

Indemnities in Commonwealth contracts

Comcover Conference

Steve McKinney
Partner

March 2015

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Overview

- Nature of Indemnities
- Interpretation of Indemnities
- Drafting Indemnity Clauses
- Commonwealth Policy and Legislation
- Indemnities cover under Comcover

Nature of Indemnities

Contractual allocation of risk

- Key function of contracts is to allocate risk between the parties
 - Contracts should be drafted and negotiated having regard to risk
- Commonwealth Procurement Rules:

Risks should be borne by the party best placed to manage them – that is, agencies should generally not accept risks which another party is better placed to manage. Similarly, where an agency is best-placed to manage a particular risk, it should not seek to inappropriately transfer that risk to a supplier.

- Principles for allocating risk include:
 - which party has greatest control over the risk?
 - which party has capacity to bear the risk?
 - which party is the most likely source of the risk?
 - which party benefits from controlling/managing the risk?
 - if loss flowing from risk will naturally fall on one party, why transfer the risk?

Indemnities – What are they?

Kirby J in *Andar Transport Pty Ltd v Brambles Ltd* (2004)

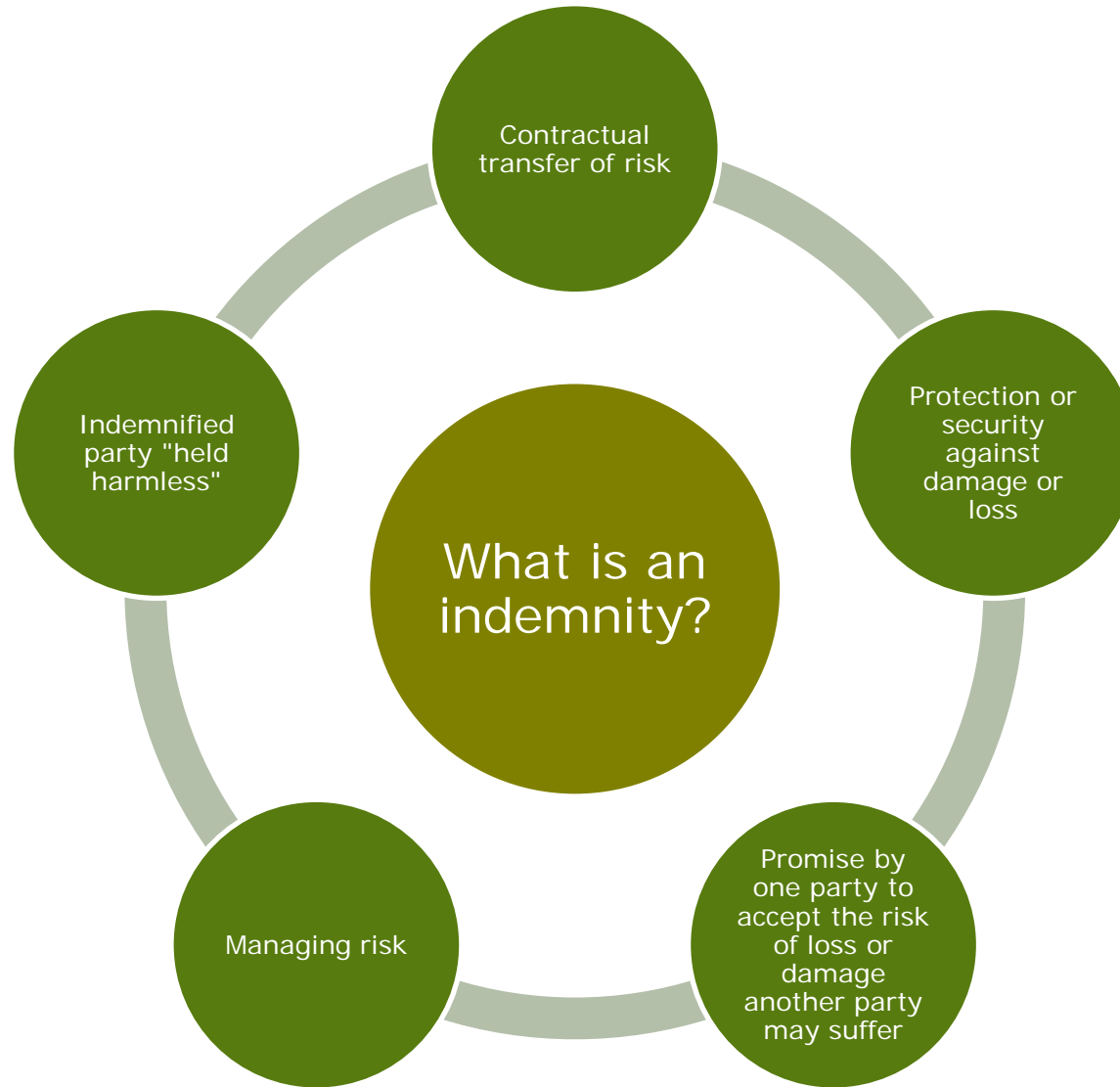
- "Indemnity clauses are provisions that purport to exempt one party from civil liability which the law would otherwise impose upon it. They shift to another party the civil liability otherwise attached by law to the first party. Self-evidently this is a serious thing to do or to attempt to do"

Mason CJ in *Sunbird Plaza Pty Ltd v Maloney* (1987)

- "An indemnity is a promise by the promisor that it will keep the promisee harmless against loss as a result of entering into a transaction with a third party"

Contexts in which they are commonly used?

- Contract clauses
- Deeds with directors & officers of Commonwealth companies
- Lease/hire arrangements
- Sale of Commonwealth assets
- Policies of insurance



The existence of an indemnity does not automatically protect against risk – the terms of and the way in which an indemnity is drafted are both essential considerations

Indemnity v Guarantees & Exclusions

Indemnity v Guarantee

- An indemnifier assumes the primary obligation
 - *Tipperary Developments Pty Ltd v The State of Western Australia* [2009] WASCA 126
 - *Sunbird Plaza Pty Ltd v Maloney* (1987) 166 CLR 245
- A guarantor assumes liability that is secondary, ancillary and accessory to the primary obligation

Indemnity v Exclusion Clause

- An indemnity is the opposite of an exclusion clause
- Where an indemnifier is assuming liability that would not before exist an exclusion clause reduces the liability of the benefiting party

Indemnities vs damages



Indemnities

Express clause specifying the remedy available to the innocent party in the event of a breach.

Used as a substitute for common law damages for breach of contract.

Does not need to be a foreseeable loss and no general obligation to mitigate.



Damages

Contractual damages attempt to place aggrieved party in the position they would be in had the contract been performed.

Remoteness, causation and mitigation apply.

General contractual damages

Causation

Is there a causal connection between the defendant's breach of contract and the claimant's loss?

Remoteness of loss

Is the loss within reasonable contemplation as a not unlikely result of that breach?

Mitigation of loss

Could any part of the loss been avoided by taking reasonable steps?

Indemnities vs damages

Indemnity

A agrees to indemnify B for certain types of loss caused by a specific event

The event occurs and B suffers the type of loss A agreed to indemnify

A must meet all the costs associated with the type of loss caused by the event

Damages

A causes an event

B suffers loss due to the event caused by A

B makes a claim against A for the loss suffered

Advantages of using indemnities

- No concept of remoteness of damage
 - Provided the words of the indemnity cover the specific type of loss incurred, remote losses will be recoverable
- No duty to mitigate loss
 - No requirement to mitigate loss as in contract law
 - The loss must at least be reasonably incurred
- Potential to extend limitation period
 - A claim for loss may be made at anytime when the indemnity is remains on foot, even if outside the statutory limitation period
- Coverage for ongoing losses
 - A subsequent claim for ongoing or subsequent loss may be made under an indemnity
- Amount recoverable is different to (and typically greater than) damages for breach of contract

Interpretation of Indemnities

How will Courts deal with an indemnity clause?

Indemnity clauses are interpreted strictly (*Andar Transport Pty Ltd v Brambles Ltd* (2004) 217 CLR 424)

- the principles informing the construction of guarantees had equal application to the construction of indemnities
- doubt as to the construction of an indemnity clause should be resolved in favour of the indemnifier
- doubt may arise not only from the uncertain meaning of a particular expression but from its apparent width of possible application

"The principle is that **a doubt as to the construction of a provision in such a contract should be resolved in favour of the surety or indemnifier.** It is implicit in this that the doubt may arise not only from the uncertain meaning of a particular expression but from its apparent width of possible application"

HCA in *Bofinger v Kingsway Group Ltd*
(2009) 239 CLR 269

Westina Corporation Pty Ltd v BGC

- Westina engaged BGC to provide a prime mover and operator
 - The BGC prime mover damaged a Westina truck
 - Westina claimed against BGC for the damage, BGC responded by saying indemnity given by Westina also covered acts of BGC's own negligence
- The hire agreement had the following clause:

9. WET HIRE

Where the Plant is hired on a Wet Hire basis, the Supplier shall:

...

(e) Bear the risk of loss in the hiring of the Plant and must defend, indemnify and hold BGC harmless against any injury, death, claim or other loss arising from the hiring of the Plant;

- Primary judge found the clause protected BGC from the negligence of its own employees

Westina Corporation Pty Ltd v BGC

On appeal:

- Buss JA (Wheeler and Newnes JJA agreeing) reversed the decision of the primary judge
- Stated that:
 - "This provision must, of course, be construed in the context of the Hire Agreement as a whole, the surrounding circumstances known to the parties, and the purpose and object of the transaction."
- Significantly, His Honour then stated:
 - "Any doubt as to the construction of an indemnity in clause 9(e)... **must be resolved in favour of Westina as the indemnifier.**"

Samways v WorkCover Queensland & Ors

- A site controller engaged a bobcat company to provide a bobcat and driver
 - A man had injured himself on the site by walking into the bobcat
 - He commenced proceedings against (among others) the bobcat company
- The site controller (*Hirer*) and the bobcat company (*Contractor*) had an agreement with the following clause:

7. The Hirer shall **fully and completely** indemnify the Contractor in respect of **all claims by any person or party whatsoever** for injury to any person or persons and/or property **caused by or in connection with or arising out of the use of the plant** and in respect of all costs and charges in connection therewith whether arising under statute or common law.

Samways v WorkCover Queensland & Ors

Decision – the site controller indemnified the bobcat company from the negligence of the bobcat driver

- His Honour decided that the indemnity clause required no reading down as it was clear enough on the face of it
- He summarised:
 - Lack of ambiguity will allow for a strict interpretation;
 - Any ambiguity as to an interpretation then it shall be resolved in favour of the indemnifier
- *Bofinger* does "**not require that ambiguity be detected** where the **natural and ordinary meaning** of the language, taken in its contractual contexts, requires **no such conclusion**"

Normoyle Pty Ltd v Transfield Pty Ltd

- Meaning of the phrase "act, neglect or default":

The sub-contractor shall indemnify and keep indemnified [the Joint Venture] and their respective officers, employees and agents against all claims, demands, proceedings, liabilities, costs, charges and expenses arising as a result of any act, neglect or default of the sub-contractor, its employees or agents relating to its execution of the Works

- Majority found that the word "act" should be read in conjunction with the words "neglect" or "default" both of which connote a breach of a legal duty
- Indemnity did not apply to an act or omission that did not amount to negligence

Restrictions on indemnities

- Statutory liabilities may not be capable of being dealt with under an indemnity
 - Contract terms may not be effective if contrary to public policy
- Statute may override allocation of risk under an indemnity
 - Proportionate liability

Drafting Indemnities

Types of Indemnities

Fault Based Indemnity

- breach of contract
- negligence
- breach of statute

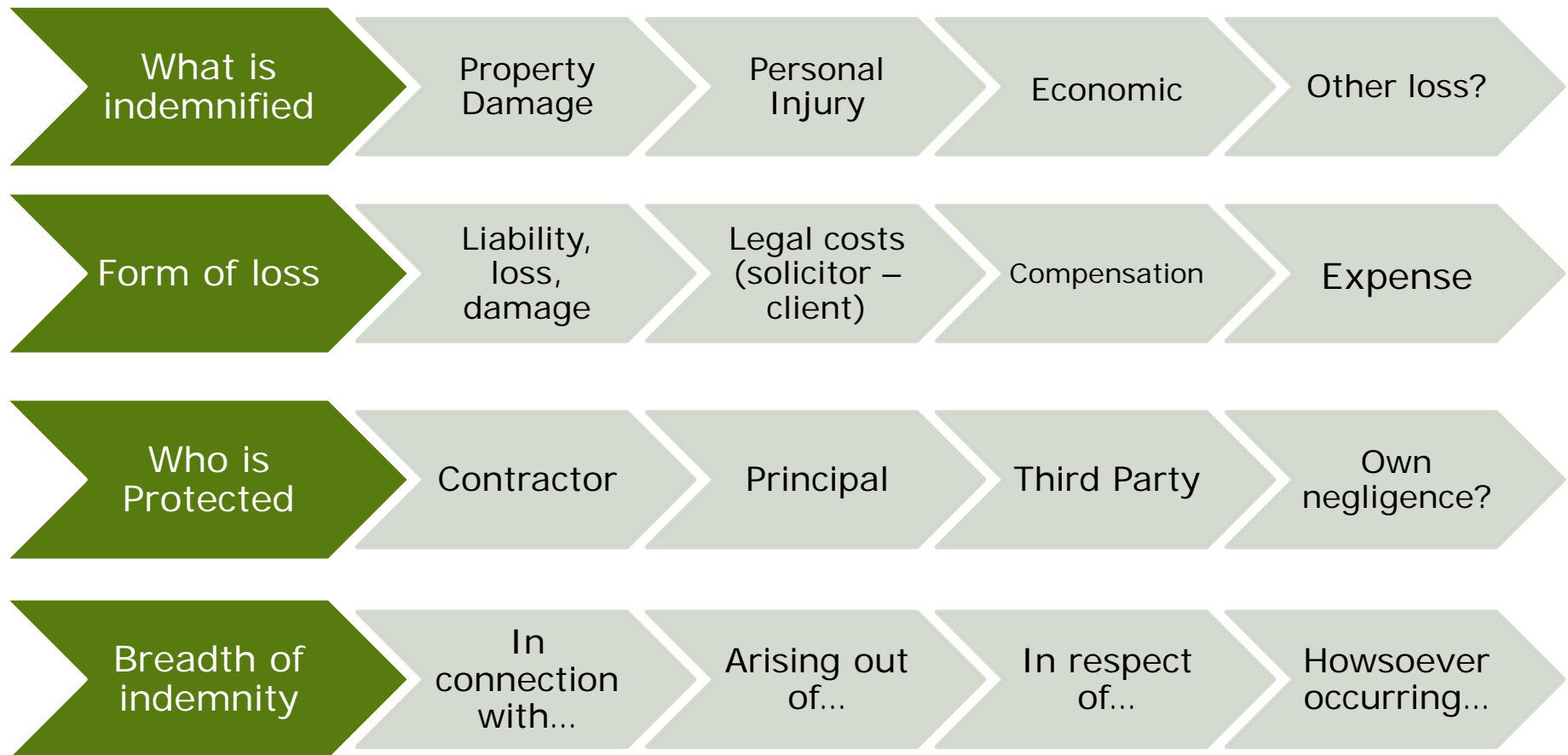
No Fault

- Damage to property regardless of cause
- Strict liabilities

Reflexive

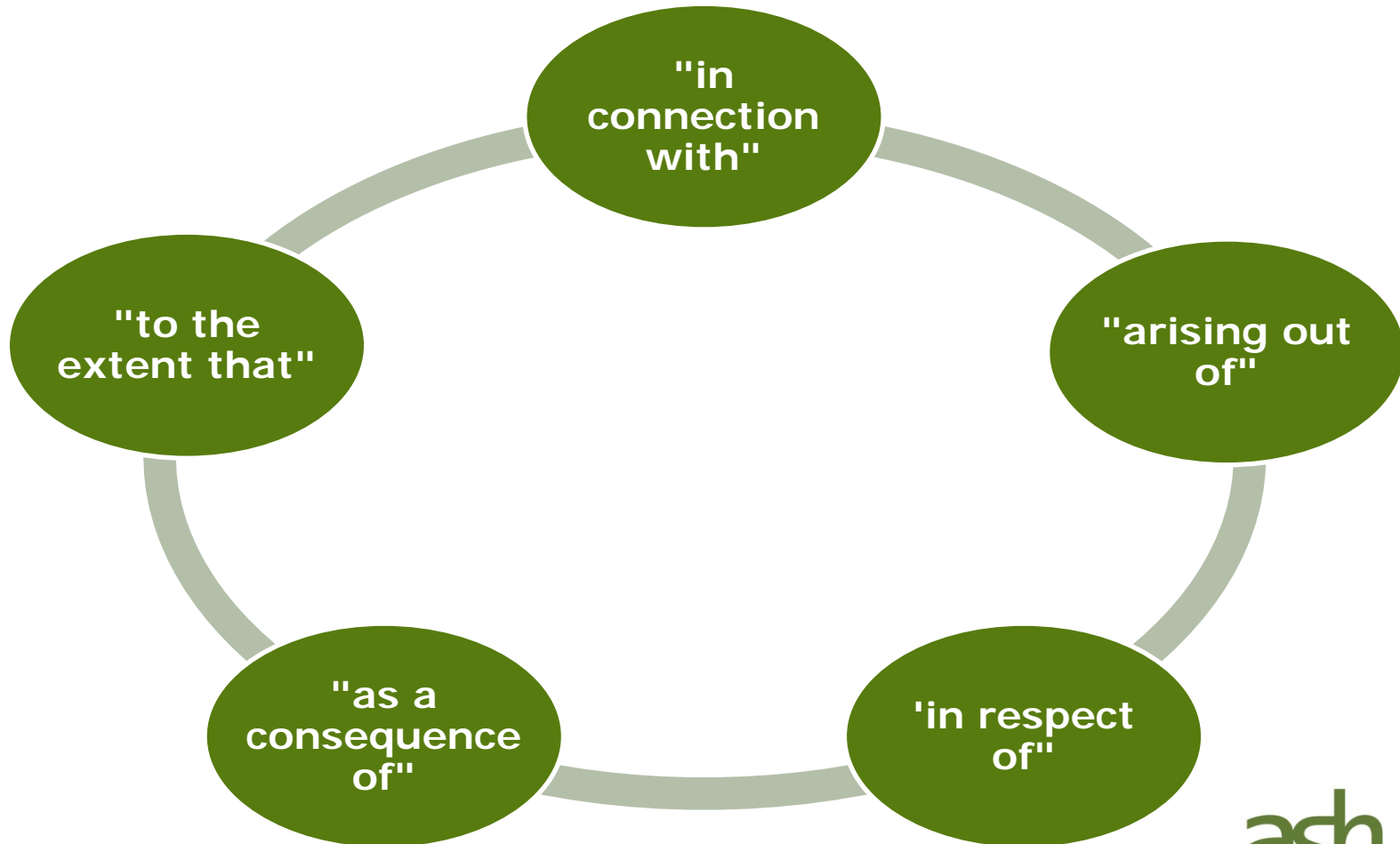
- Party A indemnities Party B for loss arising from Party B's fault

Drafting Indemnity Clauses



Indemnities – drafting issues

- Causal links – choose carefully



Drafting indemnities

Who is providing?

- Ideally the party best able to manage the risk
- Consider whether they are financially capable

Who is protected?

- To be set out in the contract
- Consider whether third parties are to be protected

Events covered

- Limited to the actions of the indemnifier only?

Losses covered

- eg personal injury, death, property damage etc
- Consider carve outs

How wide?

- eg "in relation to", "arising out of", "in connection with" etc

Cap

- Is an indemnity cap required?

Mechanism of recovery

- Can you recover under the indemnity before making payment?

Release

- A release clause should accompany an indemnity clause

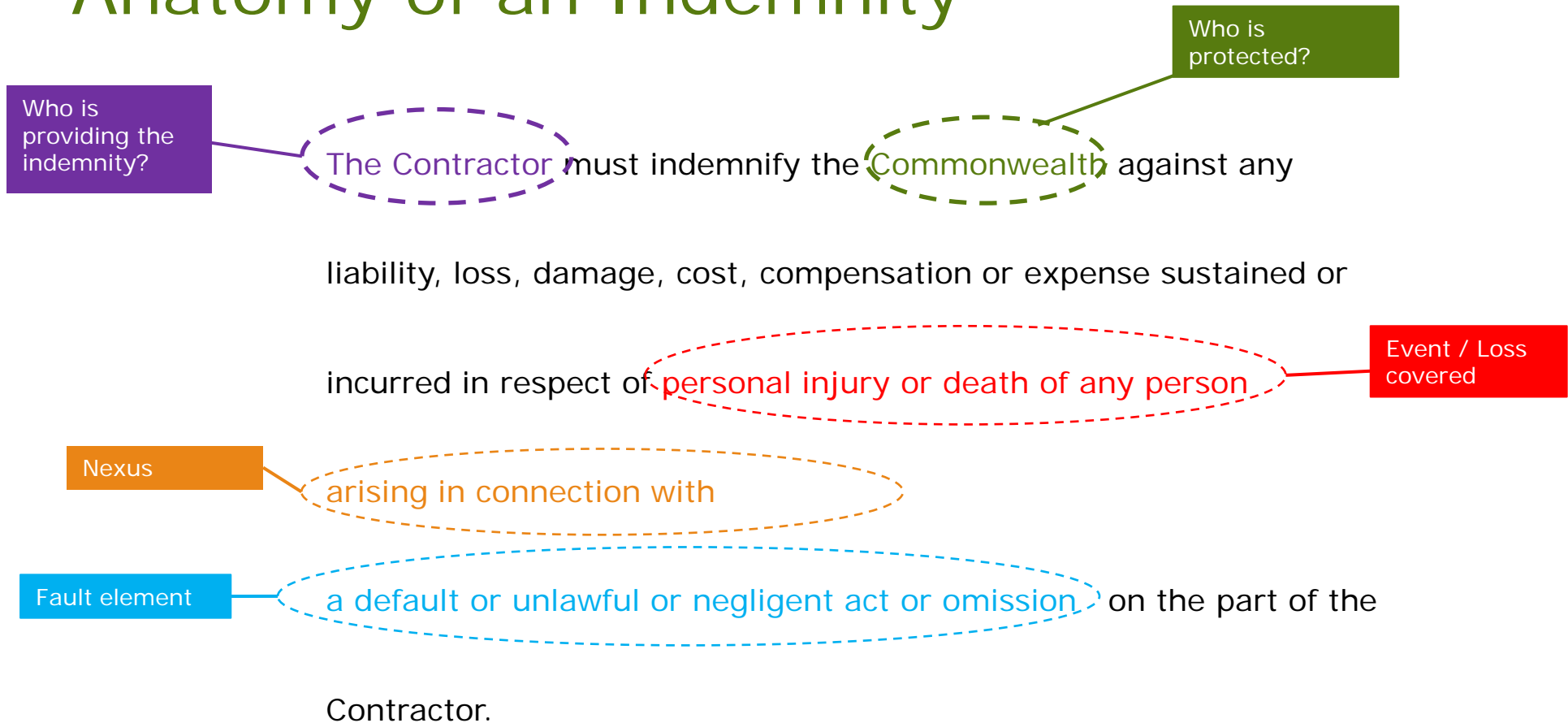
Insurance

- Coverage of potential liability under an indemnity clause

Indemnities – drafting issues

Compensation element	Loss / Event covered	Fault Element	Exclusions
<ul style="list-style-type: none">• Use the terms “pay” “compensate” “reimburse”• Avoid “hold harmless”	<ul style="list-style-type: none">• Define “loss” elements carefully• Consider types of loss: personal injury, death, disease, property damage, economic loss, loss of opportunity, loss of reputation, wasted expenditure	<ul style="list-style-type: none">• Clearly identify the level of fault:<ul style="list-style-type: none">• Breach of contract• Negligence• Liability to and claims by third parties• IP infringement / confidentiality breaches• Security/privacy breaches• Other acts or omissions	<ul style="list-style-type: none">• Draft exclusions carefully being mindful that this can colour the interpretation of the indemnity as a whole

Anatomy of an Indemnity



Narrowing the scope of trigger events

The Contractor must indemnify the Commonwealth against any liability, loss, damage, cost, compensation or expense sustained or incurred in respect of personal injury or death of any person ~~arising in connection with~~ directly caused by a default or unlawful or negligent act or omission on the part of the Contractor in connection with the performance of the contract.

Reduction of liability for CoA fault

The Contractor must indemnify the Commonwealth against any liability, loss, damage, cost, compensation or expense sustained or incurred in respect of personal injury or death of any person arising in connection with a default or unlawful or negligent act or omission on the part of the Contractor.

The liability of the Contractor is reduced to the extent that the Contractor demonstrates that the personal injury or death was caused by a default or unlawful or negligent act or omission of the Commonwealth.

Reduction of liability for third party fault

The Contractor must indemnify the Commonwealth against any liability, loss, damage, cost, compensation or expense sustained or incurred in respect of personal injury or death of any person ~~arising in connection~~ with to the extent caused by a default or unlawful or negligent act or omission on the part of the Contractor.

Expanding the parties at fault

The Contractor must indemnify the Commonwealth, its officers, employees and agents against any liability, loss, damage, cost, compensation or expense sustained or incurred by any of the them in respect of personal injury or death of any person arising out of or as a consequence of a default or unlawful or negligent act or omission on the part of the Contractor, any Subcontractor or any officer, employee or agent of the Contractor or a Subcontractor.

Extending benefit of the Indemnity

The Contractor must indemnify the Commonwealth, its officers, employees and agents against any liability, loss, damage, cost, compensation or expense sustained or incurred in respect of personal injury or death of any person arising out of or as a consequence of a default or unlawful or negligent act or omission on the part of the Contractor. The Commonwealth holds the benefit of the indemnity on trust for its officers, employees and agents and the Commonwealth may enforce the indemnity or exclusion on their behalf.

Drafting Indemnity Clauses

- Burden of Proof
 - Who need to prove the triggering event, nexus and loss?
 - Who needs to prove any contributing factor/fault?
- When can the indemnity be claimed upon
 - "It is not necessary for the Principal to have incurred any expense or made any payment before enforcing an indemnity under this Contract."
- Avoid template indemnity clauses that may not reflect the work being done under the contract

Drafting – Strategic Issues

- Consider price for transferring risk
 - Transferring risk unnecessarily or without clear limits will likely result in the contract price including a large risk premium
 - Are you the Contractor or the Principal?
- Consequential loss
 - Be clear about what is in and out
- Relationship between indemnities and insurance
- May also operate to exclude proportionate liability legislation if broad enough

Questions?



Steve McKinney

Partner

T +61 2 6234 4028

E steve.mckinney@ashurst.com

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