

## BULLETIN 20 – Part I

### INDEMNIFICATION AGREEMENTS AND RISK (LIABILITY) TRANSFER

February 2017

*This bulletin is the first of two CCDC bulletins with respect to additional insured status on another party's insurance policy and indemnification obligations and the effect on insurance coverage. Part I pertains to Indemnification Agreements and Risk (Liability) Transfer and Part II pertains to Additional Insureds. This bulletin is intended to highlight the issues; it is strongly recommended the contents be discussed with your insurance representative.*

Indemnification and hold harmless provisions are obligations we see in most contracts. To indemnify means to compensate. An indemnification provision is an obligation by one party to reimburse the financial loss of another party upon the happening of specified types of loss. To hold harmless means to hold another party harmless from financial loss. A hold harmless provision is an obligation to pay the liability on behalf of another party upon the happening of specified types of loss.

When triggered in a loss situation, one party becomes the indemnitor and the other party becomes the indemnitee. The "indemnitor" is the party that is obligated to reimburse or compensate the "indemnitee" for financial loss incurred by the indemnitee upon the happening of an event or a particular set of circumstances.

The parties affected by such provisions are not limited to owners and contractors, depending on the hierarchy of the contracting parties, they can include:

- General Contractor as indemnitor to project Owner, the indemnitee;
- Subcontractor as indemnitor to General Contractor, the indemnitee;
- Consultant or Design-Builder as indemnitor to Owner, the indemnitee;
- Consultant or Design-Builder as indemnitor to General Contractor, the indemnitee.

This descending order is the usual pattern in construction contracts as risk is often transferred downward from the party using its form of contract and doing the hiring. For the ease of reading this bulletin the party doing the hiring will be referred to as the owner and the party that supplies the services to the owner will be referred to as the contractor.

There are different forms of indemnification and hold harmless provisions:

- **Reciprocal (or mutual)** – this is a contractual obligation made by both parties in the contract to agree to indemnify and hold each other harmless from financial loss caused by the other party; they are considered the most fair and are used in the CCDC contracts.

- **One-way (or broad form)** – this is a contractual obligation often given to an owner by a contractor for financial loss incurred by the owner caused by the contractor or by its subcontractors and suppliers; it effectively absolves the owner of liability and costs arising out of the contractor’s activities even if the contractor was not negligent.
- **Intermediate** – this is a contractual obligation given by the contractor to the owner for all but the owner’s sole negligence; in other words, the contractor is obligated to compensate the owner for financial loss incurred by the owner even if largely caused by the owner

The purpose of this bulletin is to emphasize the concerns of the “one-way” and “intermediate” forms of indemnification and hold harmless contractual obligations and the importance of all parties understanding the consequences of agreeing to such onerous provisions.

Following is an example of a reciprocal indemnification provision from CCDC 2:

*“Without restricting the parties’ obligation to indemnify as described in paragraphs 12.1.4 and 12.1.5, the Owner and the Contractor shall each indemnify and hold harmless the other from and against all claims, demands, losses, costs, damages, actions, suits, or proceedings whether in respect to losses suffered by them or in respect to claims by third parties that arise out of, or are attributable in any respect to their involvement as parties to this Contract, provided...”*

Following is an example of a “one-way” indemnification provision:

*“The Contractor shall indemnify and hold harmless the Owner, its employees, and agents from and against any and all claims, losses, damages, liabilities, costs and expenses (including reasonable legal fees) which may result from the Contractor’s performance of the Contract.”*

Following is an example of an “intermediate” indemnification provision:

*“The Contractor shall indemnify and hold harmless the Owner, its employees, and agents from and against any and all claims, losses, damages, liabilities, costs and expenses (including reasonable legal fees) which may result from the Contractor’s performance of the Contract, save and except for those claims, losses, damages, liabilities, costs and expenses which result from the sole negligence of the Owner.”*

*“The Contractor’s indemnity obligations shall apply regardless of whether the party to be indemnified was concurrently negligent or whether actively or passively, excepting only where the injury, loss or damage was caused solely by the negligence or willful misconduct of, or by defects in design furnished by, the party to be indemnified. The Contractor’s defense and indemnity obligations shall include the duty to reimburse any legal fees and expenses incurred by the Owner for legal action to enforce the Contractor’s indemnity obligations.”*

Indemnification provisions set the parameters for risk transfer within a contract and can vary from reasonable risk transfer within the confines of tort law to those that make the indemnitor responsible for any and all loss, or for damages howsoever caused, even for the acts of the indemnitee or from guaranteeing a supplier's product will be free from defect in design and fit for its intended purpose.

If a standard CCDC indemnification provision has been modified or replaced by supplementary conditions as often happens with tenders, professional advice should be obtained. It is important that your insurance and legal representatives, preferably experienced in construction insurance and construction law, review the insurance and indemnification provisions prior to signing a contract or submitting a bid that includes a sample contract. Clauses that are unfair or uninsurable can sometimes be negotiated; clauses that are unclear should be clarified to avoid possible subsequent disputes resulting in costly litigation.

The case of Greater Vancouver Water District (GVWD) v. North American Pipe & Steel Ltd. (North American) that made it all the way to the Court of Appeal for British Columbia is an excellent example of assumed risk. North American entered into a contract with GVWD to supply water pipes for two projects in Vancouver. GVWD specified the type of pipe and how it was to be protectively coated. The pipe proved to be defective. Initially, GVWD sued North American for damages, with North American counterclaiming for the costs of supplying the pipe. The trial judge stated the defects caused by an owner's specs are not the responsibility of the contractor, unless the contractor guarantees fitness for a specific purpose, or a warranty can be implied by the owner's reliance on the contractor's skill and judgment. GVWD's claim was dismissed and judgment was granted in the amount of \$3,899,857.01 on North American's counterclaim.

GVWD appealed the decision. In the contract, North American warranted that the goods "will conform to all applicable Specifications...and, unless otherwise specified, will be fit for the purpose for which they are to be used," and "The Supply Contractor warrants and guarantees that the Goods are free from all defects arising at any time from faulty design in any part of the Goods." The B.C. Court of Appeal decided that because North American guaranteed the pipes would not have any defects arising from faulty design and the pipes had defects arising from faulty design, North American was liable. North American's judgement of its counterclaim for the costs of supplying the pipe was over-ruled.

Such onerous indemnification provisions can create liability for the contractor where none existed at law in the absence of the contractual obligation and can extend liability beyond the scope of commercially available insurance causing financial hardship to both parties. The Commercial General Liability (CGL) insurance coverage is intended to pay those sums the contractor becomes legally obligated to pay due to bodily injury or property damage claims advanced against the contractor by third parties arising from the contractor performing its services.

Sometimes a contract or supplementary condition to a contract may contain wording that requires the full wording of the indemnification provision to be endorsed to the CGL. Insurers will not do this because they are not privy to the contract.

Those who insist on imposing such onerous provisions may deter some bidders from bidding on their projects or contractors from working on their projects. Bidders and contractors may also increase their pricing to pay for the additional insurance costs or to fund potential uninsured losses. They can also cause hardship to the owner because the party to be indemnified can only rely upon the indemnification provision to the extent that the contractor has the financial capacity and/or insurance coverage to actually fulfil the obligation in the event of a loss. While the use of the contractor's CGL insurance coverage with additional insured status for the owner improves financial security to the owner, this insurance protection is limited and subject to the insurance policy exclusions and definitions. For example, an agreement to indemnify for loss or damage caused by pollution or operation of a watercraft will have little or no value because the CGL provides very limited coverage for pollution and watercraft where not purchased separately.

Periodically the Canadian CGL policy wording goes through substantial changes, with the last two major revisions taking place in 1987 and 2005. In the 1987 version, coverage was provided wherein the named insured could assume under contract, the complete tort liability of someone else such as a subcontractor or an owner. In the 2005 version, this was restricted so that the loss had to be caused in whole or in part by the named insured or those acting on its behalf. In other words, no longer does the named insured have much broader coverage for liability they assume in a contract as compared to what they would be responsible for in common law.

The current IBC 2100 CGL also addresses defense costs available to any entities which the contractor agrees to indemnify within the definition of insured contract. This feature would apply only to those indemnitees as set out in the insured contract that have not been added as an additional insured as they also benefit from some limited coverage under the contractual liability provisions of the CGL, despite not being an additional insured. Unlike the additional insured, these "un-named" indemnitees are only extended defense and indemnification to the point that the applicable limits of the policy have been reached, whether by judgment or settlement and are always subject to the policy terms and conditions.

The contractual liability coverage is provided only to the named insured and not others such as additional insureds. This is why an indemnitee, relying on additional insured status on someone else's insurance policy, instead of having their own sound insurance program, has no coverage for liabilities they have assumed under contract. They will have coverage only for their negligent acts and/or vicarious liability. If the pleadings in an action allege independent negligent acts of the named insured and additional insured, that additional insured status may be in jeopardy. This is why additional insureds should not rely on someone else's policy.

If the parties to a contract do not obtain insurance and legal advice prior to signing a contract or bidding on a project, the end result may be uninsurable payouts potentially causing insolvency of the indemnitor which could result in serious financial loss to the indemnitee. All parties need to be aware of the impacts and consequences of non-standard contracts or CCDC standard contracts amended by supplementary conditions. Contractors should seek advice and determine if they need to mitigate the additional uninsured risk imposed by indemnification provisions, increase their tender price to fund for the uninsured risk, or not bid the project.

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Owners should seek advice and determine if their indemnification provisions are insurable and valid at law to avoid their uninsured risk resulting in serious financial loss.

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