Contractual Legal Ramifications and Indemnification Clauses

Reading the Fine Print

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Contractual Indemnification (or how to get yourself sued!)

- Most contracts provide forms of indemnity agreements between a service provider / contractor / tenant and the other contracting party
- Most common scenarios are found in:
  - Construction
  - Service agreements
  - Leases
  - Supply agreements

Contractual Indemnification

- Purpose of Indemnification Clause:
  - Transfer the risk of misadventure to a single entity
  - Reduce the need for overlapping Insurance
  - Simplify and streamline the litigation process
  - Place responsibility for negligence on the proper party which promotes safety
  - Reduce legal, administrative and insurance costs

At least in Theory!

Types of Liabilities assumed in Contract

- The most understood form of liability is the obligation to perform the contract according to its terms e.g. install 5 utility poles, dig a ditch at coordinates x, y,, provide 500 widgets by x date.
- These are known as "express terms"
- Additionally there are "implied terms"
- These include actions such as performing a contract without negligence.
- To illustrate: it's an implied term of a contract that it will be performed without causing injury to the contracting party's person or property, or to similarly damage the person or property of the contracting party's employees, customers, etc.

Liabilities Assumed in Contract cont'd

- Finally there are conditions that require a contractor to assume legal responsibilities of the contracting party arising out of the project.
- In many if not most modern contracts involving an undertaking there is an attempt to shift responsibility for misadventure onto the contractor.
- This may included liability for injuries sustained to the contracting party or others due to the contractors negligence.
- In other cases the contracting party may try to shift responsibility for all negligence (even its own) onto the contractor (or its insurer).

Types of Indemnification Clauses

- There are two general types of common clauses requiring indemnification in contract:
  - The indemnification clause; and
  - The covenant to Insure.

Indemnification Clause

- Generally reads something like this (taken from a "pole agreement" between the City of Toronto and the Inter Urban Electric company in 1910):
- *The company shall save harmless and indemnify said corporation against any action, claim, suit or demand brought or made by the granting of any of the privileges herein before mentioned to the company, and all costs and expenses incurred thereby, and also against all loss, damages, costs, charges and expenses of every nature and kind whatsoever, which the corporation may incur, be put to or have to pay, by reason of the improper or imperfect execution of their works or any of them, or by reason of the said works becoming unsafe or out of repair, or by reason of the neglect, failure or omission of the company to do or permit anything therein agreed to be done or permitted or by reason of any act, default or omission of the company or otherwise howsoever.*

Indemnification Clause cont'd

- Will generally only cover liability based upon the conduct of the contractor. While it is possible in theory to shift liability for the contracting parties own negligence onto the contractor the Courts make this very difficult via the use of an indemnification clause.

- In ***Walters v. Whessoe Ltd and Shell Refining Co. Ltd***. (1960), [1968] 2 All ER 816, the House of Lords held:

It is well established that indemnity will not lie in respect of loss due to a person's own negligence or that of his servants unless adequate and clear words are used or unless the indemnity could have no reasonable meaning or application unless so applied… It is now well established that if a person obtains an indemnity against the consequences of certain acts, the indemnity is not to be construed so as to include the consequences of his own negligence unless those consequences are covered either expressly or by necessary implication.

Indemnification Clause cont'd

- In *Potvin v. Canadian Museum of Nature*, 2003 Carswell Ont 1932, the Court considered an "indemnity-for-defence-cost" provision. The Museum rented space under a rental agreement containing an indemnity provision. The indemnification clause in the rental agreement read as follows:

The Renter shall indemnify and save harmless the Museum from and against any and all claims, damages, suits and actions whatsoever, including any claims for any personal injury (including death resulting therefrom) or any loss of or damage to property which arise out of or in connection with the entry onto and use of the Museum's facilities on the date(s) specified in this agreement or which arise out of said event. If the Museum is made party to any litigation commenced by or against the Renter, the latter shall promptly indemnify and hold harmless the Museum and shall pay to the Museum all costs and expenses incurred or paid by the Museum in connection with such litigation…

Indemnification Clause cont'd

- The plaintiff sued the Museum for an injury suffered after leaving the dinner, when using the Museum's marble stair case. The Museum then sued Royal LePage for indemnity pursuant to the terms of the rental agreement.

The Court held that the accident was not sufficiently proximate to Royal's use of the premises to trigger the indemnity provision:

[T]he mere fact that the plaintiff was present on the premises to participate in Royal's special event when injured, but the injury was otherwise not connected in a casual sense to the activity of the event, is not a sufficient connection to invoke the indemnification provision. The connection must be more "proximate" to Royal's activity. I use the term "proximate" in the sense that the Shorter Oxford English Dictionary gives, namely, 2. Coming next in a chain of causation, agency, reasoning, etc. Unless an agreement clearly expresses an intent to transfer all of the occupier's negligence liability to a renter, the indemnity will apply only to negligence with a casual connection to the renter's use and activity.

Indemnification Clause cont'd

- In order to be effective against the contracting parties own negligence the exact conduct that is the subject to be indemnified must be absolutely explicit and include that fact that it is the contracting party's own negligence that is being indemnified.

Covenant to Insure

- Covenant to insure can be as effective if not more so than an indemnity clause.
- Typically Reads as follows:

During the term hereof and any renewal, Contractor agrees to maintain to the benefit of the contracting party the following insurance policies:

(a) Comprehensive General Liability insurance (including coverage for all non-owned automotive units) including employers', products and contractual liability, specialty and licensed vehicles, tortious liability, contractors protective liability, products and completed operations liability, and any other extensions standard to the industry, with a combined single limits of not less than two million dollars ($2,000,000.00) for each occurrence for bodily injury, death or property damage and also including sudden and accidental pollution coverage with a minimum of 72 hours discovery/reporting provision in a sublimit of not less than one million dollars ($1,000,000.00) inclusive;

Covenant to Insure cont'd

- Other language frequently reads along the lines:

The Contractor shall at its own expense, obtain and lodge with the Company a certificate of insurance, naming the Company as additional insured. The minimum limits of this liability policy shall be FIVE MILLION DOLLARS ($5,000,000.00) aggregate and TWO MILLION DOLLARS ($2,000,000.00) per occurrence. Such policy shall be maintained in full force and effect until the termination of the contract and shall include the following coverage:

a) premises and operations liability.

b) contractor's contingency liability with respect to the operations of the sub-contractor's completed operations liability,

c) contractual liability

d) automobile liability

e) non-owned automobile liability.

f) thirty-day notice of cancellation or alteration clause.

Covenant to insure cont'd

- Courts have held the clauses to be legally binding
- Provision is to protect the contracting party against unforeseen liability arising out of a project which it has contracted with another to perform.
- Considered good policy by the courts
- Trumps indemnification clauses
- Contractor is liable to provide indemnity and defence costs where it fails to provide the covenanted insurance.

Contractual Indemnification Clauses –Why they sometimes things go south

- Drafted by bright, hardworking and diligent contract lawyers
- Added to contracts by bright, hardworking and diligent negotiators
- Implemented by bright, hardworking and diligent risk managers
- Defeated by brighter, harder working and more diligent litigation lawyers

[written by a litigation lawyer]

Common Pitfalls

- The most common error with covenants to insure is:

FORGETTING TO OBTAIN THE INSURANCE

Common Pitfalls cont'd

- Next common error is to fail to obtain the appropriate insurance
- There is a need to review the policy with the insurer to make certain the required insurance has been obtained as not all policies cover all activities
- Most Commercial General Liability policies exclude activities such as: Automobiles, Pollution, and Professional negligence
- There may be a need to either obtain different insurance or amend the contract

Issues to Check

- Policy Term – Does the policy last the length of the project, is there a requirement to maintain coverage after the project is finished.
- Is the coverage claims made or occurrence based
- Does the policy cover only vicarious liability or will it cover the negligence of the contracting party
- Does the policy provide the required coverage – auto, environmental, general liability etc.
- Are there exclusions in the policy which make it incompatible with the covenant.

The MEARIE Policy

- Generally provides liability insurance for many activities provided by LDC's and their affiliated companies.
- There is a specific requirement that negligence arise out of "operations covered"

Operations Covered

- **Operations Covered**" means operations of the **Named Insured** and/or an **Additional Named Insured** but only as identified to and approved by the **Reciprocal**. Any **Affiliated Body Corporate** or **Subsidiary Body Corporate** must bean **Additional Named Insured** in accordance with Section 6.2 of the policy for coverage under this policy to apply to any such **Affiliated Body Corporate, Subsidiary Body Corporate**
- Section 6.2 reads:
- "**Additional Named Insured**" means those set out as such in the Declarations of the Policy or in a Certificate of Insurance issued evidencing coverage provided by the policy, and/or an **Insured** as defined under Section 6.10.1

Operations covered – More Simply

- Operations covered means the commercial activity performed by the LDC and its affiliates as disclosed to MEARIE
- If your operations primarily involve construction of widgets and you have not disclosed those operations to MEARIE and one of your widgets hurts someone, there is no coverage.
- If, on the other hand, you have an affiliate that produces 500 volt electric joy buzzers and you disclose this to MEARIE and MEARIE accepts the risk, your affiliate is insured!

Additional Insured

- The MEARIE policy has language dealing with additional insureds not specifically named in the policy:
- Coverage for additional insureds (as opposed to additional named insureds) is found in section 6.10.3 of the policy which reads:

"**Insured**" means …:

…

subject to Section 8.22, any **Additional Insured** to whom or to which the **Named Insured** and/or **Additional Named Insured** is obligated by virtue of a written contract or permit to provide insurance such as is afforded by Coverages A.1, A.2, B and C of this policy, but only with respect to vicarious liability of the **Additional Insured** arising from **Operations Covered** by or on behalf of the **Named Insured** and/or **Additional Named Insured** or to facilities of or used by the **Named Insured** and/ or **Additional Named Insured** and then only to the extent of the coverage required by such contract or permit and for the limits of liability specified in such contract or permit.

Contracted Services

- Section 6.10.3 requires compliance with section 8.22 which notes:

If the **Insured** enters into an agreement for the provision of **Contracted Services** with any other person, business, concern or entity, then the insurance afforded by this policy shall apply upon the following conditions:

- 8.16.4 the insurance afforded will only be to the extent of **Operations Covered**; and
- 8.16.5 the **Insured** pays the **Reciprocal** an additional premium computed pro rata from the date of such provision of **Contracted Services** to the end of the current **Policy Period**.

MEARIE requirements

- Consequently it is important before entering into any contracted service to advise MEARIE to ensure there is coverage for the contracted service.
- The automatic coverage only provides insurance to the additional insured for vicarious liability – i.e. it will not insure the additional insured for their own negligence.
- Additionally the automatic coverage only covers bodily injury, personal injury, property damage and tenants legal liability.
- For coverage such as environmental impairment, auto liability and professional liability other steps must be taken or those coverages must be written out of the contracted service agreement.
- If the contracting party insists on broader coverage than afforded by the policy contact MEARIE to discuss options
- Be aware that different limits apply to different activities.

Conclusion

- Fundamentally important to be aware of all sources of potential liability and insurance requirements when entering into an contract to perform services
- Indemnity clauses and covenants to insure are common features of these contracts
- Frequently these clauses do not mesh with existing liability policies
- It is essential to advise the insurer of any contractual assumption of liability to ensure that the proper coverage is in place for both the contractor and the contracting party.