

Understanding Indemnity Clauses



Agenda

(1) Key Terms

(2) Practical Matters

- When to ask for indemnity
- When you might be asked for indemnity
- What to look for when reviewing an indemnity clause

(3) Questions



Part 1: Key Terms

(what are we actually talking about here?)



What is an Indemnity Clause?

- Simply put, a contractual term in which one party assumes legal or financial risk faced by another party
- The party assuming the risk is called the **indemnifying party** or the **indemnitor**
- The party transferring the risk is called the **indemnified party**
- Indemnity clauses are often long, boilerplate clauses full of legalese
- Can be some of the most impactful clauses in a contract, and can be negotiated

Sample Indemnity Clause

- Indemnity clause in an agreement in which the Town of Albertaville leases Premises to ABC Corporation:

ABC Corporation shall indemnify, defend, and hold harmless Albertaville, its officers, directors, servants, agents, and employees, from and against any and all losses, claims, damages, costs (including legal costs on a solicitor and own client basis), expenses and liability due to damage or injury to any persons or property arising from the conduct of any work by, or any act or omission of, ABC Corporation or any of its assignees, sublessees, agents, employees, contractors, invitees or licensees relating to its use and occupation of the Premises

Obligation to Indemnify

“ABC Corporation will indemnify Albertaville...”

- Means that the indemnifying party, in this case ABC Corporation, will reimburse the indemnified party, Albertaville, for any amounts it has to pay to a third party as a result of its lease of the Premises
- For example, a person is injured on the Premises and sues ABC Corporation and Albertaville
- A judge orders Albertaville to pay that person damages. Under the indemnity, ABC Corporation must either pay those damages on Albertaville's behalf, or reimburse Albertaville if it pays
- The obligation to indemnify also covers amounts reasonably paid to settle a claim



Scope of Obligation to Indemnify

- Generally speaking, there are three types of indemnity clauses:
 - **Blanket**, in which the indemnifying party covers any loss, no matter the cause
 - **Intermediate**, in which the indemnifying party covers some losses, typically those it causes
 - **Reciprocal**, in which the parties indemnify each other for damage caused by their own negligence
- Default, including our sample, is intermediate since it is limited to “damage... arising from... any work by, or any act or omission of, ABC Corporation”
- An indemnity clause does not cover amounts payable as a result of the benefitting party’s own negligence unless the clause specifically states that it does

Obligation to Defend

“ABC Corporation will defend Albertaville...”

- Obligation to indemnify is only triggered once the indemnified party is required to pay a third party, it doesn't automatically cover the costs of defending a claim
- The obligation to defend does: it requires ABC Corporation to pay for a lawyer to defend Albertaville from any claims covered by the indemnity clause
- Broader than duty to indemnify: if the lawsuit alleges facts that, if proven, would trigger that duty, then ABC Corporation has to pay defence costs
- Courts have held that even “a mere possibility” that the duty to indemnify might be engaged is enough to activate the duty to defend



Obligation to Defend Pt. 2

- Typically the indemnifying party or their insurer will control the defence of any claims
- In some cases, if both parties to the indemnity clause are sued, there can be a conflict of interest between them
- If so, the duty to defend can require the indemnifying party to pay for separate lawyers for itself and the indemnified party
- Pretty rare, especially if obligations of the parties are accurately set out in the contract (i.e. who is responsible for maintenance, snow removal, etc.)



Obligation to Hold Harmless

“ABC Corporation will hold Albertaville harmless...”

- “Hold harmless” is essentially a catch-all phrase covering any costs that might have been missed by the obligations to indemnify and defend
- One judge defined the obligation to hold harmless as meaning that the indemnified party should “never have to put his hand in his pocket in respect of a claim covered”

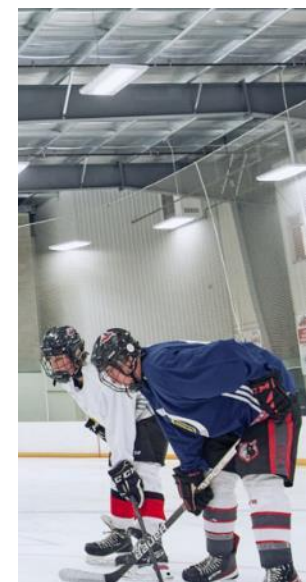
Related Clauses – Insurance

- Indemnity clause not much use if there is no money to pay for it
- To make sure that an indemnifying party is able to cover damages and defence costs, indemnity clauses are often paired with a clause requiring the indemnifying party to maintain sufficient insurance and add the benefitting party as an additional insured

Related Clauses - Assumption of Liability

- “Assumption of Liability” basically means one party agrees to pay anything the other party is required by law to pay to a third party, so similar to a hold harmless clause
- More common in waivers, but can sometimes turn up in leases or other documents that typically contain indemnities

Part 2: Practical Matters



When to Ask for Indemnity

- As often as possible, since it reduces your risk!
- Whenever another organization is undertaking an activity without your supervision or control that could leave you exposed to liability, for example:
 - Leasing municipal property
 - Performing work on municipal property
 - Providing municipal services under contract
 - Operating a municipally owned facility
- Basically, if another party earning money or gaining an advantage puts you at risk of liability, you should be looking for indemnity



When You May be Asked for Indemnity

- When you are using property owned by another party
 - For example, Lease Agreements, Use Agreements, Easement Agreements
- Property Sale Agreements
 - Can include indemnities based on environmental or other claims relating to the purchased property
 - Often include indemnities for damages based on misrepresentations by the seller (don't do that!)



Reciprocal Indemnity Clauses

- Means that whoever caused a claim will be responsible for defending and paying out that claim
- Also known as mutual or cross-indemnity clauses
- Common in partnerships, joint ventures, co-ownership situations, some construction agreements
- Useful in situations in which both parties are benefitting and are both at risk

Your Insurance Coverage

- If you are considering granting an indemnity, make sure it is covered under your insurance policy
- Alberta Municipalities' CGL policy is fairly broad about covering indemnity clauses in contracts, but exceptions and exclusions in the policy can apply
- If in doubt, ask your broker or insurer before you agree to the clause



Their Insurance Coverage

- If you are receiving an indemnity, make sure the insurance clause is going to be sufficient to cover it
- If possible, get added to the indemnifying party's policy as an additional insured or additional named insured
- Good practice to have the indemnifying party inform their insurer or broker about the indemnity clause
- You can also ask for proof of insurance
- These steps will assist with getting any losses covered right away, without the other party's insurer trying to weasel its way out of coverage



Reviewing Indemnity Clauses

- Things to look for:
 - Scope of the indemnity
 - Types of loss covered
 - Duration
 - Notice provisions
 - Who controls the conduct of lawsuits



Scope of the Indemnity

- **Blanket:** ABC Corporation shall indemnify, defend, and hold harmless Albertaville... from and against any and all losses, claims, damages, costs... *arising from any cause, including Albertaville's negligent acts or omissions*, relating to ABC Corporation's use and occupation of the Premises
- This is the absolute gold standard, very rare to get this
- Some blanket clauses have narrow exceptions, such as fraud or gross negligence by indemnified party

Scope of the Indemnity

- **Intermediate:** ABC Corporation shall indemnify, defend, and hold harmless Albertaville... from and against any and all losses, claims, damages, costs... *arising from the conduct of any work by, or any act or omission of, ABC Corporation*
- This is the most common form of indemnity
- Continue to look for exceptions: gross negligence, fraud, but also improper use of products, the acts or omissions of Dan Jackson, or “Albertaville’s bad faith failure to comply with its obligations in the agreement”

Scope of the Indemnity

- **Reciprocal:** ...*ABC Corporation and Albertaville shall each indemnify, defend, and hold harmless the other party...*
- Useful in some circumstances, but better to get a blanket or intermediate if you have limited control over the other party

Types of Loss Covered

- ABC Corporation shall indemnify, defend, and hold harmless Albertaville ... from and against *any and all losses, claims, damages, costs (including legal costs on a solicitor and own client basis), expenses and liability*
- Very broad, no types of damage excluded
- Includes legal fees on a “solicitor and own client basis”, which means all fees actually charged by a lawyer to their client



Types of Loss Covered

- Some indemnity clauses will exclude certain types of damages:

Notwithstanding its obligations set out above, in no circumstances shall ABC Corporation be liable for *special, incidental, indirect, punitive, exemplary, consequential damages, losses or expenses of any kind or nature whatsoever (including without limitation, damages for loss of business profits, business interruption, loss of business information, loss of records or data or any other pecuniary loss)*

- Not ideal, since some losses aren't covered, can lead to fights between the parties over damage classification
- If there are going to be limitations, make sure the clause is clear about what is excluded, since the terminology around damages can vary by context and jurisdiction



Limits on Loss Payable

- Some clauses will set a dollar limit on the amount of indemnity payable, for example:

ABC Corporation's liability to indemnify and defend Albertaville shall not exceed the total of \$50,000

ABC Corporation's liability to indemnify and defend Albertaville shall not exceed the total of three (3) months rent payable under this Agreement

- The fewer limitations on damages you can have the better



Duration

- Make sure indemnification obligations survive termination of the underlying agreement
 - “The indemnity, defence, and hold harmless obligations in this section will survive the termination of this Agreement by either Albertaville or ABC Corporation”
- Don’t want a claim to come up years later based on conduct during term of the lease only to have the other party or their insurer refuse to cover it
- Be on the look out for anything that limits duration:
 - “These obligations shall only apply to claims of which ABC Corporation receives notice during the term of the lease”



Notice Provisions

- Some indemnity clauses have deadlines for the indemnified party to notify the indemnifying party of any claims
- This requirement will often be something like:
 - “Albertaville shall *promptly* notify ABC Corporation of any claims...”
 - Albertaville shall notify ABC Corporation of any claims as *soon as reasonably possible*...”

Notice Provisions (Pt. 2)

- Definition of “promptly” and “as soon as reasonably possible” can vary greatly based on the circumstances, but best to notify the indemnifying party as soon as you get notice of a potential claim
- If you don’t, and the indemnifying party’s ability to defend the claim is prejudiced, for example by loss of documents or death of a key witness, a court could rule that you have breached indemnity clause
- Notice is often required to be in writing. Make sure you comply with this! Don’t want to give indemnifying party any excuse to get out of its obligations

Conduct of Lawsuits

- Though it often isn't stated in standard indemnity clauses, it is generally the indemnifying party that controls settlement negotiations and lawsuits with third parties
- This is because it (or its insurer) will be the one making any payments
- There could be some situations in which you don't want the indemnifying party to control a lawsuit
 - Risk of conflict of interest
 - You have a preferred lawyer you want to work with
 - Dispute over whether indemnity clause applies to some or all damages sought
 - Third party claimant is a key partner/vendor/customer and you want to preserve the relationship



Conduct of Lawsuits (Pt. 2)

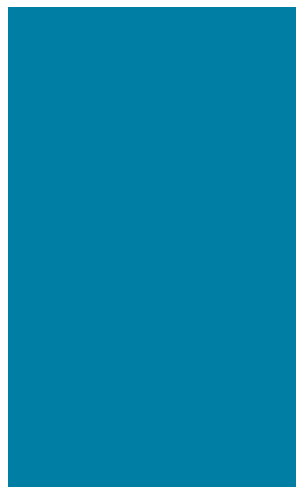


- You can negotiate some control over conduct of lawsuits
- For example:
 - “ABC Corporation will defend Albertaville using counsel of its choice, *subject to the approval of Albertaville*”

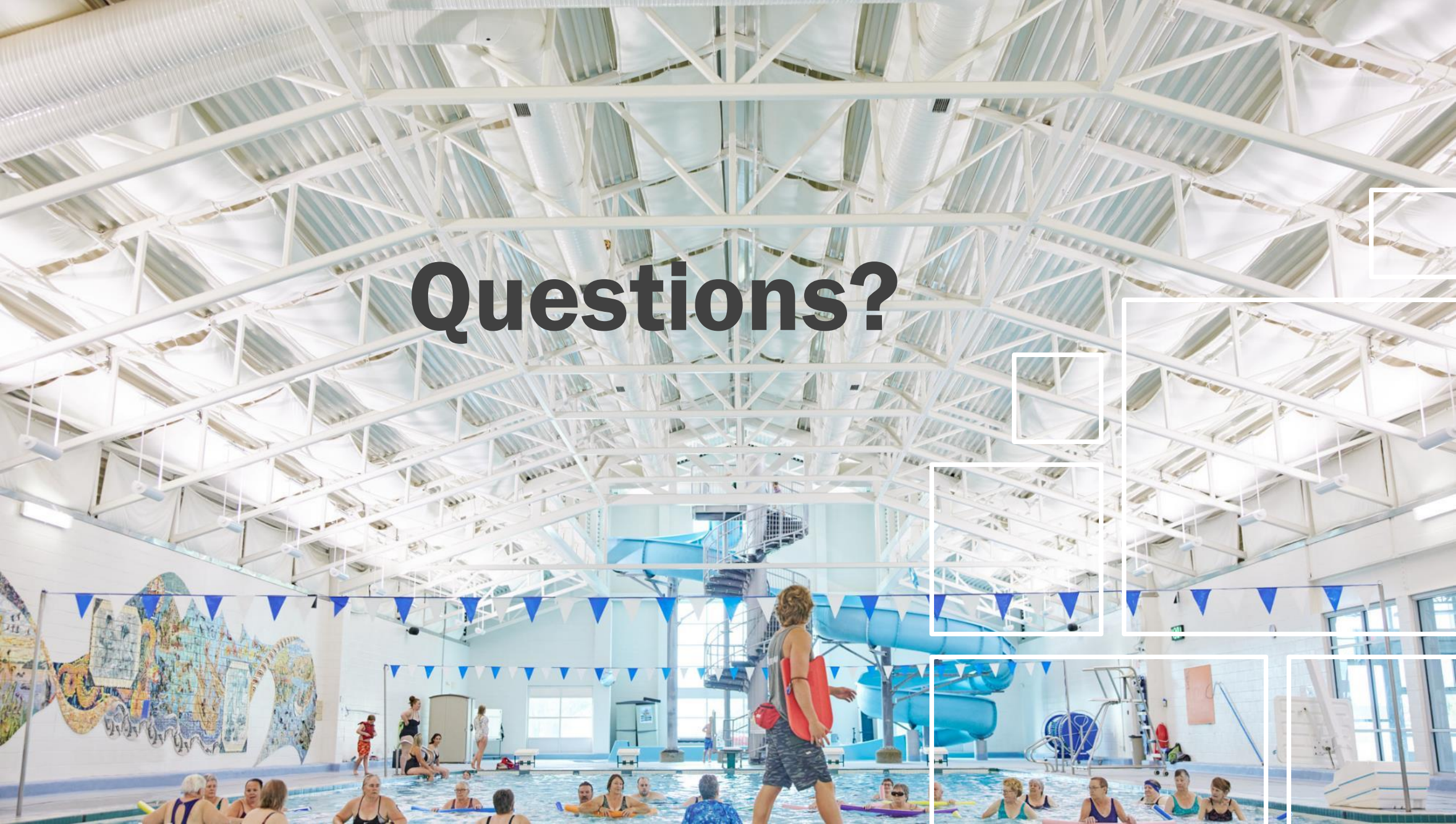


General Comments

- Understand what you are signing, either by reviewing the clause yourself or with legal assistance
- Don't assume the clause is satisfactory because it looks professional and has lots of legal terms
- Don't assume a clause drafted by another party (or their lawyer) will protect your interests
- Make sure the parties' obligations are spelled out specifically and precisely
- Don't be afraid to negotiate



Questions?



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