# Guide to Contract Management

Managing risk together

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## Contents



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# I: Introduction – Consensus ad idem

The law of contracts has been called "an affirmation of the human will to affect the future through the extraordinarily powerful mechanism of protecting exchange into the future."[1] But what does that mean? What is required for a contract to exert that extraordinary power? As a starting point, the parties to a contract will be held to have reached an agreement when they have formed a mutual intention to bargain with each other and, further, agree as to the terms of that bargain. It is only then that the parties will have reached *consensus ad idem*, or a true *meeting of the minds*.

The term "contract" from a legal perspective, refers to a written document that records a legally enforceable agreement between two parties. While a broader, less lawyerly definition of the term generally includes any enforceable promise between two or more parties that have the capacity to "bargain" with each other, this guide will focus specifically on the types of written contracts typical to MEARIE Member activities.

**Contractual risk transfer** is a legally binding way to **transfer risk** to the party that may be in the best position to control the **risks** related to the service to be provided. It is the strategic use of contractual obligations such as indemnity and hold harmless agreements, waivers of recovery rights (subrogation), and insurance requirements to pass along to others what would otherwise be one's own risks of loss.

The intention of this guide is to provide context for the use of contracts as a risk transfer vehicle and ensure your organization is not inadvertently taking on more risk than intended. This resource includes the following:

- An overview of the basic components of a contract – typical sections, terms, and clauses.
- Insurance Requirements – Typical types of insurance, definitions, and an important exclusion
- The "Battle of the Forms" – a key tip for avoiding this type of dispute
- Standard forms of indemnification that are commonly built into contracts
- Some tips for limiting liability as much as possible
- The appendices include a Vendor Insurance Certificate Checklist and a guideline for assessing the level of risk inherent in any specific type of business activity (which can help in deciding which party should assume risks when using a contract as a risk transfer vehicle).

[1] Macneil, *The New Social Contract* (1980), at 6-7.

# II: The Basics – Contract Components & Clauses

## Contract Components

By their very nature, contracts will vary widely in terms of the language used and degree of specificity required. Even within the context of electricity distribution in the province of Ontario, on its face a rather specific situation, a contract relating to the installation of several powerline poles will be markedly different from that governing the design, construction, and operation of a 5,000 MW generating station. However, certain aspects will be common to both, and a clear understanding of these basic components is essential to effective drafting, interpretation, and implementation.

**The Offer** – An offer is a communication by the offeror to the offeree indicating a willingness to enter into an agreement with the offeree on certain terms. At this stage, it is important to distinguish mere preliminary negotiations from an actual offer. This critical distinction, at its most basic, is drawn on the basis that an offer communicates a willingness to be bound by the next communication of the offeree.

> **Tenders** – A sub-category of "offer" that is particularly relevant to the types of contracts typically encountered in the electricity sector is the "tender". The process normally commences with the issuance of a "tender call" issued by the party who is wishing to retain someone to undertake the project. The tender call will outline the nature of the project and the rules relating to the submission of bids by interested parties, and will often include a draft of the building or construction contract into which the successful bidder will be expected (or required) to enter. The next stage involves the submission of bids by interested parties, followed by the opening, assessment, and selection of the winning bid. **The requirement that bidding parties submit a deposit along with their bid, which is non-refundable should it be selected, reflects the distinction between preliminary negotiations and the formation of a binding contract.**

**Communication of Offer** – To be effective, an offer must be communicated to the offeree. The fact that one has decided to make an offer does not constitute an offer, even where the offeree has become aware of the existence of the decision.

**The Acceptance** – There is no meeting of the minds unless the acceptance is a mirror image of the offer. In the simplest sense, where the offeree replies, "I accept your offer," in the absence of further negotiations by the parties, a valid contractual relationship will have been created. However, if the purported acceptance varies in any respect the terms of the offer, it will be treated as a proposal of new terms and classified as a counteroffer rather than an acceptance. It is important to note that the effect of the counteroffer is to remove the initial offer from the bargaining table. Finally, to be effective an acceptance must comply with any instructions issued by the offeror for the manner in which acceptance is to be exercised.

**Communication of Acceptance** – The *Consensus ad idem – meeting of the mind's* theory implies that an acceptance, to be effective, must be communicated by the offeree to the offeror. In most circumstances, this aspect of contract formation is straightforward, but it is important to be aware of those instances in which the analysis can become somewhat complicated:

- **Silence as acceptance**: There are essentially two different kinds of fact situations in which silence may have this effect. First, situations may arise in which the silence of the offeree is reasonably understood by the offeror to indicate any acceptance of the offer by the offeree.

The second are situations in which the offeror has waived the normal requirement of communication of acceptance. This type of situation is more likely to occur in the context of unilateral, rather than bilateral agreements.

- **Postal acceptance rule**: Under this rule, an acceptance posted by mail is effective upon posting. Obviously, with the demise of snail mail in today's connected society, this rule is of diminishing relevance.
- **Instantaneous communications**: In the age of email, courts have recognized that the traditional principle that an acceptance is communicated when it is received by the offeror is difficult to apply consistently. That being the case, the traditional principal will generally apply unless it can be shown that the failure of the offeror to receive the communication of acceptance resulted from some fault on its part.

## Common Contract Clauses

There are certain clauses that should be included as part of all contracts. The clearer a contract is at defining the terms and conditions, the less the potential for misunderstandings, or disagreements in the execution of the contract. Depending upon the purpose of the contract, there will be various clauses that will need to be included.

However, at a minimum, each and every contract should include the following clauses:

**Parties to the Contract**: who is the contract between? The exact legal names spelled out in full should appear such as Municipal Electric Association Reciprocal Insurance Exchange (MEARIE). Once spelled out in full, the short form, such as MEARIE, can be used throughout the remainder of the contract.

**Agreement and Consideration**: There must be specific wording to indicate that there has been consideration and acceptance by both parties to form a binding contract. Consideration is the benefit that each party gets or expects to get from the contractual deal. Consideration is usually either the result of:

- a promise to do something you're not legally obligated to do; or
- a promise *not* to do something you have the right to do.

**Contract Term**: There should be a date which the contract takes effect and a date or indication of when the contract ends. If there is not a specific date for termination, wording should indicate such as upon completion of service, upon delivery or one year after signing.

**Specifications:** There should be detailed language to describe each party's obligations and expectations. What service/product is being provided under the contract? What is the timetable for carrying out the contract? All specifications should be clear, concise, not in conflict with other terms and conditions of the contract; feasible and achievable; and measurable and verifiable.

**Performance Measurement**: Each contract should clearly indicate the expected outcomes to allow each party's performance to be monitored and measured over the contract timeline. The contract should provide the performance measures to be used and how often performance will be measured. Performance measurement must be such that progress is being followed and potential red flags arise before it is too late to take corrective actions.

**Dispute Resolution:** The main goal of a dispute resolution process in a contract is to prove a method to address potential issue before they escalate and adversely affect the outcome of the contract. The process should outline responsibilities of both parties in the event of a dispute, timelines for resolution and further action in the event the dispute cannot be resolved.

**Indemnification:** The other party should always agree to defend and indemnify your company and your employees, directors, officers, agents, volunteers against liability for personal injury or property damage arising out of the other party's performance under the contract. If the other party will not accept an indemnification clause, this may be a potential red flag before entering into a contractual relationship with the partner. (Please see page 16 below on indemnification.)

**Don't accept any sort of language in a contract that includes or requires the assumption of the liability arising out of the operations of the other party**. The other party should be responsible for their own actions and liability arising from them. The other party should be agreeing to indemnify your company if they cause a loss.

**Warranty:** The contract should adequately protect your company in the event the other party does not perform their obligation satisfactorily. A strongly worded warranty can serve to ensure the other party performs as per the terms and conditions while protecting your interests.

**Intellectual Property Rights**: Clearly indicate the ownership of any intellectual property that is developed under the contract.

**Payment:** The contract should detail the terms, conditions and timing of payments, as well as penalties for late payment and your rights in the event of non-payment. The clearer and more well defined the payment terms, the more likely it will be to expect prompt payment without disputes. Consider having payment tied to performance of achieving key measurement milestones and payment terms that do not require significant payment of large advances. Also consider a "hold back" until the contract is satisfactorily completed. Be particularly mindful of language that would permit your client to withhold payment of disputed invoices.

**Termination**: Is there a process to protect your company in the event it becomes necessary to terminate the contract without breaching the contract? When entering any contract, an organization must think of how to exit out of it. Preferably, this will involve no penalty by providing written notice within a particular time frame.

**Governing Law:** A contract should specify which legal jurisdiction under which the contract is to apply. MEARIE's coverage is triggered when a cause of action is filed in North America. Consideration should be given so the Laws of Canada apply as historically awards have been much higher in foreign jurisdictions.

**Severability Clause:** Contracts should have a severability clause that will ensure if any provision or clause in the contract is deemed to be invalid or unenforceable, it will not affect the remainder of the contract. Thus, the contract remains in full force and effect.

**Confidentiality Clause**: This clause will survive the termination of the contract. If either party is required to protect the confidential information of the other party, it means that an obligation (contract) has been created to ensure procedures are in place to safeguard and protect the other party's information.

**Signature Line**: There must be a place for an "Authorized" individual from each party to sign. The individual must be authorized by the company to act on its behalf and to commit the company to the binding terms of the contract. The information should include the name, title, address, telephone number and email of each individual signing.

**Consequential Damage:** The contract should include a waiver for Consequential Damages. Consequential damages arise when a party to a contract fails to hold up their duties under their contract, and the other party is damaged as a result. Consequential damages extend beyond the direct damage caused. Instead, any damage incurred because of the failure to uphold the contract could be in play – *unless limited in the contract*. Unless reigned in, consequential damages could extend far beyond the terms of the contract.

**Limitation of Liability (LOL):** A LOL clause in a contract is used to establish the maximum liability each party will be responsible for an insurance claim. This is important as an LOL fairly allocates liability to a reasonable proportion of fees. (Please see page 18 below on liability limitations.)

**Mediation:** This is a dispute resolution option that helps disputing parties reach agreement between themselves. A contract should include a clause that calls for mediation as the first step in dealing with disputes. In some jurisdictions, including Toronto and Ottawa, mediation is mandatory for all Superior Court actions.

**Force Majeure:** This clause would state that a party is able to delay or terminate performance under a contract, when a situation or circumstance arises that is out of the party's control and would make performance, impossible, illegal or otherwise inappropriate.

# III: Insurance Requirements

Insurance requirements should be spelled out clearly and unequivocally. They should reflect the nature of the work contemplated by the contract. Most importantly, they must reflect the expectations of the parties to the contract. Keep in mind that insurance requirements stipulated in a contract are there to ensure the contracted company has insurance in the event they injure the contracting company or a third-party while performing the work. Ensuring appropriate insurance coverage is important because:

- Your company can be held liable for damages caused by your contractors.
- Responsibility encourages safety on the part of all parties
- Risk is placed upon those best able to control the work
- The contractor's insurance policy becomes a source of payment for claims
- Helps maintain the project budget
- Ensures your company maintains your own good loss history on your own insurance policies

## Types of Insurance

**General Liability**
A Commercial General Liability (CGL) policy protects a business from financial loss should it be liable for property damage, bodily injury, personal and advertising injury caused by services provided, business operations or employees. As a MEARIE Member, your Comprehensive Liability policy is broadly worded and tailored specifically for the unique exposures faced by MEARIE members. It provides coverage under a single policy that encompasses the scope of six traditional, separate policies, as follows:

- Bodily Injury Liability
- Personal Injury & Advertising Liability
- Property Damage Liability
- Environmental Impairment Liability
- Errors & Omissions/Professional Liability
- Directors & Officers Liability
- Terrorism Liability
- Privacy, Cyber & Network Security Liability
- Tenant's Legal Liability
- Legal Expense Reimbursement
- Occupational Health & Safety Expenses
- Defense Settlement
- Non-Owned Automobile Liability

As such, when you are approaching a third-party company to request insurance requirements, their policies will different than the MEARIE policy. They may have separate policies for General Liability, Environmental, E&O/Professional Liability, Privacy/Cyber, etc. Based on this, if your company is drafting the contract, ensure to list out all of the coverages, limits and acceptable deductibles in the insurance requirements in the contract that would be expected.

Policy wording may not be standardized between carriers, so it is important to understand what will be covered, and what may not be covered. MEARIE is available to provide a review of contractual insurance requirements, provide risk management advice and provide coverage interpretation based on MEARIE policy wording only.

## Definitions

The following are some of the most common definitions often found in insurance policies which are pertinent to insurance requirements relating to contracts.

**Per occurrence limit of liability** – The per occurrence limit is the maximum amount of money the policy will pay during the policy term for any one insured loss.

**Aggregate limits of liability** – The maximum amount the insurance policy will pay in the policy term notwithstanding the number of claims.

**Notice of Cancellation (days)** – A provision that permits the insurer or an insurance company to cancel a policy at any time before its expiration date, generally stated in X business days (30/60/90). The longer the period the better, as there then there is more time to be notified that a policy is being cancelled which may impact the contracted work.

**Cross Liability / Severability of interest clause** – Each insured is insured separately under the general liability policy. This clause will allow for Insured vs Insured actions under the policy. Please see page 12 below for more information regarding Insured vs Insured exclusions.

**Primary and Noncontributory** – This term stipulates the order in which multiple policies triggered by the same loss are to respond. Within the context of contractual insurance requirements, a Primary and Noncontributory clause in a contract means that the contracting party's policy must pay before other applicable policies and without seeking contribution from other policies that also claim to be primary.

**Waiver of Subrogation** – A Waiver of Subrogation is a contractual provision whereby an insured waives the right of their insurance carrier to seek redress or seek compensation for losses from a negligent third party. Such provisions prevent one party's insurance carrier from pursuing a claim against the other contractual party to recover money paid by the insurance company to the insured or to a third party to resolve a covered claim.

**Additional Insured** – An additional insured status in a CGL policy extends the coverage beyond the named insured to other individuals or groups that were not initially named in the policy. With an additional insured endorsement, the additional insured will then be protected under the named insurer's policy and can file a claim if they are sued. Additional insured typically applies where the primary insured must provide coverage to additional parties for new risks that arise out of their connection to the named insured's conduct or operations.

You may be asked to add another party to your insurance as an Additional Insured. MEARIE will add the other party to whom you are providing a service under contract as an Additional Insured.

*Note: An additional insured cannot be provided under a Property or Vehicle policy.

This only provides coverage for the other party as it relates to your operations. If you are providing a service to another party, you can expect them to request being added to your policy as an Additional Insured. If you are being provided a service, you should be added to the supplier's policy as an Additional Insured.

> ***For example…*** *A general contractor might require subcontractors to name the general and the owner on the subcontractor's policies. For example, a general contractor might contract out of work to be done on a project to plumbers, electricians, and engineers. These workers are providing a service to the general contractor as third parties. As a result, the contracted third parties could sue or file a claim against the general contractor if they get hurt on the job. In this way, if the general contractor or owner is sued due to accidents arising out the work of the subcontractor, the subcontractor's insurance will protect the general contractor and owner.*

The following is a sample of the wording which appears on a MEARIE Certificate of Insurance to add Party A as an Additional Insured:

> *It is agreed and understood that the aforementioned Additional Insured(s) (Party A) are added (General Liability only) but only with respect to Additional Insured's vicarious liability arising out of the Operations Covered of Party B solely as it relates to the project, event or contract listed below, but excluding any negligent acts committed by such Additional Insured.*

**Certificate of Insurance (COI)** – A document that gives evidence of the Insured's financial stability (by way of an insurance policy) in the event of a claim. The COI gives evidence that the party has appropriate insurance limits to cover the claims for which they are responsible. The document should outline information on specific insurance coverage(s) required within the contract. The certificate outlines types and limits of coverage, insurance company, policy number, named insured and the policy effective and expiry periods.

A COI is intended to prove a policy's status, provide quick access to its coverage details, reduce exposure to risk, and protect against third-party liability. Regarding the reduction in risk exposure, by carefully documenting certificates of insurance from all third-party vendors, your business is more readily able to transfer loss to those party's (and by extension their insurer's) if something goes wrong.

If you wanted to confirm that a party with whom you are contracting has adequate insurance in place to cover any losses to property or bodily injury in the case of an accident, the simplest approach would be to request a copy of their insurance policy. However, simply confirming that there is a policy to respond to a third-party claim is not sufficient when any negligence on the part of that third party may also adversely affect your business. In this case, you would want the third party to issue a COI by which that party's policy would be endorsed to extend additional insured status to your business. If your business is subsequently named as a defendant in a lawsuit due to an incident related to the third party's work, it should be squarely covered by that party's insurance policy.

**MEARIE's recommendations:**
**For vendor and /or contractor standard certificates is a $5,000,000 limit of Liability for both Liability and Vehicle Insurance.**
**Ensure to collect insurance certificates from any contracted entity, to ensure that insurance requirements are met and that your organization is listed as an Additional Named Insured.**

## Waiver of Subrogation

A waiver of subrogation clause is included in a contract to minimize lawsuits and claims among the parties. The risk is determined to stop there, without allowing the insurer to seek costs from a third party. This guarantees that if a loss occurs, the owner's insurer pays the claim and the insurance proceeds can be used to fund the cost of repairs without determining who was at fault

However, as with virtually all CGL policies, the ability to waive your business', and by extension your insurer's right to subrogate is limited. The following provision is taken from the MEARIE Liability policy:

> **8.10 SUBROGATION**
> In the event of any payment or assumption of liability to pay under this Policy, the Reciprocal shall be subrogated to any Insured's right of recovery against any person or organization, and any Insured(s) shall execute and deliver instruments and papers and do whatever else is necessary to secure such rights, but the Reciprocal shall have no right of subrogation against the Insured, as defined in Sections 6.18.1, 6.18.2 or 6.18.3 herein. Nothing shall be done by any Insured(s) to prejudice the Reciprocal's rights of subrogation.

## Contractual Liability Exclusion

Most insurance policies, including the MEARIE Liability policy, contain exclusionary language against liability arising from a contract. The purpose is clear, in that insurance is meant to cover fortuitous risk, not deliberate decision-making on behalf of its insureds. A contractual liability exclusion generally operates to bar or deny coverage of personal injury and property damage claims for which an insured is obligated to pay by reason of the assumption of liability in a contract or agreement, when an insured takes on liability for the conduct of a third party. Think about indemnity clauses, an indemnity clause is an assumption of liability and commonplace in most contracts.

The following are the sections taken from the MEARIE Liability policy to illustrate this:

> **3.25 CONTRACTUAL LIABILITY EXCLUSION**
> To any **Claims** for **Bodily Injury** or **Personal Injury** or **Property Damage** or **Environmental Impairment** for which the **Insured** is obligated to pay compensatory damages by reason of any actual or alleged **Breach of Contract** or assumption of liability in a contract or agreement. This exclusion does not apply to liability for compensatory damages:
>
> i. that the **Insured** would have had in the absence of the contract or agreement; or
> ii. Assumed in a contract or agreement that is an **Insured Contract** provided the **Bodily Injury** or **Personal Injury** or **Property Damage** or **Environmental Impairment** occurs subsequent to the execution of the contract or agreement. Solely for the purposes of liability assumed in an **Insured Contract**, reasonable legal fees and necessary litigation expenses incurred by or for a party other than an **Insured** are deemed to be compensatory damages because of **Bodily Injury** or **Personal Injury** or **Property Damage** or **Environmental Impairment** provided:
>
> (a) Liability to such a party for, or for the cost of, that party's defence has also been assumed in the same **Insured Contract**, and

(b) Such legal fees and litigation expenses are for defence of that party against civil or alternative dispute resolution proceeding in which "compensatory damages" to which this insurance applies are alleged.

***For example**… A construction company working on a city government building may be required to hold the city harmless if someone were to be injured on the construction site. The constructions company has agreed to assume liability and indemnify the city. A contractual liability insurance policy would protect the contractor from losses that the building contract protects the city from.*

***Key Takeaways:***

- *Contractual liability insurance protects against liabilities that policyholders assume when entering into a contract.*
- *Contractual liability involves the financial consequences emanating from liability, not the assumption of the indemnitee's liability itself.*
- *A common phrase found in contracts states that one party agrees to hold another party harmless for any injuries, accidents, or losses that occur while the contract is in effect.*

## "Hold Harmless"

Another important aspect of the contractual liability exclusion, which ties into our discussion regarding indemnification below, is understanding that the true meaning of the terms "hold harmless," "indemnify," and "defend" differ. These terms are common in contract language. "Hold harmless" means an agreement to assume the financial consequences of another's liability. "Indemnify" means to reimburse damages and defence costs but it does not include the obligation to defend. If an indemnitee wants to be defended, it must say so in its contract.

## Exceptions to the Exclusion

Many companies have general liability polices that protect them from the many risks they face in day-to-day operations; however, these policies may exclude coverage in some instances. In the case of a contractual liability exclusion, there are certain situations, or exceptions, where the exclusion will not apply.

1. Liability that would be present in absence of an agreement – think tort claims. Contractual liability is liability arising from someone's refusal or neglect to honour the commitments taken under a contract. They are not fulfilling, or only partially fulfilling, their obligation under the contract, which results in harm (or damage). Extra-contractual liability designates situations of civil liability that occur in the absence of a contract between the victim and the guilty individual.

***For example…** Your company executes a contract with another company to complete a component of a larger project. Your CGL policy explicitly excludes liability that you have voluntarily assumed under the contract with the subcontractor (the party that you retained). An accident occurs, and it is subsequently determined that the subcontractor carried out its scope of work in an unsafe an unworkmanlike manner. From a legal perspective, they acted negligently in carrying out the duties for which they were contracted. Here, the contractual liability exclusion may not be applicable as there is a duty to perform work safely, whether in the presence of a contract or not.*

2. Liability assumed in an insured contract as defined in the policy – The key here is the term "insured contract," which will be defined in the policy. This exception typically requires that the "bodily injury" or "property damage" at issue occurs subsequent to the execution of the contract or agreement.

> ***For example…*** *Most CGL policies will define "insured contract" in several ways, the most important of which typically includes something along the lines of "that part of any other contract or agreement pertaining to your business under which you assume the tort liability of another party to pay for "bodily injury" or "property damage" to a third person or organization. Accordingly, if the contractor or contractor carries a standard CGL policy, then "contractual liability" is included, provided that the contract between the parties satisfies the definition of "insured contract."*

## Insured vs. Insured Exclusion

A question that commonly arises in the context of insurance polices that cover multiple additional named insureds has to do with the Insured v. Insured exclusion that is typically found in most CGL policies, including MEARIE's. Specifically, there is often a concern regarding potential coverage issues that may arise in a case where more than one named insured is brought into an action as a defendant, and each points the finger at the other in terms of liability for the subject loss. Because both are insured, and both are seeking coverage under the same policy, will it be excluded solely on that basis?

The short answer is **no**. Coverage would not be excluded by virtue of s. 3.29 of the MEARIE CGL policy, reproduced below for ease of reference:

> **3.29 Insured v. Insured Exclusion**
> With respect to Coverage E and, if purchased, Endorsement 5, to any Claim which is brought directly or indirectly, by or on behalf of:
>
> a) any Named Insured or Additional Named Insured;
> b) any shareholder of the Named Insured or Additional Named Insured; or
> c) any Insured;
>
> regardless of the capacity in which such Named Insured, Additional Named Insured, or Insured was acting. However, this exclusion shall not apply to any Claim brought by an Insured where such Claim is in the form of a crossclaim or third party Claim for contribution or indemnity which is part of and results directly from a Claim which is not otherwise excluded by the terms of this Policy.
>
> **Coverage E – Directors and Officers and Errors and Omissions Liability**
> To pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay as compensatory damages arising out of Operations Covered, for any Claim made against the Insured because of a Wrongful Act, provided that:
>
> a) the Claim is first made against the Insured during the Policy Period; or

b) Other Notice of Claim First Received by the Insured occurred during the Policy Period and provided that coverage is not provided by Coverages A.1, A.2, B, C, or D.

Virtually all directors and officer's liability insurance policies contain some variation of an "Insured vs. Insured" exclusion clause. Such exclusions typically excluded coverage of any claims brought by present and past directors and officers, as well as claims by the corporation itself and the corporation's shareholders, creditors or other brought in the name of the corporation (i.e., derivative claims) against current directors and officers.

The primary purpose, in most cases, of this type of exclusionary provision is to eliminate coverage for four types of situations:

- employment practice claims;
- internal disputes/infighting;
- claims involving collusion; and
- claims by organizations against their directors and officers for imprudent business practices.

*For example*: In theory, without an Insured vs. Insured exclusion, a company could pursue a risky business strategy knowing that if the plan failed and caused losses, the company could recoup those funds by merely having one executing sue another, claiming that he disagreed with the risky strategy and demanding that the insurer make the insured company whole for the negligent acts of management

Section 3.29 of the MEARIE CGL policy stipulates that this exclusion will not apply to any Claim brought by an Insured where such Claim is in the form of a crossclaim or third party Claim for contribution or indemnity which is part of an result directly from a Claim which is not otherwise excluded by the terms of this Policy.

## IV: The Battle of the Forms

It is very common practice that parties entering an agreement purport to do so on the basis of standard forms, likely prepared for them by their lawyers, in which they each propose to set out the terms and conditions of their contractual relations. Invariably, the parties' respective forms are very likely to conflict in various important respects. This is compounded by the fact that it will very often be the case that neither party has explicitly agreed to the forms being utilized by the other party. And thus, arises the *Battle of the Forms*.

The traditional analysis holds that a contract is created by a series of conflicting forms only when the last form utilized is followed by conduct amounting to acceptance of the counteroffer stated in the last form. This approach is problematic. Simply rewarding the party that "fired the last shot", so to speak, is arbitrary and may not reflect the parties' true intentions.

The more contemporary mode of analysis involves looking at both forms and determining whether the provisions contained in each can be reconciled with each other. On this view, the parties' agreement would be constituted by the terms that are common to their respective forms, together with implied reasonable terms.

> ***For example…*** *Your company meets with a prospective client to discuss the potential of providing unspecified services at an as-yet underdetermined time in the future. During the initial meeting, the client provides a standard-form Request for Service, which includes a list of terms & conditions (T&C's) applicable to each project for which your company may be retained.*
> *Time passes, during which your company provides various services as requested and after each project, you submit your standard invoice which includes your standard, boiler-plate T&C's (likely on the back or a separate sheet, in small print). At some point, a dispute arises, and the question of whose T&C's becomes a central issue.*

To avoid disputes regarding the applicability of your T&C's:

- Ensure that they are conspicuously displayed in the body of, or immediately following the main body of the contract as opposed to hidden in small font and tucked on the back of an invoice, purchase order, etc…
- Require that the parties to the contract acknowledge the primacy of your T&C's in writing (by signature or initial)
- Include a specific term that elevates your T&C's above all others
- Discuss openly with the other party(ies), and to the greatest extent possible, ensure that everyone comprehends the implications of agreeing to the proposed T&C's

# V. Indemnification

The indemnification provisions contained within a contract are rarely found on the front page but are often at the heart of any dispute that may arise from the interpretation of that contract. In its most basic sense, to indemnify means to compensate another for their loss sustained as a result of a specific event, or occurrence. In practice, however, what on its face is a relatively simple concept can become quite complicated and sorting out who owes who what is often a complex exercise.

Within the context of contract drafting and interpretation, ensuring that the language deployed accurately reflects the intended outcomes that the parties to the agreement intended is fundamental. This is even more so with respect to indemnification provisions, as the triggering event, or occurrence, may not cleanly fit within the exclusive jurisdiction of one party or the other.
Types of Indemnity

The types of indemnification can be broken down into six basic types:

1. **Bare Indemnities**: Party A indemnifies Party B for all liabilities or losses incurred in connection with specified events or circumstances, but without setting out specific limitations. The agreement will be silent as to whether they indemnify losses arising out of Party B's own acts and / or omission. This, in effect, makes bare indemnities a blanket protection from Liability in certain circumstances.

   *Example: Party A agrees to indemnify Party B for all liabilities or losses during the project.*

2. **Reverse or Reflexive Indemnities**: In these clauses, one party will indemnity the other for losses due to the negligent party's acts.

   *Example: An example of this type of indemnity clause: Party A agrees to indemnify Party B for losses incurred as a result of Party B's own act and / or omissions (usually due to Party B's negligence).*

3. **Proportionate or Limited Indemnities**: This is the opposite of reverse indemnities. Here, one party will indemnify the other for losses except for those that arise from that party's negligence.

   *Example: An example of this type of indemnity clause: Party A agrees to indemnify Party B for all losses, except for those incurred as a result of Party B's own acts and/ or omissions.*

4. **Third Party Indemnities**: In these clauses, one party will indemnify another party for claims by or liabilities to a third party.

   *Example: An example of this type of indemnity clause: Party A agrees to indemnify Party B against liabilities to or claims by a Party C.*

5. **Financing Indemnities**: In these clauses, one party will indemnify another party if a third party fails to meet a financial obligation to one of the contracting parties.

6. **Party/Party Indemnities**: In these, indemnification goes both ways, with each party agreeing to indemnify the other if a contract breach occurs and losses are incurred.

## Duty to Defend vs. Duty to Indemnify

Commercial general liability policies, in an effort to provide financial protection to an insured party in the event that it is sued by a third party, result in the insurer assuming a "duty to defend" – requiring the insurer to pay for and instruct legal counsel in defending a claim against the insured, and a "duty to indemnify" – requiring the insurer to pay for any judgement or settlement costs that have been awarded against the insured.

For the purposes of this guide, the key question is: when are those duties are triggered? Traditionally, insurers are only required to indemnify the insured for claims and damages which fall under the coverage provide in the insured's insurance policy. As a result, the insurer's duty to indemnify is not typically triggered until a legal action has been concluded.

However, the insurer's duty to defend is activated at the outset of a legal action and is governed by the allegations in the Statement of Claim. The Supreme Court of Canada, in *Nichols v. American Home Assurance*, ruled that the duty to defend would be activated if any of the facts within the pleadings, which are assumed to be true for the purposes of this analysis, would result in the insurer having to indemnify the insured. Furthermore, only "the mere possibility that a claim within the policy may succeed" is required to trigger the duty.

***Key Takeaway:*** *It is possible for an insurer to have a duty to defend the insured without having a duty to indemnify. However, it is not possible for the insurer to have a duty to indemnify the insured without having the duty to defend.*

- *The duty to defend is triggered at the mere possibility of an allegation within a pleading giving rise to an insurer's duty to indemnify;*
- *The duty to defend is a distinct contractual obligation to an insured that is to be abided by from the outset of a legal proceeding. If triggered, the insurer has a duty to defend an insured in the entirety of an action and not just against claims that are covered within the insurance policy;*
- *The duty to defend does not discriminate against additional insureds. To accept the argument that an additional insured is protected through the defence of only the insured would be to diminish the rights of an additional insured under the insurance policy.*

## Hold Harmless Agreements

A Hold Harmless Agreement is the provision in a contract that requires one contracting party to respond to certain legal liabilities of the other party. It is recommended that a "limited form" or an "intermediate form" hold harmless clause be accepted.

**Limited Form Hold Harmless** – Where the Party A holds Party B harmless for suits arising out of the Party A's sole negligence. Your company is thus protected when it is held vicariously liable for the actions of the Supplier.

**Intermediate Form Hold Harmless** – Where the Party A holds Party B harmless for suits alleging sole negligence of Party A or the negligence of both the Party A & Party B.

> **Sample Wording:**
> *Party A shall defend, indemnify and hold harmless Party B (your company), subsidiaries, affiliates and their respective officers, directors, employees, agents, and successors (each Party B Indemnitee) from and against all losses, damage, liabilities, deficiencies, actions, judgments, interest, awards, penalties, fines, costs or expenses of whatever kind, including reasonable legal fees, the cost of enforcing any right to indemnification here under and the cost of pursuing any insurance providers, arising out of or resulting from any third party claims against Party B Indemnitee arising out of or resulting from Party A's failure to comply with any obligation under this contract.*

While not a requirement or formal part of a contract or indemnity agreement, it should be stated in the contract that the contract supersedes all previous correspondence, negotiations or discussions.

> ***For example…*** *The Agreement contains the entire understanding between the parties and shall control over any Purchase Order. Any previous oral or written communications, representations, warranties, or commitments are superseded by the Agreement.*

# VI: Limiting Your Liability

## Vicarious Liability

Vicarious liability is a situation in which one party is held partly responsible for the unlawful actions of a third party. The third party also carries his or her own share of the liability. Vicarious liability can arise in situations where on party is supposed to be responsible for (and have control over) a third party and is negligent in carrying out that responsibility and exercising that control.

An employer can be held liable for the unlawful actions of an employee, such as harassment or discrimination in the workplace. An employer might also be held liable if an employee operates equipment or machinery in a negligent or inappropriate way that results in damages to property or personal injury.

> ***For example…*** *A construction worker mishandles the controls of a crane and topples the wall of a nearby building that was not slated to be worked on. The company overseeing the construction will likely face vicarious liability.*
>
> *An engineer loses control of a train, and it proceeds down the tracks on its own. The company that owns and operates the train may face vicarious liability for any damages and injury afflicted by the runaway locomotive.*

As an owner, you could be vicariously liable for the actions of:

**Your employees**. For liability to pass from an employee to you or your business, the employee must be acting within the scope of their job or professional duties. Even if an employee acts against directions you give them, you could be held liable for the damage their action (or lack of action) causes.

**Agents you work with**. "Agent" is a classification that includes anyone who works on behalf of someone else (the principal). Agents can be either independent contractors or employees, and they have the authority to alter or create legal relationships between the principal and third parties. Typically, in vicarious liability cases involving the agent-principal relationship, both the agent and the principal assume some liability, meaning that the person harmed by the wrongdoing can seek damages from both parties.

**Independent contractors**. One reason some business owners choose to work with independent contractors is to avoid exposure to vicarious liability. While the general rule holds that principals (you) are not liable for work done by independent contractors, there are a few situations in which vicarious liability can pass up the chain. These include instances when you are negligent (e.g., you hire a contractor who isn't qualified for the work they're required to do); when you hire a contractor to complete tasks that, by law, you're required to do yourself; and when you hire a contractor to complete work that is inherently dangerous to third parties.

The following insurance policies usually cover the expense of defending yourself against vicarious liability claims:

**General liability insurance** protects you from the costs of lawsuits over personal injuries or third-party property damage caused by you or your employees or incidents that happened on your business property.

**Errors and omissions insurance** (professional liability insurance) shields you from the costs of mistakes and oversights you and your team make while performing your work (or from the costs of lawsuits over perceived mistakes).

While not a requirement or formal part of a contract or indemnity agreement, it should be stated in the contract that the contract supersedes all previous correspondence, negotiations or discussions.

A statement such as the following can be included for clarity:

> The Agreement contains the entire understanding between the parties and shall control over any Purchase Order. Any previous oral and written communications, representations, warranties or commitments are superseded by the Agreement.

## Limitation of Liability Clauses & Professional Liability (E&O)

Standard limitation of liability clauses are very common in engagement letters with certain professional designations, including auditors, accountants, lawyers (and most relevant for our purposes) architects, engineers, and design consultants. A usual term is that the professional's damages exposure is limited to the fees paid by the client for the engagement. The efficacy of limitation of liability clauses, like all matters of contract interpretation, is equally dependent on the language deployed in the contract and the facts of the case.

The inclusion of a limitation of liability clause in a contract allows for the prediction of liability and procurement of appropriate coverage at a reasonable cost. Courts will allow professionals to limit or exclude the scope and extent of their liability through limitation of liability clauses, but such clauses must be clearly drafted, contemplate revisions to the project, and include all project owners as signatories to the contract.

The Supreme Court of Canada defined the test applicable to the enforceability of limitation of liability clauses as follows:

- As a matter of interpretation, does the limitation of liability provision apply to the circumstances established in the evidence?
- Was it unconscionable at the time of contract formation?
- Is there an overriding public policy reason to refuse enforcement that outweighs the very strong public interest in the enforcement of contracts?

In commercial cases, limitation of liability provisions are almost always enforced in accordance with their terms – unconscionability and public policy are very narrow exceptions that rarely apply.

Limitation of Liability clauses may limit the design consultant or design engineer's liability to the following:

- The value of the design consultant or design engineer's fee for services rendered
- To a percentage of the fee charged for services rendered
- To a percentage of the construction costs with respects to Professional work
- To the amount of errors and omission (E&O) coverage in effect at the time
- A specified dollar amount ($value)

**Important note:** You can never limit or exclude liability for death or personal injury caused by negligence, liability for fraud, or strict liability. (Strict liability torts involve activities that are so fraught with risk that compensation to those injured is awarded without the need to establish the defendant's fault).

The following are some potential clause wordings. These wordings are suggestions only and have not been reviewed by legal counsel. As with any contract, consideration should be given that the final contract be reviewed by your legal counsel. For the following examples the word Consultant can be changed to Engineer as required depending upon the professional that is providing the consultation services under the contract.

> ***Sample Wording:***
> *To the fullest extent permitted by law, the total liability, in the aggregate, of Consultant, Consultant's officers, directors, partners, employees, agents, and sub-consultants, to Client, and anyone claiming by, through, or under Client for any claims, losses, costs, or damages whatsoever arising out of, resulting from or in any way related to this Project or Agreement from any cause or causes, including but not limited to negligence, professional errors and omissions, strict liability, breach of contract, or breach of warranty, shall not exceed the total compensation received by Consultant or $_____ whichever is greater.*

For higher risk projects, it may be desirable to limit not only you, the design consultants or design engineer, but also the contractor and their sub-contractors from damages arising from your contract. Some courts may interpret this as an indemnification agreement. Consideration should be given to splitting the limitation of liability clause agreement into two paragraphs so that should the contractor and sub-contractor section be disputed the limitation of liability clause may survive intact.

> ***Sample Wording:***
> *To the fullest extent permitted by law, and not withstanding any other provisions of this agreement, the total liability, in the aggregate, of the Consultant and the Consultant's officers, directors, partners, employees and sub-consultants, and any of them, to the Client and anyone claiming by or through the Client, for any and all claims, losses, costs or damages, including attorneys' fees and costs and expert-witness fees and costs of any nature whatsoever or claims expenses resulting from on in any way related to the Project or Agreement from any cause or causes shall not exceed the total compensation received by the Consultant under this Agreement, or the total amount of $_____, whichever is greater. It is intended that this limitation apply to any and all liability or cause of action however alleged or arising, unless otherwise prohibited by laws.*

***Sample Wording (Contractor/subcontractor's claim):***
*The Client further agrees, to the fullest extent permitted by law, to limit the liability of the Consultant and the Consultant's officers, directors, partners, employees and sub-consultants to all construction contractors and subcontractors on the Project for any and all claims, losses, costs, damages of any nature whatsoever or claims expenses from any cause, including attorney's fees and expert witness fees and costs, so that the total aggregate liability of the Consultant and the Consultant's sub-consultants to all those named shall not exceed $_____, or the Consultant's total fee for services rendered on this project, whichever is greater. It is intended that this limitation apply to any and all liability or cause of actions however alleged to arising unless otherwise prohibited by law.*

MEARIE is available to provide a review of insurance requirements from contracts when Professional services are being considered for the project.

**MEARIE's recommendation for vendor and /or contractor certificates, based on project size and scope, is a limit of $5,000,000 for Professional Liability.**

## VII: In Closing…A Few Tips

- As the drafting party, understand your requirements and expectations
- To the greatest extent possible, ascertain how well the other party(s) to the contract comprehend the implications of it
- Stick to the three "Cs" – clear, concise, and consistent
- Do not shy away from definitions – particularly important terms that may otherwise be left to interpretation
- Include conflict resolution procedures, such as a mediation/arbitration provision
- Always consider the implications of the contract should a lawsuit or other litigated event arise
- Always collect and review insurance certificates from any contracted parties, confirming all insurance requirements are met
- *REDUCE EVERYTHING TO WRITING* – verbal contracts and unwritten amendments to existing agreements are almost certainly doomed to result in conflict

### How Can MEARIE Help?

**Contact insurance@mearie.ca for any assistance on any of the below.**

- Contract Reviews
- Discussion of coverage interpretation
- Confirmation of insurance requirements
- Certificate issuance

# Appendix A: Vendor Insurance Certificate Checklist

| VENDOR INSURANCE CERTIFICATE CHECKLIST | | | | | | | |
|---|---|---|---|---|---|---|---|
| **IS THIS PRESENT/ACCEPTABLE IN THE CERTIFICATE PROVIDED?** | | **Yes** | **No** | **N/A** | **Don't know** | **If no: Change needed?** | **Date Required?** |
| | | | | | | **Who is responsible?** | |
| **1.** | Name of vendor / contractor a legal entity – correct on certificate? | | | | | | |
| **2.** | Hold harmless clause | | | | | | |
| **3.** | Indemnity clause | | | | | | |
| **4.** | General Liability Limit (min $5,000,000) | | | | | | |
| **5.** | Limitation of liability clause included? (if required by contract) | | | | | | |
| **6.** | Non-Owned Automobile | | | | | | |
| **7.** | Automobile Limit (min $5,000,000) | | | | | | |
| **8.** | Additional Insured (if required by contract) | | | | | | |
| **9.** | Contractors Equipment (if required by contract) | | | | | | |
| **10** | WSIB Newer than 90 days | | | | | | |
| **11** | Applicable law is Province of Ontario? | | | | | | |
| **12** | Cancellation Clause if applicable | | | | | | |
| **13** | Primary / Non-contributory clause (if required by contract) | | | | | | |
| **14** | Waiver of Subrogation (if required by contract) | | | | | | |
| **15** | Contractual Liability (if required by contract) | | | | | | |

# Appendix B: Assessing Risk Level for Insurance

The following criteria provides guidelines for assessing the level of risk inherent in any specific type of activity. When two or more factors are present in different categories, use the higher rating category. This assessment may help when deciding which party to a contract should assume certain risks and/or what level of insurance requirements should be built into a given contract.

**Low Risk**

Low risk activities require only basic types of insurance, generally automobile and general liability with typically the minimum limit set by the corporation. Some contractors may not use owned vehicles in the course of the work resulting in no need for automobile insurance. The conditions listed below must be met in order to be classified as a low risk project or activity.

- Work does not involve any modification or maintenance to owned property.
- No engineering or architectural services required.
- No bodily injury to others anticipated or likely.
- No damage to, destruction or loss of property anticipated or likely.
- No loss of income or additional expenses anticipated or likely.

**Medium Risk**

The work or project has all or some of the following characteristics:

- Work involves some minor modification or maintenance to be performed to owned property, including engineering and/or architectural services.
- Some potential risk of damage to, destruction or loss of property possible or likely.
- Some potential loss of income or additional expenses possible or likely.
- Some potential of bodily injury to others anticipated or likely.
- Recreation program with moderate physical activity or vulnerable people (e.g. children, seniors, disabled).
- Activity will occur at locations belonging to other parties.

**High Risk**

These activities meet all or a most of the following conditions:

- A large number of people are present or will utilize the end product.
- New construction over $5 million in project costs.
- High risk of bodily injury to customers or employees possible or likely.
    - An event on your premises will include consumption of alcoholic beverages, possibility of rowdy attendees and/or presence of illegal drugs.
- High risk of damage to, destruction or loss of property possible or likely.
    - Contractor/consultant will have access to confidential information that could harm your firm if released or result in an unauthorized invasion of privacy for employees or the public.
    - The contractor or event operator/tenant is occupying a facility you own (or are responsible for) that is worth more than $2 million.
    - High risk of loss of income or additional expenses anticipated or likely if a problem arises.