ACO to "indemnify, defend and hold harmless". The use of the word, "defend", said ACO, required Codemaster to hand over defence of the claim to ACO. The judge didn't agree. If that was the purpose, much more would be required in the clause.

ACO ran other interpretation points of less merit.

Conclusion

This case is a reminder to take a closer look at indemnities to make sure they work as intended.

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[4] Codemasters 22-39

We welcome your feedback on this article and any enquiries in relation to its contents. This article is intended to provide a summary of the material covered and does not constitute legal advice. We can provide specialist legal advice on the full range of matters contained in this article.

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