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Interpretation of Contractual Indemnities

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Background

Contractual indemnities are common and are varied. Although an indemnity is capable of being broadly classified into types, as are referred to below, even with some guidance being afforded by some classification there is still difficulty and uncertainty which faces the practitioner.

Whilst there are specific contracts of indemnity, such as contracts of insurance, an indemnity has a broad meaning. Typically indemnity clauses are included in commercial contracts that arise out of specific commercial interests of contracting parties, and almost always, rendering indemnity clauses the subject to interpretation within the specific context of the contractual relationship of the parties.

As can be imagined, in the context of commercially contracting parties, there is a vast range of commercial contexts and types of clauses, the arrangements are often complex and the contractual indemnities often ambiguous, notwithstanding that indemnity clauses often appear in very typical and common contracts (leases, sale agreements, finical and security documents and with greater frequency contract involving the provision of a service).

The Contract and the Indemnity

The contract plays an import role in commercial dealings, in almost all cases the parties desire to make clear their respective rights and liabilities and to allocate varies responsibilities including, and relevantly to this discussion, the allocation of risk. Indemnitees often appear in contracts that sought to govern the whole, or at least the major parts, of the parties commercial arrangements, as such they are not simply a contract in itself, but rather a part of a greater contract. The type and extent of the indemnity offered and taken in a contract is usually determined (during the negotiation phases) by a number of factors, including the type of the contract and the relative bargaining strengths of the parties.

In commerce it is often that most of the sophisticated and experienced parties will have a good understanding of the scope or breadth of the indemnity, the way it is to be called

on and the requirements of additional actions (often specific insurance), these additional matters are themselves the subject to specific clauses in the same contract.

An indemnity (broadly speaking) "……is a contract by one party to *keep the other harmless* against loss." (Yeoman Credit Ltd v Latter [1961] 2 All ER 294 per Harman LJ at 296 (emphasis added). It has also been defined as: "an obligation imposed by ... contract on one person to *make good a loss* suffered by another." (See Andrews GM and Millet R, Law of Guarantees).

The High Court has said: "An indemnity is a promise by the promisor that he will keep the promisee harmless against loss *as a result of entering into a transaction with a third party*" (Sunbird Plaza Pty Ltd v Maloney (1988) 166 CLR 245 at 254 per Mason CJ, emphasis added), and indemnities "are designed to satisfy a liability owed by someone other than the guarantor or indemnifier to a third person". Andar Transport Pty Ltd v Brambles Ltd (2004) 217 CLR 424 at 437; (2004) 206 ALR 387 (Andar).

The substantive difference between a promise to *hold harmless* and one to *make good* is the effect of the obligation has on assessing damages, which is referred to briefly at the end of the paper.

The Difficulties

The difficulties for the practitioner (draftsman and litigator alike) is neatly and succinctly stated by Giles JA "*The operation of any contractual indemnity must be found in the application to the facts of the relevant clause, construed as part of the contract as a whole. Decisions on the operation of contractual indemnities in different words in different contracts are likely to be of limited assistance*" (Erect Safe Scaffolding (Australia) Pty Limited v Sutton & Anor [2008] NSWCA 114 (Erect Safe)).

By reason of the breadth of commercial arrangements, and very often, the complexities of the contracts themselves, the resulting interpretation the indemnity and the manner in which it operates may in fact be very different to that that the parties thought they were agreeing to.

Types of Indemnities

Notwithstanding Justice Giles' views, indemnities are capable of some form of classification, and as such can be a guide as to it scope and operation.

1. "bare" indemnities: Party A indemnifies Party B against *all* liabilities or losses incurred in connection with given events or circumstances, but *without* setting out any specific *limitations*. These indemnities will be silent as to whether they indemnify losses arising out of Party B's own acts and/or omissions, and maybe be interpreted to have the effect of a "reverse" indemnity.
2. "reverse" or "reflexive" indemnities: Party A indemnifies Party B against losses incurred as a result of Party B's *own acts and/or omissions* (mostly B own negligence) (See Qantas Airways Ltd v Aravco Ltd (1996) 185 CLR 43).
3. "proportionate" or "limited" indemnities: these are the opposite of "reverse" indemnities, Party A indemnifies Party B against losses *except* those incurred as a result of Party B's own acts and/or omissions.
4. "third party" indemnities: ie Party A indemnifies Party B against liabilities to or claims by Party C.
5. "financing" indemnities: Party A indemnifies Party B against losses incurred if Party C fails to honour the financial obligation (ie the primary obligation) to Party B. (Most often these are coupled with a guarantee.)
6. "party/party" indemnities: ie each party to a contract indemnifies the other(s) for losses occasioned them by the indemnifier's breach of the contract.

(Note that these terms are not a universally used).

The construction and implementation of the Indemnity Clause

As, hopefully, it will become apparent, there seems to be emerging a set of rules that apply to the construction of indemnity clauses (not unlike say exclusion clauses).

It has been well established that contract, especially commercial contracts should be interpreted in such a manner which is commercially sensible, and in accordance with commercial reality (see Carter on Contract 12-040).

Although there have been countless determinations of commercial contracts, and in a great many of those judgements the commercial and less narrow approach to the

interpretation of the parties intentions in the commercially sensible context of their relationship has been referred in one way or another. Thus, a wide body of law has ensued, the law in respect to the interpretation of indemnity clauses has been the subject of much comment and, as set out below, even then there is debate amongst judges as to the proper interpretation of the indemnity clause.

It would appear that in respect to the construction of indemnity clauses a more specialised approach is appropriate, as the cases of Andar Transport Pty Ltd v Brambles Ltd (2004) 217 CLR 424; (2004) (Andar), and Pacific Carriers Ltd v BNP Paribas (2004) 218 CLR 451; (2004) (Paribas); and, as referred to above, the Supreme Court of Appeal was called upon to adjudicate and indemnity in Erect Safe.

Construction of an Indemnity Clause and ambiguity

As practitioners are well aware that construction is the process by which the meaning, legal effect or application of a contractual term may is resolved, this is really a matter of law rather than fact.

When a court approaches the interpretation of a contract it starts by interpreting the words of a contract giving then their ordinary every day meaning. Further, as referred to above, the courts also approach the interpretation of commercial contracts with the view to giving it commercially sensible interpretation in accordance with commercial reality. Often the courts have shied away from overly technical interpretations and methods of interpretation, of commercial contracts. However, as it would seem, in Andar the court took a more technical approach to the interpretation of the indemnity, and of course its effect, yet in the same year the court said:

"The construction of the letters of indemnity is to be determined by what a reasonable person in the position of [the indemnified party] would have understood them to mean. That requires consideration, not only of the text of the documents, but also the surrounding circumstances known to [the parties] and the purpose and object of the transaction." (Paribas)

Fundamentally the basis of construction is objective, the actual belief or views of a individual party to a contract as to what obligation was being imposed or accommodation was being afforded is immaterial. The process is of the analysis of the intention of the parties, (and their resulting rights and liabilities) turn on what their words would be

reasonably understood to convey, not upon actual or subjective beliefs or intentions. (Yeoman Credit Ltd v Latter [1961] 2 All ER 294 per Harman LJ at 296).

Andar

The facts and background of Andar Transport Pty Ltd v Brambles Ltd (2004) 217 CLR 424 are Andar contracted with Brambles for the provision of delivery services, the injured person was an employee of Andar (previously an employee of Brambles undertaking essentially the same activities), at first instance the injured person alleged that Brambles was negligent. Brambles was held to be negligent and sought to rely upon an indemnity clause. The indemnity clause did not specifically refer to an indemnity for Brambles' own negligence. The relevant clause is set out below.

[Andar] shall –

"8.1 Conduct the Delivery Round at its sole risk and releases [Brambles] from all claims and demands of every kind and from all liabilities of every kind which may arise in respect of any accident loss or damage to property or death of or injury to any person of any nature or kind in the conduct of the Delivery Round by [Andar].

8.2 Indemnify [Brambles] from and against all actions, claims, demands, losses, damages, proceedings, compensation, costs, charges and expenses for which [Brambles] shall or may be or become liable whether during or after the currency of the Agreement and any variation renewal or extension in respect of or arising from –

8.2.1 loss damage or injury from any cause to property or person occasioned or contributed to by the neglect or default of [Andar] to fully, duly, punctually and properly pay, observe and perform the obligations, covenants, terms and conditions contained in the Agreement and on the part of [Andar] to be paid, observed and performed.

8.2.2 loss, damage, injury or accidental death from any cause to property or person caused or contributed to by the conduct of the Delivery Round by [Andar].

8.2.3 loss, damage, injury or accidental death from any cause to property or person occasioned or contributed to by any act, omission, neglect or breach or default of [Andar].

[N]otwithstanding that any of such actions, claims, demands, losses, damages, proceedings, compensation, cost, charges, and expenses shall have resulted from any act or thing which [Andar] may be authorised or obliged to do under the Agreement and notwithstanding that any time waiver or other indulgence has been given to [Andar] in respect of any obligation of [Andar] under the Agreement AND PROVIDED ALWAYS it is

agreed and declared that the obligations of [Andar] under this Clause shall continue after variation or termination of the Agreement and any renewal or extension in respect of any act, deed, matter or thing happening before such termination."

The majority of the court thought that cl 8 was ambiguous with respect to Brambles' own negligence. The Hight Court by majority (with Callinan J dissenting) applied a strict interpretation of the clause. The application of strict rules of construction, rather than the often favoured "commercial construction, this resulted in an implied a "proportionate" limitation of indemnity. In arriving at its conclusion the High court concluded that the *strictissimi juris* rule of construction (as applicable to contracts of surety) applied in the construction of indemnities. The ambiguity resolving in favour of Andar and not Brambles.

Erect Safe

In Erect Safe Scaffolding (Australia) Pty Limited v Sutton & Anor [2008] NSWCA 114, broadly Sutton, employed by Dalmar Formwork Pty Ltd ("Dalmar") was injured whilst working on the construction of a multi-storey residential and commercial building. The head contractor on the site was Australand Constructions Pty Ltd ("Australand"). Dalmar was a sub-contractor to Australand. Erect Safe Scaffolding (Australia) Pty Ltd ("Erect Safe") provided scaffolding services to Australand pursuant to a commercial contract. It was essentially responsible for erecting and maintaining of the scaffolding on site. Erect Safe, in the manner in it which had performed its works, had created a hazard, and that hazard caused injury to Mr Sutton. In the process of ensuring that the work site was safe, Australand had formed a safety committee. On the facts, the hazard was either known or ought to have been known to Australand and to Dalmar.

The contract provided for an indemnity between Erect Safe and Australand. Relevantly it stated:

> *"11.* ***Indemnity***
>
> *The sub-contractor must indemnify Australand Constructions against all damage, expense (including lawyers' fees and expenses on a solicitor/client basis), loss (including financial loss), or liability of any nature suffered or incurred by Australand Constructions arising out of the performance of the sub-contract Works, its other obligations under the sub-contract.*
>
> *12.* ***Insurance***

Public Liability. Before commencing work, the sub-contractor must effect and maintain during the currency of the sub-contract, public liability insurance in the joint names of Australand and the sub-contractor to cover them for their respective rights and interests against liability to third parties for loss of or damage to and death of or injury to any person. The policy must include a cross-liability clause in which the insurer agrees to waive all rights of subrogation or action against any of the persons comprising the insured and for the purposes of which the insured accepts the term 'insured' as applying to each of the persons comprising the insured as if a separate policy of insurance had been issued to each of them (subject always to the overall sum insured not being increased thereby)."

The Australand was held liable to Sutton, and it sought indemnity from Erect Safe as above.

In the facts and circumstances of this case, the Court held that the liability of the head contractor was caused or arose out of its own failure and/or its own conduct. Essentially the Court of Appeal interpreted that the indemnity provided by Erect Safe was dependent upon a relationship between the liability of the head contractor to the Plaintiff and the performance of the sub-contract works. As the liability of Australand to the Plaintiff arose out of its own conduct and not the performance of the sub-contract works, the Court held that the Australand was not entitled to be indemnified by Erect Safe.

Some Indemnity Clauses prior to Erect Safe

The court in Erect Safe, in particular Giles and Baston JJA, considered a number of the authorities and in particular the operation of varies clauses that had been previously considered.

In particular Giles JA looked at the expression "arising out of the use of" relevantly he stated:-

"10 In *Dickinson v Motor Vehicle Insurance Trust* (1987) 163 CLR 500 it was held that injury caused when a child left temporarily in a parked car played with matches arose out of the use of the car. The Court said at 505 -

> "**The test posited by the words "arising out of" is wider than that posited by the words "caused by"** and the former, although it involves some causal or consequential

> relationship between the use of the vehicle and the injuries, does not require the direct or proximate relationship which would be necessary to conclude that the injuries were caused by the use of the vehicle: *State Government Insurance Commission v Stevens Bros. Pty. Ltd* [(1984) 154 CLR 552, at 555, 559]."

Once the clause in *Roads and Traffic Authority of New South Wales v Palmer* [2003] NSWCA 58 was construed **so that the damage or claim had to arise out of the contractor's performance of the works**, the effect given to "arising out of" was similar to that in [Erect Safe]"

14 In *F & D Normoyle Pty Ltd v Transfield Pty Ltd* [2005] NSWCA 193 (Normoyle) *(note which followed Andar)* the Joint Venture was liable to the worker for breach of statutory duty in not providing safe access, a passageway being obstructed by stored pipes. The words in the indemnity clauses were "**arising as a result of any act, neglect or default of the sub-contractor ... relating to its execution of the works**". It was held by the majority that "**act**" **did not extend to an act which was neither a neglect nor a default, and that neither of the sub-contractors had been in neglect or default.** Ipp JA added, however -

> "90 Further, in my view, while the phrase "**arising as a result of**", in cl 12, **is a particularly broad expression of the notion of causation, it is not open ended.** The clause plainly does not connote "proximate cause" or "direct cause", but it could not be construed so as to import an unlimited concept of causation. The clause does involve some causal or consequential relationship (cf *Dickinson v Motor Vehicle Insurance Trust* (1987) 163 CLR 500 at 505). **Remoteness must form an element of the meaning of "arising as a result of"; more is required than the mere existence of connecting links between an act, neglect or default of the sub-contractor and the liability incurred by the Joint Venture.**
> 91 In my opinion, **the acts of Normoyle** in bringing the pipes on to the ground level of the construction site and storing them in their proper place **are so remote from the accident** which caused Mr Vranjkovic's injuries that the liability which the Joint Venture incurred in consequence of

those injuries could not be said to arise as a result of those acts."

Basten JA (dissenting) (it should be noted that his Honour did not agree with the outcome in *Erect Safe* and was of the view that Erect Safe ought to have indemnified Australand). examined very closely the reasoning in Andar and the judgement is extremely useful aid to practitioners:-

"67 In *Leighton Contractors Pty Ltd v Smith* [2000] NSWCA 55 [Leightons Contrators], this Court (Mason P, Meagher JA and Fitzgerald JA) considered the operation of an indemnity clause in the following terms:

"The subcontractor shall **indemnify** and keep indemnified the company against all loss or damage including but not limited to all physical loss or damage to property (other than property for which the subcontractor is responsible under clause 16) **and all loss or damage resulting from death or personal injury arising out of or resulting from any act, error, or omission or neglect of the subcontractor.**"

68 The injured worker was an employee of the company (Leighton Contractors) but was working for a sub-contractor securing roof trusses on a building site, when one of the trusses collapsed and the worker suffered serious injuries. Both Leighton and the sub-contractor were found liable to the worker and the Court unanimously held that the natural and ordinary meaning of the indemnity clause required the sub-contractor to indemnify Leighton Contractors for its liability. Their Honours specifically relied upon the statement of principle in *Darlington Futures* requiring the Court to give the words in the contract their natural and ordinary meaning.

Inconsistent authorities

69 ...*Normoyle* sought to distinguish *Leighton Contractors*. ....it is far from clear that *Darlington Futures* is no longer good law. However, prior to *Normoyle*, both this Court and the Victorian Court of Appeal had reached conclusions at variance with those which might have resulted from the application of ... *Leighton Contractors*. The earlier of the two decisions was *Australian Paper Plantations Pty Ltd v J & EM Venturoni* [2000] VSCA 71 ("*Venturoni*"). A worker was struck by a falling tree, whilst working for a sub-contractor in a forest on land owned by APP. The liability of APP was said to have depended upon the land being "unsafe" and APP failing to provide "a safe system for felling trees". The contract between APP and the sub-contractor included the following indemnity:

"The [sub-contractors] hereby **indemnify** and agrees [sic] to keep the Company indemnified against all costs, damages, fines, expenses, claims, actions and suits **whatsoever arising out of or in respect of the carrying out of the agreement.**"

70 The argument against the operation of the indemnity was that the only connection between the claim and the performance of the contract was that the sub-contractors had brought the worker onto the land for the purpose of carrying out the tree felling. Buchanan JA (with whom Ormiston JA agreed) noted that the contract was almost entirely devoted to setting out the obligations of the sub-contractors and concluded that the words "costs, damages, fines and expenses" produced absurd results if the clause applied to the performance of the contract by both parties: at [11]. His Honour also noted that APP had agreed to obtain insurance at its own expense in favour of the sub-contractors. The prescribed form of insurance "provided indemnity against the liability of the insured to pay compensation under the Act and to pay damages at common law in respect of injuries sustained by a worker", leading his Honour to conclude at [13]:

"In my view it would be incongruous if the appellant agreed to provide insurance for the respondents against claims by their workers and at the same time was able to visit upon the respondents liability for injuries sustained by workers engaged by the respondents pursuant to [the indemnity clause]."

71 After referring to authorities requiring that the clause be given its natural and ordinary meaning, his Honour noted that the construction adopted by the trial judge, in favour of the sub-contractors, was not strained. His Honour held at [18]:

"Rather, the trial judge interpreted the clause in the manner conceded by the appellant to be appropriate, that is, by requiring that the carrying out of the contract be more than the occasion of the liability in question and held that that requirement was not met in the present case."

72 The reasoning also turned in part upon the proposition that the indemnity should not have been read to extend to carrying out the contractual obligations of APP, as opposed to those of the sub-contractor. However, **it was the action of the sub-contractor in bringing the worker onto the land to engage in tree felling that was a step in the chain of events leading to the injury. That, it appears, was conceded to be insufficient to engage the indemnity**. The submission of the appellant that there need only be a "discernable and rational link" between the liability or claim and the carrying out of the contract was not expressly rejected, but the possibility of absurd results, combined with the acceptance by APP that it would take out insurance for those working on its land, appear to have resulted in the adequacy of the connection being rejected as no more than temporal.

73 *Venturoni* was distinguished by Giles and Hodgson JJA in *State of New South Wales v Tempo Services Ltd* [2004] NSWCA 4 at [20] and disapproved by Meagher JA at [8]. It was referred to by Spigelman CJ in *Roads and Traffic Authority of NSW v Palmer* [2003] NSWCA 58, as an authority relied upon by the primary judge Wood CJ at CL, in *Palmer* at first instance, but without expressly applying it. In *Palmer*, the indemnity was identified by Giles JA at [237] in the following terms:

"The immediately relevant words are those in cl 18, '... against any claim or action brought by any person against the Principal ... in respect of personal injury ... of any person ... **arising out of the construction of the Works by the Contractor**', although the indemnity also deals with damage to the Principal's property and claims against the Principal in respect of damage to property."

74 Spigelman CJ (with whom Handley JA agreed) held at [213], after expressions of doubt as to the correct result:

"**The concluding words 'by the Contractor' perform a function in the nature of the limitation**. If cl 18 had ended with the words 'arising out of the construction of the Works', it may very well be that the differences between this case and *Venturoni* would lead to the conclusion that one would not add any further words. In those circumstances, it may have been the case that the proper construction would be to extend the indemnity to acts performed by the Principal. The addition of the words 'by the Contractor' were intended to limit the scope of the 'claims or actions' for which [the sub-contractor] agreed to indemnify the Council."

...

(note that the this judgement as a whole is extremely useful in the examination of the law on the topic)

79 On the facts the dangerous condition of the road was the consequence of Pioneer spreading gravel on the surface in the performance of its contract. The negligence of the Council was its failure to erect proper warning signs with appropriate speed restrictions. Because the act of Pioneer gave rise to the obligation of the Council, the case is authority for the **conclusion that an essential contributory factor will not engage such an indemnity**, where the liability of the party indemnified is attributable to breach of its own separate duty. This approach was not consistent with *Leighton Contractors* (to which the Court in *Palmer* was not referred) or *Speno*, even on the restricted reasoning of Wheeler J referred to above.

...

82 Ipp JA relied upon two further factors in distinguishing *Leighton Contractors*. One was his Honour's view that by reason of the decision of the High Court in *Andar Transport*, the natural and ordinary meaning approach in *Darlington Futures* "can no longer be relied upon in regard to indemnity clauses": at [64]. For reasons already noted, it seems unlikely that the relevant High Court authorities, including *Andar Transport*, should be read as inconsistent with *Darlington Futures*, in a sense to which no reference was made in the later cases. As Bryson JA noted in *Normoyle* at [141]-[142], **there is no necessary discordance between a rule that ambiguous provisions in an indemnity should be construed in favour of the surety and the rule that ambiguity may**

properly be detected if it is a reading to which the contractual language "is fairly susceptible without placing a strained construction on it, thereby giving it" its natural and ordinary meaning. The *contra proferentem* rule is designed to resolve ambiguities, not to create them.

83 Finally, in *Normoyle* Ipp JA noted as another point of distinction of that case from *Leighton Contractors* that "the argument in the present case is not that the indemnity applies to liabilities *solely* arising as a result of any act, neglect, or default of the sub-contractor". **That statement suggested no departure from the usual approach to questions of causation, which will take account of material contributing factors.** (His Honour went on to quote [90] et seq, as referred to in Giles JA judgement - above)"

Returning briefly to Tempo the Court also considered the relationship between the performance of services and injury and the term "arising out of or in connection with or caused by".

An injured cleaner pursued a claim against the State arising out of an accident which occurred at a State school. The State sought indemnity pursuant to a contract made with Tempo as the cleaning company and the plaintiff's employer. The Court distinguished Venturoni and held that the fact of the plaintiff's presence at the school had no other reason than the performance of the contractual services compelled a finding that the injury arose in connection with the performance of the services, and as the injury occurred at a workplace, during working hours, when the plaintiff was there for the purpose of performing services, that meant that there was a sufficient connection between the injury and the provision of the services. The Court accepted the proposition that the words "in connection with" did not require any causal connection. Meagher JA held:

> "The words in connection with are words of the widest input, do not require any direct or proximate relationship with the contract in question but must have some causal or consequential relationship with it."

The presence of the injured worker at the accident site was because the contract required her to be there and she was performing duties in connection with the contract. His Honour distinguished *Australian Paper Plantations* on the basis that the words "in connection with" were not considered in that case.

In QBE Insurance v. SLE Worldwide (2005) NSWSC 776 the Court considered the term "liability arising from and in relation to the activities of the NRL at Stadium Australia" in the context of an insurance policy. The mere temporal relationship between the liability and the activities of the NRL was not sufficient. "Arising from" denotes the need for, at least, an indirect causal relationship which is not satisfied merely by the presence of the other party.

Again briefly returning to Leightons, the Court held that the indemnity was to be provided in the event that there was a relationship between the act, error, omission or neglect of the sub-contractor and the personal injury. No question of liability on the head contractor arose out of the conduct of the sub-contractor:

> *"First, the present clause is not directed to the cause of Leighton's 'loss or damage' ie its liability to [the injured person], but to the cause of [the injured person's] personal injury. It is irrelevant to the operation of the clause that [the sub-contractor's] 'act, error or omission or neglect' was not the cause of Leighton's liability. It was a cause of ... personal injury."*

The Effect of the Indemnity

Once the extent of an indemnity has been determined, the question of damages arrises. Is the effect of the indemnity clause one that gives rise to damages for the breach of the contract (debt) or for damages (such as compensation).

Although important and a matter that needs to be considered, time does not permit a full analysis here. However, briefly, should the effect of the indemnity be that the contract is breached then will such breach give rise to other remedies under the contract (eg termination or particular liquidated damages, or the rights such as to payment being effected, suspended or even terminated). Or rather is does the indemnity have the effect of allowing the indemnified party the right to say a payment, compensation or a reimbursement,

Again, as has been seen from the general approach in regard to commercial contracts, much will turn on the factual matrix surrounding the contract and the events giving rise to the claim.

Foot note- Drafting

Drafting is not a focus of this paper (and would in itself be more a subject of its own paper), however one thing maybe clear, should party A wishes to be indemnified for its own negligence then it would be best to say so rather than to leave it "bare". It appears preferable that an indemnity is cast to provide for compensation rather than for damages for breach, hopefully thereby giving a broader range of damages (rather than the usually more narrow result for breach of contract damages) and not having an indemnifying party being in breach of a contract, especially in circumstances where such breach could be out of its control.

M J Stevens