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BARRISTERS & SOLICITORS

"Releases and Indemnities (Shields and Swords)"

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International Council of Shopping Centers
- Canadian Law Conference
March 26-27, 1998

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RELEASES AND INDEMNITIES (SHIELDS AND SWORDS)

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RELEASES AND INDEMNITIES
(SHIELDS AND SWORDS)

A risk manager has three basic goals:

1. the transfer of risk in contracts such as leases, purchase orders, cleaning and maintenance, and other contracts, and in other contractual dealings with other parties with which the company does business.

2. purchasing and administering insurance for risk that can not be transferred.

3. prevention of loss through safety programs

This paper deals with the weapons that are used to accomplish the first of these goals. Contractual prior releases and indemnities are the shields and swords that the risk manager uses to reduce insurance costs, repair and replacement costs, legal liability costs, and the indirect costs associated with disruption due to litigation.

PRIOR RELEASE (EXCULPATORY) CLAUSES

An example of a prior release clause is attached as Exhibit "1". These clauses are inserted into contracts to serve as a shield against claims by other parties to the contract arising from personal injury, property damage, and business losses where the other parties might otherwise have legal rights to sue for compensation as the result of things that occur during the operation, or term of the contract. To be truly useful they need to be worded to protect not only the released party but also the officers, directors, and employees, of the released party. The Supreme Court of Canada decision *London Drugs Ltd. v. Kuehne and Nagel International Ltd.,[1992] 3 S.C.R. 299* has established that if a contract between an employer and a third party contains a limitation of liability the employees will be protected by the clause if:

1. the clause limiting liability expressly or impliedly extends the benefit to the employees seeking to rely on it; and

2. the employees act in the course of their employment and perform the very services provided for in the contract when the loss occurs.

It is suggested that the principle would apply to officers and directors of the party with the benefit of the limitation of liability as well.

Prior release clauses tread on a sensitive area. They entail the giving up of rights, and that makes most people nervous and suspicious. They are a red flag to the courts, warning against the possibility that language might be stretched or extended to deprive a person of rights that she or he might not have really intended to give up. The concern is heightened when the release is a prior release which is agreed to prior to the occurrence of the events that would otherwise give rise to the claim and the release involves excusing another party from negligence or other wrongful acts. In some jurisdictions in the United States prior releases in respect of negligence are not enforceable for public policy reasons and in others the clauses are strictly limited in application. In Canada they are enforceable but only if dealt with carefully. The article written by David Gillanders entitled "Exculpatory Clauses" at page 59 of the book, "Shopping Centre Leases" published in 1976 by Canada Law Book gives a useful overview of the attitude of the courts and legislatures in the United States and Canada relating to prior releases clauses.

To be effective these clauses must be drafted with great care and clarity. If there is any doubt about whether a person has agreed to give up rights that would otherwise be available, to sue for damage, the court will conclude that the person did not intend to do so. For example, it has been held that when a person releases another in respect of all claims for damages whatsoever, and however they arise, that does not necessarily mean that the person intended to exempt another from claims arising from the negligence of the other. Unless negligence is specifically referred to in the release clause,

there is a high probability that the court will assume that it was not intended that negligence be exempted. A recent case that illustrates this principle is the case of *Teasdale v. Cesario [1997] O.J. 114* in which Cosgrove J. states at paragraph 6;

> "A general release (exculpatory) purporting to protect a Defendant against damages has been confined in its application to loss occurring through causes other than negligence unless negligence is excluded in clear terms; such exclusion can be in terms that are explicit or implicit."

This reluctance to extend the intent of language in prior release clauses to situations or types of damage that are not clearly identified in the clauses, is doubly evident when gross negligence, or willful acts are involved, or where bodily injury occurs. It is difficult to imagine any situation where a court would be willing to find that a person intended to exempt another from the consequences of acting in a grossly negligent manner or from the consequences of deliberately hurting the person, even when there is clear language that purports to create such a release. The court would strive hard to find some means of finding that the clause did not really apply to the particular circumstance.

It should be noted too that if a prior release clause is contained in a general clause, or is located in a part of the contract that seems isolated from the particular category of acts or circumstances that give rise to a claim there will be a tendency to conclude that the parties did not intend to have the release clause apply to the particular act or circumstance that gives rise to a claim. For this reason it is common to find numerous specific release clauses in leases that deal explicitly with identified categories of claims in specific circumstances, even when there is elsewhere in the lease, a strongly worded prior release clause of general application.

THE PRINCIPLE OF IMMUNITY

There is an apparent exception to the reluctance of courts to imply an intention for one party to release another from claims for negligently caused property damage. A line of cases beginning with

the Supreme Court of Canada decision of *Ross Southward Tire Ltd. v. Pyrotech Products Ltd. (1975) 57 D.L.R. (3d) 248 (S.C.C.)* has established and developed the principle that if a party to a contract (which, for this purpose certainly includes a lease) agrees with another party to buy insurance to cover an asset, or the other party contributes to the cost of insurance on an asset, then in the absence of clear language to the contrary in the contract, (or lease) the other party is considered to be released from all damage to the asset, even if the asset is damaged due to the negligence of that other. The underlying rational for this principle is simply that in these circumstances the parties have agreed that compensation for damage to the asset is to be funded by a third party, an insurance company. Attached as Exhibit "2" of this paper, are summaries of two recent cases, which illustrate the trend. They are the cases of *Independent Tank Cleaning, a Division of By-Products Inc v. Zabokrzycki (c.o.b. Sign World) [1997] O.J. No. 764 (Ont. Crt.) (Gen. Div.) and Tony and Jim's Holding's Ltd, v. Silva, Ont. Gen. Div.[1997] O.J. No. 3744 (Ont. Crt.) (Gen. Div.)* . The former case sets out a set of seven principles to establish an implied waiver in connection with property insurance obligations. The latter case went so far as to "pierce the corporate veil" to give the benefit of an implied release to an individual that operated the business of a company which had signed a lease that required the landlord to insure property. The point to be taken from these cases is that when a lease or contract contains clauses that impose obligations to insure property, to contribute to the cost of property insurance (and these obligations may be merely implied), a release of liability in respect of property damage may exist although the party bound by the release did not really think about granting a release.

RATIONALE FOR PRIOR RELEASES

There are four main reasons why prior release clauses are included in leases:

The Reasonable Man is Not Really Human and He Doesn't Understand Business

1. It is often difficult to determine whether a particular act or omission amounts to negligence, or is really a wrongful act. The general test is whether a person's conduct in the

circumstances was reasonable. That is could the person reasonably have foreseen that her or his conduct was likely to cause harm to another to whom a duty of care is owed. To make this determination the courts refer to a hypothetical creature called the "reasonable man" whose virtue and carefulness often seem to border on that of the angels. The result is that whenever loss or damage occurs, someone is always able to make a case that the "reasonable man" would have avoided it. Consequently, litigation occurs in many situations where the conduct complained of does not truly carry the taint of moral turpitude, or blameworthiness that the general public would want to see the courts involved in. Business people generally prefer to avoid being drawn into disputes where there is little obvious blame, or where the conduct of the so called party at fault seems only marginally below the general expectations of the business community. To minimize these troublesome and often expensive disputes, it is better to obtain releases in advance (when they can be obtained) and, conversely in preference to resorting to the inefficient court process, to obtain recovery in respect of the person's own losses and damage from a source where fault does not have to be proven, (that is from an insurance company or an insurance fund). To summarize the thinking of shopping centre and building owners, tenants are to manage their own risks of property loss and damage by maintaining property insurance instead of trying to make the landlord responsible every time something happens to the tenant's property. On the other hand, tenants who pay the premiums on the landlord's property insurance policies, should not find the landlord suing them when the landlord suffers property damage, but should instead, obtain recovery from the insurance company.

When You Are Litigating You Are Not Doing What Your Business Does To Earn Profit

2. The costs of conducting litigation are very high, and these include substantial disruptive indirect costs. Filling out reports, consulting with expert and other witnesses, attending and preparing for examinations for discovery, reporting internally to supervisors and managers, liaising with and instructing lawyers, reviewing their bills, reviewing reports and transcripts and participating in court procedures, trials and the many other attendant

matters of litigation, sap valuable time, energy, and resources away from the main undertaking and goals of a business. This is true whether the plaintiff or the defendant's position is being advocated. Lost business opportunities, and project delays caused by these inefficiencies are often more harmful than the particular property loss or damage. A prior release should avoid these costs. Moreover, the party that gives the release may well benefit substantially if, as is common, the insurance policy allows the insured to grant prior releases. The insured party will be spared the cost and tedium of assisting its insurance company in litigating a subrogated claim against the party in whose favour the release is given after the insurance company has paid the claim.

Suing People Often Makes Them Angry

3. Suing your tenant or your landlord, places two persons in adversarial positions when they should regard themselves as allies in business. That may harm future business dealings, and preclude capitalizing on future opportunities.

Prior Releases Reduce Insurance Costs and Can Benefit the Releasing Party Too (Really)

4. If a landlord releases a tenant for damage to the premises and the parts of the building that are in the care custody or control of the tenant, the tenant is not required to maintain tenant legal liability insurance. Instead the landlord restores damage out of proceeds of the property insurance on the building and the premises. In net leases, the tenant pays the premiums, or a share of the premiums on the landlord's policy. This arrangement under which a tenant is released from damage for which the Landlord carries insurance, avoids the duplication of legal liability premiums. In addition if the landlord releases the tenant from liability for damage to the rest of the building, and instead resorts to the policy maintained by it at the tenants' expense, the tenant's need to carry high liability limits on its general liability policy is reduced. These cost savings reduce the tenant's cost of its space and may result in more money being available to pay rent. Conversely, if the tenants release the

landlord from damage to their property, the landlord's liability insurance costs can be reduced. Operating costs for the project are reduced when claims against the liability policy of the landlord are minimized and the entire group of tenants that pay these costs benefit from the higher deductibles, lower rates and lower upper limits that the landlord can achieve when it has the benefit of prior releases from its tenants.

INDEMNITY (HOLD HARMLESS) CLAUSES

A sample of a typical indemnity clause from a lease is attached as Exhibit "3". These clauses are like swords inserted into a contract to make another party assume responsibility for damage or loss for which the other party would not otherwise be legally liable. At first this might seem to be a form of robbery, but in practice it often amounts to a kind of Robin Hood situation where the rich (i.e. insurance companies) are forced to pay the poor (i.e. landlords and tenants). This is because generally, the funding of this assumed liability is intended to be achieved through the contractual liability endorsement of the Commercial General Liability Policy of the party giving the indemnity.

These indemnity clauses work in two basic ways:

1. They make suing easier by supplementing rights of recovery that might already exist when a contract is breached, or a duty of care is breached. When a plaintiff seeks recovery for damages, the defendant can raise a number of defences that the indemnity clause will try to eliminate. For example:

    (a) A party must mitigate its damages and recovery will be reduced where it fails to demonstrate that it has done so. This often entails lengthy, expensive and tedious efforts to establish that what could reasonably have been done by the plaintiff to reduce the loss flowing from the defendant's breach was in fact done. An indemnity clause is usually worded to avoid this defence.

(b) Before damage is recoverable in respect of a breach it is necessary to show that the damage was a reasonably foreseeable consequence of the breach. This also entails much effort and expense as the plaintiff and defendant dispute what could or could not have been reasonably foreseen by the defendant and accordingly the indemnity clause will seek to avoid or minimize this area of dispute by making the indemnifier responsible for all damage associated with a particular occurrence whether or not it was reasonably foreseeable.

(c) If a plaintiff sues a defendant for breach of a contract, or a breach of a common law or other duty of care, the defendant can often complicate, and delay the lawsuit by claiming over against third parties that might have a duty under contract or under negligence legislation to contribute to payment for the loss. Moreover the other party called into contribution might not be solvent, or might be a party against whom the plaintiff would prefer not to litigate. This problem too is addressed in indemnity clauses.

All of this makes the conduct of litigation for the party that has the benefit of an indemnity clause, much more manageable, and less expensive, by narrowing the scope of inquiry, and this enhances the chances of an early favourable settlement.

2. The second basic purpose of indemnity clauses is to impose liability on another party in circumstances where the other party might not otherwise have any duty or legal liability to the indemnified party. For example, it is typical for net leases to include a clause requiring the tenant to indemnify the landlord against all claims arising from occurrences on the leased premises. If a person is injured on the tenant's premises and, as often happens, sues the landlord in addition to the tenant, although the tenant may not be at fault in any way the indemnity clause requires the tenant to pay all the landlord's costs of defending the person's claim against the landlord, and must pay any claim that the injured person succeeds in establishing against the landlord. The simple fact that the injury occurred on the premises

leased to the tenant is sufficient to make the tenant responsible for the costs associated with the occurrence.

Principles of Interpretation

It is not surprising, since indemnity clauses entail a party's assuming responsibility and giving up defences that might otherwise be available, that the principles of interpretation applicable to them, as is the case with prior release clauses, work against broad application and against general, wide, scopes of protection. The more specific and direct the description of the category of event that the clause is expressed to protect against, the more likely it will be given full effect. Also, the courts will be reluctant to impose an obligation for one party to indemnify another where the other has been negligent, or has failed to take ordinary precautions against the loss for which it claims indemnity. In the Supreme Court of Canada decision *Consumers Gas Co. v. Fenn 18 C.C.L.T. 258* decided in 1981, Martland J. refers to the following indemnity clause in a contract:

> "3. The Company [Consumers] shall at all times wholly indemnify the City from and against all loss, damage and injury and expense to which the City may be put by reason of any damage or injury to persons or property caused by the construction, repair or operation by the Company of its works in the said City as well as against any damage or injury resulting from the imprudence or want of skill of the employees or agents of the Company in connection with the construction, repair, maintenance or operation by the Company of any of its works in the City unless the cause of such loss, cost, damages, injury or expense can be traced elsewhere."

Commenting on this paragraph, Martin J. states:

> "The proper interpretation of clause 3, in the context of the whole agreement, is that it is intended to indemnify the City against loss occasioned by acts of Consumers or of those for whom Consumers may be responsible in law.
>
> Furthermore, this clause does not state in clear and unambiguous language that Consumers is to indemnify the City against the results of the City's own negligence or of negligence for which it is responsible in law. Without such clear language, an indemnity clause ought not to be construed as conferring a right of indemnity for loss occasioned by one's own negligence (the principle is stated early in these reasons, along with two cases supporting it: Can. Lines Ltd. v. R., Supra and Smith v. South Wales Switchgear Ltd., Supra). We think the same rule applies to negligence of another for the results of which one is, in law responsible". [emphasis added]

These comments of Martin J. need to be kept in mind whenever an indemnity clause is being interpreted in the context where negligence might be involved.

RATIONALE FOR INDEMNITY CLAUSES IN LEASES

The rationale for indemnity clauses in leases is similar to that for including prior release clauses. As with prior release clauses the rationale can be explained by two basic notions.

The Reasonable Man Can Seldom Make a Decision Without a Team of Expensive Experts to Tell Him What Reasonable Men Do

1. Because of the uncertainty concerning what constitutes negligence and what does not, the indemnity clause seeks to employ a simple cut and dry objective test for determining when a party must pay claims. Adjustment and settlement of claims are much easier to achieve. Resorting to expensive court procedures is less likely to be necessary. The theory is that a party that has the benefit of an indemnity in respect of a specific event, in order to recover, need only establish that it has suffered a loss and that the loss arose from an occurrence that took place and is in the category of occurrences to which the indemnity applies.

Instead of Litigating You Get to Collect from the Indemnifier's Insurer

2. Since the Indemnity inserted into the contract is intended to be funded by the liability insurer of the party granting the indemnity, the likelihood that the indemnified party will require to sue to obtain recovery for compensation in respect of its property damage is reduced. The wear and tear on business relations between the parties (i.e. the landlord and the tenant) and the indirect concomitant costs of litigating are often greatly reduced by an indemnity. Instead of one party proving that another was at fault, it is only necessary to establish that an occurrence took place which caused damage to which the indemnity applies and for which the insurance company is required to pay.

TRIPS AND TRAPS

Lawyers involved in drafting and negotiating leases frequently fail to properly interconnect and mesh the prior release, indemnity, insurance, and other obligations within the lease document. The result is that there are inadvertent errors, overlaps, inconsistencies and duplications of liability or insurance cost. Increased costs of litigation and hampered loss settlement and adjustment flow from these inconsistencies. Attached as Exhibit "4" is a memorandum setting out examples of common errors. They illustrate the need for careful drafting. Prior releases and indemnity clauses are and will always be an integral and important part of commercial leases. However, if they are not dealt with in clear, concise, and direct language and in particular, if they are not analyzed from the perspective of internal consistency, they can cause more harm than good.

EXHIBIT "1"

SAMPLE PRIOR RELEASE CLAUSE

The Landlord shall not be liable for any death or injury arising from or out of any occurrence in, upon, at, or relating to the Lands or Development or damage to property of the Tenant or of others location on the Premises or elsewhere in the Development, nor shall it be responsible for any loss of or damage to any property of the Tenant or others from any cause, whether or not any such death, injury, loss or damage results from the negligence of the Landlord, its agents, employees, contractors, or others for whom it may, in law, be responsible. Without limiting the generality of the foregoing, the Landlord shall not be liable for any injury or damage to Persons or property resulting from fire, explosion, falling plaster, falling ceiling tile, falling fixtures, steam, gas, electricity, water, rain, flood, snow or leaks from any part of the Premises or from the pipes, sprinklers, appliances, plumbing works, roof, windows or subsurface of any floor or ceiling of the Development or from the street or any other place or by dampness or by any other cause whatsoever. The Landlord shall not be liable for any such damage caused by other tenants thereto, or the public, or caused by construction or by any private, public or quasi-public work. All property of the Tenant kept or stored on the Premises shall be so kept or stored at its sole risk and the Tenant will indemnify and save the Landlord harmless from any claims arising out of any damage to the same including, without limitation, any subrogation claims by the Tenant's insurers.

EXHIBIT "2" (PART 1 of EXHIBIT "2")

THE INDEPENDENT TANK CLEANING CASE

Courts are reluctant to interpret clauses so as to prevent one party from suing another for negligence. In certain jurisdictions of the United States, waivers of negligence are not enforceable because they are considered to be against public policy. In Canada they are enforceable but they must be worded with crystal clarity and waivers by inference or implication are generally not found.

There appears to be one major exception to this principle. Where a person agrees with another to insure an item of property, the Courts will imply that the other is released from liability for negligent damage to the item. Surprisingly, a line of cases seems steadily to be widening the kinds of clauses that will be treated as an agreement to insure with the result that a person is implicity released from liability for negligent damage to the item. The most recent in this line of cases is *Independent Tank Cleaning, a Division of By-Products Inc. v. Zabokrzycki (c.o.b. Signworld) [1997] O.J. No. 764.* Insurance companies have the right to sue persons that negligently damage property which they insure but this right is a subrogated right. It only allows the insurance company to sue if the insured person has the right to sue the negligent person for the damage. If the insured person has released the negligent person from liability, the insurance company cannot sue the negligent person either. In the Independent Tank Cleaning case, a landlord insured premises that were damaged by a fire and the insurance company that paid for the restoration sued the tenant claiming that the tenant's negligence caused the fire. The tenant had agreed to repair the premises but there was an exception for damage by fire, lighting and tempest. In addition, the tenant agreed that if its conduct of business in the premises resulted in increase in insurance premiums on the building, the tenant would pay the increased amount. The tenant also agreed not to carry on any business that might make the insurance held by the Landlord void. The tenant was also entitled to terminate the lease if the premises were damaged by fire and could not be repaired within 120 days, and to abate rent if the premises were not useable while they were being repaired.

It is significant that there was no express covenant by the landlord to pay insurance premiums or to insure.

The Court approved 6 principles that were initially set out in the dissenting decision of a Judge in the 1977 Supreme Court of Canada decision, *T. Eaton Co. v. Smith (1977) 2 D.L.R. (3d) 425 S.C.C.*:

1. A repairing covenant by the terms of which the tenant agrees to repair on notice "damage by fire excepted" does not exculpate the tenant from liability for a fire caused by its negligence;

2. The simple fact that the landlord has obtained fire insurance does not relieve the tenant of its obligation to make good the loss or cost;

3. The subrogation rights of the landlord's insurers are co-extensive with the recovery rights of the landlord under the lease;

4. If the landlord has waived its rights of recovery against the tenant in all circumstances, the insurer cannot recover from the negligent tenant;

5. Fire insurance, by definition, provides indemnity to the insured mentioned in the policy for both accidental fire and negligently caused fire (although not for gross negligence);

6. A clear covenant between landlord and tenant that the fire insurance to be obtained by the landlord will be for the benefit of both, will constitute a bar to the subrogation action of the insurer.

The Court then accepted a 7th principle which had been set out in the Ontario Court of Appeal decision, *St. Lawrence Cement Inc. Wakeman and Sons Ltd. (1995) 26 O.R. (3d) 321 C.A.* The 7th principle is that the agreement to be responsible for insurance can have no purpose other than to benefit the two parties to that agreement. (Presumably, however, the parties could expressly agree otherwise). The Court concluded that although, in this case, there was no express written agreement

between the landlord and the tenant that fire insurance would be obtained by the landlord for the benefit of both, the landlord had in fact agreed to insure the property against fire. The Court concluded that there was an inferential covenant in the leasehold arrangement that the landlord insure the property against fire and, as a result of that inference, there was a clear covenant between the landlord and tenant that the fire insurance would benefit both the landlord and the tenant. The tenant was therefore exempt from its negligence. This resulted in a bar to the subrogated action by the insurer.

Although at first, this trend to imply a release for negligence where there is a covenant to insure seems surprising it is actually a logical exception. The promise to insure indicates that the parties mutually agreed to fund loss to the item of property from a third party source (the insurance company). To allow one party to sue the other for recovery of loss to the item of property (even if negligence is involved) is unfair because the insurance company is required to pay for the loss regardless of whether the insureds (the persons benefitting from the policy) are negligent.

EXHIBIT "2" (PART 2 of EXHIBIT "2")

Tony and Jim's Holdings Ltd. v. Silva, [1997] O.J. No. 3744 (Ont. Crt.) (Gen. Div.)

In this case, the court "pierced the corporate veil" in order to provide the benefit of a waiver of subrogation to an individual carrying on business in premises leased to a corporate tenant.

A fire broke out in the premises leased to Mama Mia Pizza Ltd. and damaged the building. The Landlord's insurance company paid the claim for property damage, then made a subrogated claim against an individual who, according to the corporate records, was not a shareholder of the corporate tenant. He was the only one on the premises the morning of the fire.

The court found that the individual (Norman Silva) had been the directing mind of the business for many years and was in fact the individual with whom the landlord dealt during the tenancy. The landlord knew him to be operating the pizza business located in the leased premises.

Norman Silva had signed the lease for the premises as president of the tenant company and in addition, payments of rent for the leased premises "were topped up by the business' pro rata share of the costs of insurance; all as set out in the lease".

The court accepted the fact that the landlord could not sue its tenant and therefore the insurance company could not sue by way of subrogation. The case of *Ross Southward Tire Ltd. v. Pyrotech Products Ltd. (1975) 57 D.L.R. (3d) 248 (S.C.C.)* was cited as authority.

The issue before the court was whether it should lift the corporate veil in order to determine who was behind Mama Mia Pizza Ltd. (the corporate tenant) for the purposes of determining whether a subrogated insurance claim could be made. The plaintiff insurance company argued that since Norman Silva was not a shareholder of the corporate tenant, he was not entitled to be protected by the corporate veil.

The court held that in certain circumstances, justice requires lifting of the corporate veil and, in a case where an insurable interest has been demonstrated and where inequity would otherwise result, if the person would be prejudiced by the property's destruction by fire, relief should be granted.

Norman Silva could not be said to be a "stranger" to the contract of insurance. He and the corporate tenant had an "identity of interest". *London Drugs Ltd. v. Kuehne & Nagel International Ltd., [1992] 3 S.C.R. 299 (S.C.C.)* was cited for authority. The rights and liabilities contracted for between the insurance company and the landlord, in exchange for consideration, were contracted for in the knowledge and expectation that Norman Silva would be acting through, for, and as the personification of Mama Mia Pizza Ltd. The landlord knew that he was making pizza, selling pizza, and remitting through the corporate tenant, the business's pro rata share of the insurance premium. The landlord was aware of the risks of fire, insured against them, and the tenants of the project paid for their share of the protection against those risks. The risk of loss was placed directly on the landlord and through it by way of contract on the insurer. It was unreasonable to conclude that Norman Silva had somehow, by virtue of the incorporation, transferred the risk back to himself. It was reasonable to conclude that Norman Silva was one of the intended objects of the expected insurance benefits. *Greenwood Shopping Plaza Ltd. v. Beattie [1980] 2 S.C.R. 228 (S.C.C.)* was cited for authority. There were no principles of privity of contract breached or offended. The insurance company's subrogated claim was not sustainable.

EXHIBIT "3"

SAMPLE INDEMNITY

Notwithstanding any other provisions of this Lease, the Tenant shall indemnify the Landlord and save it harmless from all loss (including loss of Net Rent and Additional Rent) claims, actions, liability, damages, loss and expense in any way arising from related, or connected to loss of life, personal injury, damage to property or any other loss or injury whatsoever arising out of this Lease any breach of the Tenant's obligations under this Lease, or any occurrence in, upon or at the Premises, or the occupancy or use by the Tenant of the Premises or any part thereof, or the use by the Tenant or its customers and invitees of the Development or part thereof, or occasioned wholly or in part by any act or omission of the Tenant or by anyone permitted to be on the Premises by the Tenant. This indemnity is absolute and applies despite any allegation of negligence by the Landlord or failure to mitigate. If the Landlord shall, be made a party to any litigation commenced by or against the Tenant, then the Tenant shall protect, indemnify and hold the Landlord harmless in connection with such litigation. The Landlord may, at its option, participate in or assume carriage of any litigation or settlement discussions relating to the foregoing, or any other matter for which the Tenant is required to indemnify the Landlord under this Lease. Alternatively, the Landlord may require the Tenant to assume carriage of and responsibility for all or any part of such litigation or discussions.

EXHIBIT "4"
TRIPS AND TRAPS

These examples illustrate the extent of problems that are created for people who are required to manage insurance coverage for risks created by or transferred by a lease document. They should illustrate, as well, the cost inefficiencies and duplication that arise through internal inconsistencies and misunderstandings concerning the operation of releases, implied releases, indemnities and insurance obligations.

1. PRINCIPLE OF IMMUNITY

A line of cases beginning with the Supreme Court of Canada case, *Ross Southward Tire Ltd. v. Pyrotech Products Ltd. (1975) 57 D.L.R. (3d) 248 (S.C.C.)* has established and developed the principle of immunity under which there is a deemed release where one party agrees to insure an asset or where one party requires another to contribute to the cost of insurance for the asset. The result is that one party may inadvertently release another from claims for negligence.

2. EXPRESS SUBROGATION TRAP

Where one party to a contract expressly agrees to obtain a waiver of subrogation from the insurance company a risk is created. If a party has not released the other and a subrogation waiver is not obtained, there is a risk that the party who agreed to obtain the waiver from its insurer could be sued for a breach of that obligation if the insurance company makes a subrogated claim against the other party (i.e. landlord or tenant) who was to have the benefit of the waiver of subrogation. The result is the effective loss of insurance coverage. Note: the principle of immunity could work indirectly to provide the party that agreed to but failed to obtain the waiver, with protection in this situation by blocking the insurer from suing the other even though there is not an express waiver of subrogation. (There is an implied release as the result of party's agreement to obtain the insurance and to obtain the waiver.) However, if the party expressly reserved the right to hold the other liable

for negligence, no release is implied, the insurer can sue the party at fault, and the party that failed to obtain the waiver of subrogation from the insurer is in breach, and liable to be sued by the other party.

3. LANDLORD FLIP-FLOP

Landlord releases the Tenant from claims for damage arising from Tenant's negligence but the Tenant indemnifies the Landlord from all loss, cost or expense arising in any way in connection with the Tenant's use or occupation of the premises. This seems to negate the effect of the release. (The indemnity clause should be made expressly subject to the release clause.)

4. TENANT FLIP-FLOP

Tenant does not release the Landlord from negligence but Tenant does agree to indemnify Landlord from loss, cost or expense and all claims arising in connection with the Tenant's use or occupation of the premises. This seems to imply that Tenant can't sue Landlord for property damage. (The indemnity should exclude claims arising from Landlord's wrongful acts or negligence.)

5. FAULTY INDEMNITY TRAP

Tenant agrees to indemnify Landlord in respect of loss, cost or expense suffered by Landlord in connection with use or occupation of the Tenant's premises <u>but not where Landlord is negligent</u>. When damage occurs either to Landlord's property or when other property is damaged and Landlord is sued by third parties, Landlord does not know whether it has the benefit of protection under the Tenant's indemnity until the issue of negligence has been determined. This necessitates duplicate legal proceedings and legal costs and vitiates the value of the indemnity.

6. NAMED INSURED DEDUCTIBLE TRAP

Tenant agrees to add Landlord as a named insured under its liability policy (not as a mere additional insured in respect of vicarious liability but a "named insured"). Tenant agrees to obtain a waiver of subrogation under its property insurance policy but expressly reserves the right to sue the Landlord for negligence in order to ensure that it is able to recover its deductible if the Landlord is negligent. Tenant suffers damage, obtains recovery from insurer in excess of the deductible and sues the Landlord for the deductible. Landlord claims coverage under the Tenant's liability insurance policy and Tenant's liability insurer pays the deductible.

7. NAME INSURED INDEMNITY TRAP

Tenant agrees to name Landlord under its liability insurance policy (again as a named insured and not merely as an additional named insured in respect of vicarious liability) but fails to do so, or adds Landlord only as an additional insured in respect of vicarious liability. Landlord is sued in connection with its negligence pertaining to an occurrence on the leased premises and claims recovery under the Tenant's liability insurance policy. Tenant's liability insurer denies coverage. Landlord sues Tenant for breach of its obligation to provide liability coverage to Landlord. Tenant is, in effect, required to indemnify Landlord.

8. DOUBLE INSURANCE TRAP

Tenant agrees to maintain and repair the premises but the Landlord is required to take responsibility for structural repairs. Tenant is responsible for insuring the premises for the full replacement cost. Damage occurs and Tenant insists on Landlord repairing the structure although Tenant has insurance for full replacement cost of premises. The effect is that Landlord needs to carry, or should have carried, property insurance for the structure. This results in overlapping duplicate insurance coverages.

9. FAULTY RENT ABATEMENT TRAP

Landlord agrees that Tenant does not have to pay rent if premises are damaged by fire or other peril and are not tenantable but rent abatement does not apply if tenant is negligent. When premises are damaged by fire or other peril, the issue of negligence must be determined before Landlord and Tenant know whether Tenant is responsible to pay rent. This results in needless litigation.

10. SELF-INSURANCE - DEEMED INDEMNITY TRAP

Instead of agreeing to carry property insurance (or in some cases even liability insurance), Tenant agrees that it will self-insure and the lease is amended to indicate that Tenant will be deemed for all purposes to have taken out insurance as required under the lease. The premises, including leasehold improvements owned by Landlord are damaged and Landlord or Tenant exercises right to terminate the lease instead of restoring. Landlord requires Tenant to pay to Landlord actual cash value of premises including leasehold improvements. The effect is that Tenant is more than simply a self-insurer but also an insurer for the benefit of Landlord.

SHOPPING CENTRE INSURANCE

POLICIES AND LEASES

by

CHRIS STEER

This presentation deals with the kinds of insurance that reasonably well advised Landlords and Tenants will carry and which are likely to be referred to in leases.

The first part of the presentation talks about these coverages in what I hope is a fairly non-technical way and is in any event designed to clear away some of the mystery with which we who are in the insurance business surround what we do for a living.

I've included an example of lease language drawn up in my office for clients in time gone by. These things, of course, vary greatly from one property to the next and one Tenant to the next and the one enclosed is, again, an example, possibly imperfect, of the art of drafting insurance clauses.

It is really there to emphasize the need for language that will produce the desired result. In insurance terms that means the use of expressions that are readily understood by insurance brokers and insurance companies and point them directly without ambiguity to the sort of insurance policy that is desired. When you are drafting a clause whose intent is to be put into effect by people in a business that has its own jargon, it's just as well if you seek help from somebody who speaks it.

As one reasonably proficient in the language, let me now begin to tell you about Landlords and Tenants Insurance more or less in the order that these coverages are apt to be dealt with in leases.

As follows:

BUILDING & CONTENTS INSURANCE

The Landlord is seeking to insure against the possibility of damage to its building, fixtures, equipment and leasehold improvements.

The Tenant is seeking to insure whatever it is that belongs to it that is in that building which may be inventory, trade and office furniture and fixtures and leasehold improvements installed at the cost of the Tenant or which, in the event they are damaged, the Tenant will be responsible to replace.

Financing / Acquisition Issues - ICSC March 27

Lender Issues when underwriting debt

Term
- Corporate Debt Profile
- Market Demand

Interest Rate
- fixed - setting the rate
- floating - BA's, Prime based

Loan to Value
- Appraisal

Rating
- DBRS et al
- quality of cash flow
- tenancy profile

Liability
- several versus joint & several
  joint & several security with several covenants.
- recourse versus non-recourse

Environmental
- availability of current physical surveys
  - asbestos
  - PCBs
  - CFCs
- requirement for remedial action (ie. regulatory reqmt vs. Lender reqmt)
- access to tenants premises provided for in lease?
- responsibility for remedial costs (anchor tenants)?

Structural
- availability of current surveys
  - parking
  - roof
  - HVAC

Management
- ability to change

Sale/ Transfer
- release of covenant
- due on sale

Covenants
- property specific
- maintenance tests

Space Leases
- co-tenancy clauses
- assignment of leases as security
  - restrictions on dealing with
    - shortening term
    - surrender
    - change in monetary terms
    - release of covenant
- early termination / go dark clauses

Tenant Estoppels
- requirement by lender
- provided for in leases

Ground Leases
- remaining term

- leasehold mortgage provisions - priority / subordination issues

Prepayment - conventional mortgage versus mortgage bond

Sources of Capital
- capital markets
- conventional mortgage market
- bank financing

Due Diligence
- process

WHAT THE PURCHASER AND/OR LENDER ARE LOOKING FOR

Key Lease Clauses/Issues
Value vs. Risk

Covenant
- tenant
- indemnifier
- security deposit/letter of credit
- assignment provisions
  - release of liability
  - right to re-take/terminate
  - right to increase rent

Term
- options
  - market rent
  - then current lease form

Rent
- minimum
- percentage
  - exclusions from gross revenue
  - right to audit
  - payable monthly/quarterly
- operating costs, taxes, utility charges
  - net lease clause
  - standard definitions
  - exclusions
  - caps
- advertising/promotion contributions
- prepaid rent
- free rent periods
- abatement
  - damage and destruction
    - substantial destruction to centre
    - destruction to premises
    - inability to restore within ____ days
  - expropriation
  - failure of utilities
  - % of CRUs and/or anchors not open for business
  - premises not available or work not completed

Operating Covenant
- for the term or?

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Options to Terminate

- damage and destruction
- % of CRUs and/or anchors not open for business
- failure to achieve sales expectations
  - notice period
  - consideration

Use Clauses
- merchandise mix

Damage & Destruction

- obligation to rebuild
  - partial destruction
  - substantial destruction

Restrictive Covenants

- exclusive use
- right of first refusal/first offer
- "no build" area
- relocation clause
- option to purchase
- right to expand
  - zoning
  - parking
  - construction
  - rent

Set-off, abatement, counterclaim

Subordination, Non-disturbance, Attornment

Estoppel Certificates

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