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ALLOCATING RISK THROUGH RELEASES, INDEMNITIES AND INSURANCE

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I. INTRODUCTION

In an effort to keep legal and insurance costs down, local governments are increasingly seeking indemnities, insurance and releases from the parties with whom they contract. Local governments often require these obligations to be included in contracts with service providers, construction and maintenance contractors and facility users in an effort to reduce the risk arising from the activities contemplated in the contract. This paper will discuss these methods of allocating risk, their effective use, and some pitfalls to be avoided.

II. INDEMNITIES

An indemnity is a promise by one party, the "indemnitor", to accept the risk of a loss that the party to whom the indemnity is given, the "indemnitee", may suffer. Indemnities can be an effective way for a party to shift the risk arising from entering into a contract to the other party. There are two reasons a local government may require an indemnity. The first and most common reason is to protect the local government from claims from third parties for personal injury, death and damage to property that arise from the subject matter of the contract. These types of indemnities are often sought by local governments from contractors when entering into contracts for the construction of public works and facilities or when providing services for or on behalf of the local government, from developers of subdivisions, and sometimes from recreational leagues when entering into facility use contracts.

The second reason to seek an indemnity is to provide additional protection from breaches of the contract by the indemnitor. By requiring the other party to indemnify the local government in the event of breach, your local government gains some advantages that it would not enjoy in a breach of contract claim. Those advantages will be discussed later in this paper.

A. Types of Indemnities

The protection afforded by an indemnity will be dictated by its terms and should be tailored to each contract. However, indemnities can be grouped into several common types:

- A bare or blanket indemnity seeks to provide blanket protection against any and all amounts and types of liability that may arise, without specific limitation. Example: Party A hereby indemnifies and holds harmless Party B from all liability, costs, expenses, fees and taxes arising from or in any way related to this Agreement.

- A reverse indemnity provides protection for the indemnitee's own negligence. Example: Party A hereby indemnifies and holds harmless Party B from all liability, costs, expenses, fees and taxes arising from a negligent act or omission of Party B.

- A proportionate indemnity expressly excludes losses arising from the indemnitee's negligence, breach of contract and wilful, fraudulent or illegal conduct. These are essentially the opposite of a reverse indemnity. Example: Party A hereby indemnifies and holds harmless Party B from all liability, costs, expenses, fees and taxes, arising from or in any way related to this Agreement except to the extent, if any, to which such liability, costs, expenses, fees and taxes arise from or are in any way related to a negligent act or omission, breach of contract, or wilful, fraudulent or illegal act of Party B.

- A third party indemnity provides protection for the indemnitee from a specified third party. Example: Party A hereby indemnifies and holds harmless Party B from all liability, costs, expenses, fees and taxes incurred to Party C arising from or in any way related to this Agreement.

- A party/party or mirror indemnity provides that each party shall indemnify the other for that party's negligence or breach of contract. Example: Party A hereby indemnifies and holds harmless Party B from all liability, costs, expenses, fees and taxes arising from a negligent act or omission of Party A. Party B hereby indemnifies and holds harmless Party A from all liability, costs, expenses, fees and taxes arising from a negligent act or omission of Party B.

B. Agreements to "Hold Harmless"

Indemnities often include the obligation to "indemnify and hold harmless" or "indemnify and save harmless." Unfortunately, there is considerable judicial disagreement on the meaning of this phrase. The jurisprudence of some common law countries considers "hold harmless" a mere synonym for "indemnify" and gives the phrase no effect at all. In other countries, the jurisprudence imposes an additional obligation on the indemnitor but the content of the obligation varies.

The prevailing view in Canada, or at least the view supported by some authority, is that an obligation to "hold harmless" imposes a further obligation on the indemnitor. In *Stewart Title Guarantee Company v Zeppieri*, [2009] OJ No 322 (SC), the Ontario Superior Court of Justice held that an obligation to indemnify and hold harmless must include more than an obligation to indemnify – under any other interpretation the words "hold harmless" would be superfluous. The court reasoned that to restore a party to that party's former state after suffering harm is not the same as holding the party harmless because the party will have gone to the trouble and expense of incurring the costs up front. The court concluded that the words "hold harmless" must mean to not only pay the damages for which the indemnitee may become liable but also to pay the ongoing costs associated with the loss as they come due. Consequently, where the indemnitor has agreed to indemnify the indemnitee for legal costs, an obligation to hold harmless amounts to an obligation to advance the costs of defending an action.

As *Zeppieri* has not been followed in British Columbia, it is not certain that a court would interpret the obligation to "hold harmless" to require advance payment of litigation costs. Accordingly, if you want your local government "held harmless" within the meaning of *Zeppieri*, the phrase should be avoided altogether and the obligation to advance the costs of litigation imposed in plain language within the indemnity.

C. Indemnities for One's Negligence/Wrongful Conduct

There is a strong but rebuttable presumption that in the absence of express language an indemnity is not intended to extend to liability arising by reason of the wrongful conduct of the indemnitee and the indemnitee's servants and agents, whether it be breach of contract or negligence. In *Smith v Global Plastics Ltd*, 2001 BCSC 1336, the owner of a company, Kietaibl, agreed to sell the company to another person, Friesen. As part of the purchase agreement, Kietaibl agreed to grant the company an indemnity for all claims brought against the company, including claims related to a breach of the representations and warranties in the purchase agreement. A third party, Smith, worked as a sales agent for the company. Prior to the sale, Kietaibl expressed his opinion that Smith was an independent contractor and not an employee but this representation was not made within the terms of the purchase agreement. After the sale was completed, Friesen terminated Smith and Smith sued the company claiming he was an employee and entitled to reasonable notice of termination. Friesen, through the company, called upon Kietaibl to fulfill the indemnity in the sales agreement in respect of Smith's claim.

Kietaibl argued that the loss suffered by the company was due to Friesen's actions and not by any action on his part. He also argued that if Friesen had intended the indemnity to extend to losses arising from the company's actions, the indemnity should have been drafted as such. The Court first concluded that since Kietaibl had never made a representation about Smith's relationship with the company within the purchase and sale agreement, the indemnity in respect of breaches of representations could not be called upon. With respect to Friesen's other claims, the Court found that the indemnity, although broadly worded, did not apply to the company's negligence. The Court concluded that where the actions of an indemnitee have given rise to liability, the indemnity must by very clear words define the indemnitor's responsibility to pay for those consequences. No such words appeared in this instance.

The presumption against indemnifying a party for its own negligence can be rebutted if the wording of the indemnity is broad enough and denying the claim would render the clause of virtually no application. In *Neely v McDonald*, 2014 ONSC 2866, a golf tournament was hosted by a lawyers' association. The association hosted the tournament at a golf club, which had required the association to grant the golf club an indemnity for claims arising from the tournament as part of the rental agreement. The plaintiff Neely was participating in the golf tournament when her golf cart was struck by a driverless golf cart. The operator of the driverless cart had jumped out of the cart after losing control going down a steep slope. Neely sued the driver and the golf club claiming that the golf club was aware of accidents on the steep slope and had done nothing to prevent them. The golf club called upon the indemnity in the rental agreement. The indemnity specifically provided that the association would "hold [the

golf club] and its officers and employees free and harmless from any damage or claims of any nature which may arise from or through the use of a golf cart."

The association argued that in order for the golf club to be indemnified for its own negligence that obligation had to be expressly set out in the indemnity. The Court found that the wording of the indemnity was very broad in respect of liability arising from golf cart use. Furthermore, the Court noted that the bulk of claims relating to golf carts were bound to be personal injury claims in which the injured party alleges the golf club was negligent. The Court held that finding that the indemnity did not apply to the golf club's negligence would undermine the business rationale for the clause and render it essentially meaningless. The Court concluded that the association was required to indemnify the golf club for its own negligence.

So, if your local government intends to be indemnified for its own misdeeds, including breaches of contract and negligence, that obligation should be clearly set out in the indemnity unless the circumstances make it very clear that was the parties' intention at the time the agreement was made.

D. Indemnities for Breaches of Contract

A right to recover damages for breach of contract is a legal right in favour of a plaintiff to be compensated for injuries recognized by the law suffered by the plaintiff as a result of the conduct of the defendant. In contrast, a right to be indemnified usually exists where the indemnitee has suffered no injury at the hands of the indemnitor but rather where the act giving rise to the right was committed by a third party. However, a party can agree to indemnify another in respect of its breaches of contract. But what further benefit does the indemnitee derive from this arrangement?

1. Legal Costs

One answer is that the indemnitee can recover its out-of-pocket legal expenses by specifying that the indemnitor must pay the indemnitee's legal costs associated with the breach on a solicitor and client basis. This means that the indemnified party can recover the full amount of legal fees it paid its solicitors. Full legal fees are not recoverable in a breach of contract claim. Although court costs are often awarded to a successful plaintiff, as anyone who has been awarded costs knows these typically cover only 25-40% of the actual legal fees incurred by the plaintiff litigating the matter.

The exception to full recovery of legal costs under such an indemnity is when an indemnitee incurs legal costs defending a claim which is indefensible, such as where the claim is for a debt that is clearly due. After all, as put by Lord Tenterden CJ in a very old case from England, *Gillett v Rippon* (1829), 173 ER 1205 (NP), "a man has no right merely because he has an indemnity to defend an action, and to put the person guaranteeing to useless expense."

While there are varying authorities on the matter, an indemnitee seeking to be indemnified for the full amount of legal fees paid to the indemnitee's solicitor should specify that the indemnitor shall indemnify the indemnitee for legal costs on a "solicitor and client basis".

2. Mitigation

The common law duty to mitigate one's damages may not apply to a claim under an indemnity. In a breach of contract claim, the defendant may claim that the plaintiff failed to mitigate its damages by taking steps to limit the losses it incurred arising from the defendant's breach. If a court finds that the plaintiff failed to take sufficient steps to limit its liability, the amount the plaintiff is awarded in damages will be reduced to the damages they would have incurred if they had mitigated.

Some jurisprudence indicates that there is no duty to mitigate costs incurred by an indemnitee arising from the indemnitor's breach. In *Aramark Canada Ltd v Ontario (Workplace Safety & Insurance Board)*, [1999] OJ No 2629, the plaintiff provided catering services to the defendant's facilities on a "cost plus" basis, meaning the defendant compensated the plaintiff for its costs of providing the service, including paying wages, and a specified amount of profit. The agreement also provided that the plaintiff would be reimbursed for all costs associated with complying with all laws, including workers compensation and employment standards legislation. When the defendant reduced its need for catering services, the plaintiff had to terminate some of its employees. Pursuant to the Ontario *Employment Standards Act*, the plaintiff paid nearly $73,000 in severance benefits to the terminated employees and then claimed reimbursement of those costs from the defendant.

The defendant claimed that the plaintiff had a duty to mitigate its damages and had failed to do so by not keeping the employees on or reassigning them. The plaintiff argued that its claim was in debt and that the amounts involved were liquidated damages, so no duty to mitigate arose. The Court agreed that the claim was for liquidated damages and so no trial on the issue of mitigation was necessary.

Given the scant jurisprudence on this issue, if your local government intends that a duty to mitigate its damages not arise following a breach by the indemnitor, it would be best to make that clear in the indemnity.

E. Negotiating an Indemnity

Indemnities give rise to contingent liability, the scope of which may be difficult to quantify at the time a contract is being negotiated. Accordingly, the party from whom the indemnity is sought may vociferously object to it. Common objections include that it is not reasonable for the party to agree to cover an indeterminate amount of liability arising from events over which it may have little or no control, and that they are essentially becoming the local government's insurer with respect to the activities contemplated by the contract.

In the end, what your local government gets will depend largely on the relative bargaining power of the parties. If, for example, your local government is negotiating with a local contractor for the provision of garbage collection services, you should be able to obtain a strong indemnity. If you are negotiating a software services contract with a national or multi-national software provider, the company may have a standard form of contract from which it is not willing to deviate and it may be the local government giving the indemnity.

While this paper is primarily concerned with indemnities sought in favour of a local government, I pause here to note two issues when considering granting an indemnity. The first is to ensure that your insurer, such as the Municipal Insurance Association of British Columbia, will cover the liability assumed under the contract. The second is section 175 of the *Community Charter*, made applicable to regional districts under section 403 of the *Local Government Act*. These sections, together with the *Municipal Liabilities Regulation*, provide that a local government must not, without elector approval, incur a liability of a capital nature under an agreement that is longer than 5 years. Although it is difficult to conceive of an indemnity as a capital liability, the *Approval of the Electors Exemption Regulation* specifically provides that a liability under section 175 does not include an obligation to indemnify the grantor under an agreement to acquire a right or interest in land. The existence of this exemption could be interpreted to indicate that, in the absence of the exemption, such an indemnity would be considered to be of a capital nature under the *Municipal Liabilities Regulation*. Since these regulations have not been judicially considered, a local government should proceed with caution when considering whether to grant an indemnity under an agreement that is longer than 5 years.

If you are negotiating with a party with greater or relatively equal bargaining power or a party who refuses to accept your form of indemnity, your local government may have to adjust the indemnity to make it more palatable, including by limiting the indemnity to direct or reasonably foreseeable losses, excluding losses to the extent they are caused by the local government's negligence, limiting coverage only to the local government and not its officers, employees, etc., removing legal fees from the scope of recoverable losses, capping liability, or providing that a minimum amount of liability is required before anything can be recovered. Before making such concessions, the local government must take into account the risk arising from the contract and the magnitude of the potential liability and only settle on a form of indemnity that represents a bearable amount of risk.

Some parties are restricted from granting indemnities, which may provide a further obstacle to obtaining ample protection for your local government. Under the *Financial Administration Act*, a "government corporation", which includes crown corporations and their subsidiaries, can only grant an indemnity if the indemnity is approved by the Minister of Finance or his or her director of Risk Management, or if the indemnity is approved through an approval process having received the prior approval of the Minister of Finance. Such approval processes may require approval from the board of directors of the government corporation, which can be a lengthy and cumbersome process. In these circumstances, the best strategy is to begin the negotiation process early.

F. Managing the Indemnity

1. Enforcement

When an indemnitor refuses to honour an indemnity, the indemnitee must enforce the indemnity in court. There is significant case law on the enforcement of indemnities, but as each case turns on its own facts and the specific wording of the indemnity in question, a review of the cases is of limited value. Instead, a few key principles can be drawn out. When interpreting indemnities, the courts will apply the general principles of contract law in reviewing the words of the indemnity within the context of the contract as a whole. The courts will attempt to reach a result that is reasonable and reflects their interpretation of the intentions of the parties at the time the contract was formed.

To aid enforceability, an indemnity should be drafted to clearly identify the beneficiaries, the nature of the activities to which it relates and the type of damages or liabilities covered. The indemnity must also be as unambiguous as possible. As discussed above, if the local government intends to be indemnified for its own negligence, the indemnity should unequivocally provide for that.

Unlike releases or waivers, indemnities are less likely to be held unenforceable on the basis of unconscionability or an alleged failure to bring the clause to the attention of the releasing/indemnifying party. This is because unlike releases, indemnities are usually given by relatively sophisticated parties in the context of a contract that is carefully negotiated by parties of roughly equal bargaining power and subjected to legal review.

A local government can experience problems enforcing an indemnity when it is overly broad and ambiguous and/or given by an unsophisticated party. In *Griffiths v New Westminster (City)*, 2001 BCSC 1482, Mr. Griffith was injured while playing recreational hockey at Moody Park Arena. The injury arose from a faulty ice surface. He sued the City and the organizer of the session. The organizer, Mr. Jover, had rented the ice time via a licence agreement under which he agreed to keep the facility in a clean and tidy condition and be responsible for supervision during ice time. The licence also contained an indemnity which required Mr. Jover to "indemnify and save harmless the City in respect of any and all claims, demands, actions, suits and costs arising out of any act or omission of the Licensee…"

The Court refused to give effect to the indemnity in respect of the alleged omissions of Mr. Jover to keep the facility clean and tidy and supervise ice time. The Court found that Mr. Jover had supervised ice time, and read down the obligation to keep the facility in a clean and tidy condition to a responsibility only to ensure that the arena structure, fixtures and equipment

were not damaged. The Court commented that requiring him to be responsible for keeping the entire facility, including its ice surface, in good repair would have been far beyond the abilities of Mr. Jover and the contemplation of the parties at the time the contract was formed. The Court also concluded that the City could not call upon the indemnity because the injury to Mr. Griffiths was caused by the negligence of the City and the indemnity only covered acts and omissions of Mr. Jover.

The Court also commented that it would be inappropriate for the City to require someone like Mr. Jover act as the City's insurer. Such an arrangement would be entirely inconsistent with the purpose of the licence, which was only to rent ice time. Lastly, the Court held that in the circumstances, a clause as onerous as the one sought to be relied upon by the City must be brought to the attention of the person asked to agree to it. Since the standard form licence was mailed to Mr. Jover and the indemnity clause was not presented in a manner that alerted Mr. Jover to its presence, the court was satisfied that Mr. Jover was not aware of the clause and that when he signed the licence his signature did not represent his true intentions. The Court dismissed the City's third party claim against Mr. Jover.

2. Settling Claims from Third Parties

Whether an indemnitee can settle a claim and seek to recover the amount settled from the indemnitor depends on whether the settlement was reasonable. In *Burrard Management Ltd v Strata Plan BCS 3699*, [2014] BCJ No 421 (SC), the plaintiff developer contracted with an electronic concierge service to provide services to its recently constructed building. Pursuant to an assignment and assumption agreement, the strata incorporated in respect of the building became liable on that contract. When the strata didn't pay the electronic concierge, the service provider sued the developer and the strata for the unpaid fees. Since the strata refused to pay and the developer was still liable on the contract, the developer settled the litigation and sought to recover the amount of the settlement and its associated legal fees via an indemnity in the assignment and assumption agreement.

The Court held that it was reasonable for the developer to settle the litigation given that there was no apparent defence to the claim for the unpaid fees. However, since legal fees were not expressly set out as part of the indemnity, the developer was only able to recover the amount of the settlement and had to bear its own legal costs dealing with the service provider's claim.

So, where your local government is sued by a third party and the loss is likely recoverable via an indemnity, it would be prudent to settle the claim only after obtaining a legal opinion that assesses the claim as reasonably strong or the settlement offer as reasonable. If not, the indemnitor may dispute its liability and your local government could find itself involved in another lawsuit.

III. INSURANCE

An indemnity is of no value if the indemnitor is financially incapable of honouring it. Therefore, depending on the circumstances, including the nature of the activity and magnitude of a potential loss, it may be prudent for your local government to require that indemnitor obtain insurance so that the money will be there when required.

Commercial General Liability insurance (CGL) is the type of coverage useful in most situations. It provides broad coverage for claims made in respect of bodily injury and death and damage to the property of third parties arising from the insured's activities. When negotiating the terms of insurance that will be required under a contract, the key terms to require are:

- Additional Insured – If the local government is named as an "additional insured" under the policy, the local government is an insured beneficiary under the policy of insurance just as the primary or named insured is, and any insured loss sustained by the local government is payable to the local government notwithstanding that the local government did not take out the policy of insurance or pay the premiums.

- Waiver of Subrogation – Normally, when an insurer pays a loss to an insured it has the right to step into the shoes of the insured and attempt to recover the loss from the party responsible. This is known as the right of subrogation and entitles the insurer, after it makes the insured party whole, to attempt to make itself whole. If your local government is named as an additional insured and the insurer has waived the right of subrogation against the local government, in the event of a loss to the named insured caused by the negligence of the local government the insurer cannot recover its loss from the local government after making the named insured whole. Insurance coverage containing a waiver of subrogation is more expensive for the insured because the insurer cannot make itself whole.

- Cross Liability Clause – A cross liability clause ensures that all insureds, including additional insureds under the policy, are treated as if separate policies of insurance exist for each. Accordingly, a breach of the policy by the primary or named insured will not invalidate coverage for your local government as additional insured. Furthermore, it indemnifies the named insured and additional insured from claims from the other, meaning that if the other party successfully sues your local government in negligence the loss will be covered by the insurer.

- Notice of Cancellation – This clause provides a local government advance notice that a policy of insurance is going to lapse or when there will be a material change to the terms of the policy. Notice of cancellation enables the local government to ensure the contractor is maintaining the required policy and

gives the local government an opportunity to arrange for their own insurance should the other party be unable to provide it. It also gives notice of breach under the contract.

- Certificate of Insurance – The purpose of a certificate of insurance is to provide proof that the insurance coverage required under the contract has been obtained. It is important to require delivery of the certificate of insurance before the activity that is the subject of the contract begins to ensure that the required insurance has been obtained.

The terms of the agreement should also specify policy limits. Since these may vary depending on the risk, we recommend that you contact your insurance advisor in each case to determine appropriate limits.

IV. RELEASES

Releases, or waivers, are the voluntary surrender of a right or privilege. A release requires the party granting the release, or releasor, to release the party released, the releasee, from specified claims, liabilities, costs and expenses associated with the activities related to the subject matter of the contract in which the release appears. A release can be distinguished from an indemnity in that a release is aimed at protecting the releasee from the releasor's attempts to recover costs it incurs for which the releasee would otherwise be liable.

A release in favour of a local government can take many forms depending on the context and activities to which it relates. A local government may require a release from a developer constructing works in a subdivision, from a contractor providing services, or a recreational user of a facility.

In the context of a service agreement, the release will be a term of the agreement. For such a release to be enforceable, the release should list all the potential claims which are being released, such as damage to property and personal injury and death and it should include all the parties which are to be protected from such claims, including the local government and its officers, employees, agents, contractors and, if applicable, volunteers.

The release should also describe, broadly, the event or activity to which it applies. In *Dixon v British Columbia Snowmobile Federation*, 2003 BCCA 174, the Court of Appeal reversed the decision of the trial judge which held that a release of liability in respect of "the Event" did not include a claim arising from an injury sustained during a practice run. The Court of Appeal gave the release a plain language reading and held that the term "the Event" would normally be interpreted to encompass not only the race but practice runs in anticipation of the race. A local government can avoid litigation on such issues by clearly defining the activity or activities to which the release relates.

In the context of facilities use, the release can take the form of a written waiver signed by the releasor, but can also be posted on a sign, be printed on a ticket, or be displayed on a computer screen in the form of a "click through" document. The key to the enforceability of all of these forms of release is that a reasonable effort must be made to bring the attention of the releasor to the release before the contract is formed. Where the release is a term within a carefully negotiated contract, this is largely a non-issue. However, where there is no written contract or the contract is on a standard form template, this means that the release must be brought to the releasor's attention before consideration (money) is given by the releasor.

A good case to illustrate this principle is *Tilden Rent-a-Car Co v Clendenning*, [1978] OJ No 3260 (CA). In that case, Mr. Clendenning signed a rental car agreement containing a number of limitations of liability, including that he could not rely upon the auto-insurance purchased under the contract if the car was driven in a manner prohibited under the contract. On the back of the contract printed in small type as to be hardly legible was a series of conditions, including that the car would not be driven by anyone who had consumed any amount of alcohol. Mr. Clendenning damaged the car when he swerved to avoid an accident and struck a utility pole. When the company learned that Mr. Clendenning had pleaded guilty to impaired driving, it claimed Mr. Clendenning could not rely on the insurance.

Mr. Clendenning argued that he had pleaded guilty to the impaired driving charge on the advice of his lawyer and that his ability to safely operate the vehicle was not impaired at the time of the accident. He also argued that the prohibition on consuming any amount of alcohol was not brought to his attention at the time he signed the contract and that he never would have agreed to such a term. The Court held that in order to rely on such an onerous term, the party seeking to rely upon it must have taken reasonable measures to draw it to the attention of the other party. Since no such efforts were made, the Court refused to uphold the release.

The lesson to be taken from *Clendenning* is that when seeking to rely on a release that is not part of a negotiated contract made with a relatively sophisticated party, a local government should make reasonable efforts to bring the release to the attention of the releasor prior to the contract being formed. If the release is printed on a sign, it should be highly visible from the desk at which the contract is made. If it is printed on a ticket, the release should be printed in bold text. If a release appears in a standard form contract or licence, the contract should require the releasor to signal their agreement to it by initialling beside the clause.

V. CONCLUSION

Releases, indemnities and insurance can be effective ways of allocating the risks that arise from entering into contracts. However, the existence of a release, indemnity or obligation to obtain insurance is not a guarantee that risk has been successfully shifted to the other party. A local

government must carefully draft the terms of such obligations to ensure that they are not overbroad, ambiguous, or simply inappropriate or unnecessary. Lastly, in the case of releases that appear in standard form or unwritten contracts, special care should be taken to ensure that the circumstances in which they are signed cannot be construed as a bar to their enforcement.

NOTES