ICSC CANADIAN LAW CONFERENCE

APRIL 30 – MAY 1, 2018

Are You Released? Are You Indemnified?

How Do Releases and Indemnities Fit Together?

Prepared by: Jory Grad
Owens Wright LLP
Toronto, Ontario

The parties to a commercial lease typically allocate risk through numerous provisions of the lease, including, but not limited to, the repair, insurance, indemnity and release clauses. These clauses, in addition to the damage and destruction clause, should be drafted in harmony to ensure that risk has been allocated consistently. Caution must be taken as, absent explicit language, risk may be implicitly allocated pursuant to rules of contractual interpretation or common law.

Most net commercial leases are drafted so that the tenant is liable for the risk of property damage and liability claims. The landlord typically pays for its insurance coverage over the building, and the tenants of the building contribute to the landlord's insurance premiums through operating costs. By allocating the risk of property damage and liability to the tenant, the landlord is able to keep its insurance premiums low, which helps to control operating costs.

Risk can be allocated in the lease through waivers of subrogation, indemnities and releases. While the entire lease must be prudently reviewed prior to execution, these three areas necessitate special attention so that potential damages and losses are assumed as intended.

Basic Concepts

Liability

Liability can arise through common law rules (i.e. negligence or vicarious liability), or through breach of statute, contract or trust. Where one party to a lease suffers a loss for which the other

party is liable at law, the party who suffered the loss has the right to sue the other in respect of that loss *unless that other party has been released from its liability*.[1]

Insurance

Insurance is the primary form of risk management used in commercial leasing. Often, parties to a commercial lease must obtain insurance to fund certain unforeseen financial risks and obligations. Landlords typically insure against damage to the building and common areas, interruption of rental income arising from such damage, and liability for the landlord's operation and management of the property. Tenants are usually required to insure against damage to the leased premises, including improvements, fixtures and personal property, interruption of sales revenue arising from such damage, and liability for the tenant's operations in the leased premises.

Subrogation

After making payment of a claim, the insurer will often bring an action against the party that is responsible for the loss. "Stepping into the shoes" of the insured in this manner is called subrogation. Subrogation applies to claims in both contract (through a contractual indemnity) and tort (through negligence). The great majority of commercial leases require the tenant to provide a waiver of subrogation to the landlord. If obtained, the waiver of subrogation will prohibit the insurer from "stepping into the shoes" of the insured. The insurer may also be restricted from subrogating against the party responsible for the loss if there is an express or implied release of such party in the lease.[2]

---

[1] Dawn Michaeloff, *Insurance and Risk Management in Commercial Leasing*, (Aurora: The Cartwright Group Ltd., 2009) at p 52.
[2] See *Greenwood Shopping Plaza Ltd. v. Neil J. Buchanan Ltd.*, [1980] 2 S.C.R. 228, 111 D.L.R. (3d) 257.

Exculpatory Clauses and Releases

Exculpatory clauses and releases allocate risk in the event that one party to a lease has a claim against the other. They serve as a "shield" against personal injury, death, property damage and economic loss.[3] Without such clauses, the party who is liable for a loss is exposed to a potential law suit from the suffering party. Exculpatory clauses relieve one party of liability to the other for injury, loss or damage suffered. Releases are a subset of exculpatory clauses whereby liability is assumed and released. Exculpatory clauses and releases are used by landlords to carve out liability for damage to the tenant's leased premises or personal property, and for personal injury suffered by the tenant in the leased premises or shopping centre.

Indemnities

An indemnity is a transfer of risk between two parties to compensate for a loss that may occur in which the indemnifying party would not otherwise be liable. Indemnity clauses in commercial leases allocate risk by protecting against the effects of an act, a contractual default or, in some cases, another party's negligence. Most landlord-drafted commercial leases will require a contractual liability endorsement from a tenant as part of the tenant's general liability insurance coverage. Typical indemnity clauses also allow for recovery of full legal fees.

[3] Dawn Michaeloff, *supra*, footnote 1 at p 57.

Contractual Interpretation

Both releases and indemnities are interpreted narrowly by the courts.[4] A broadly drafted clause is at risk of being interpreted unfavourably against the party with a claim. Conversely, a specifically worded clause may only protect against specific circumstances. This has given rise to the more all-encompassing release and indemnity clauses often seen in modern commercial leasing. As in other commercial contracts, *contra proferentum* rules apply to construe an ambiguous clause against the drafter. Additionally, unclear clauses may be interpreted against the party receiving its benefit[5].

Implied Releases (The Principle of Immunity)

For many years, Canadian courts have found that a release of liability would not apply where the loss arose from the negligence of the party being released. Only express language in a commercial lease would protect the party being released from its own negligence. Forty years ago, three Supreme Court of Canada cases[6] (known colloquially by the commercial leasing bar as the "Trilogy") created an implied release that is known as "the principle of immunity". This principle provides that, even without express release language in the lease, a contractual obligation to obtain insurance or to contribute to the cost of insurance can be considered to be an implied release. The presumption is that by purchasing or contributing to the cost of insurance, the contractual parties

---

[4] See *Adler v. Dickson*, [1955] 1 Q.B. 158, [1954] 3 All E.R. 397. See also *Terminal Warehouses Ltd. v. J.H. Lock & Sons Ltd.* (1958), 12 D.L.R. (2d) 12 (Ont. C.A.). See also *Broben Investments Ltd. v. Cadillac Contractors & Developments Ltd.* (1961), 31 D.L.R. (2d) 402, [1962] O.R. 207 (H.C.J.). See also *Elfassy v. Sylben Investments Ltd.* (1978), 91 D.L.R. (3d) 96, 21 O.R. (2d) 609 (H.C.J.).

[5] See *Canada Steamship Lines Ltd. v. The King*, [1952] 2 D.L.R. 786, [1952] A.C. 192 (P.C.).

[6] *Agnew-Surpass Shoe Stores Ltd. v. Cummer-Yonge Investments Ltd.*, [1976] 2 S.C.R. 221, 55 D.L.R. (3d) 676; *Ross Southward Tire Ltd. v. Pyrotech Products Ltd.*, [1976] S.C.R. 35, 57 D.L.R. (3d) 248; *T. Eaton Co. v. Smith*, [1978] 2 S.C.R. 749, 92 D.L.R. (3d) 425.

must have intended for such insurance to fund the insured loss, regardless of negligence. The principle of immunity has created an implied release, which can be rebutted by express language to the contrary. The principle of immunity can be in favour of landlords or tenants. Most net commercial leases include a covenant for the tenant to maintain insurance to cover for loss or damage to its premises, fixtures, equipment and personal property. This creates an implied release in favour of the landlord for any loss or damage caused to the tenant's premises, fixtures, equipment and personal property, even if such loss or damage arises from the landlord's own negligence, and the resulting loss or damage will be funded by the tenant's insurance. At the same time, most net commercial leases require landlords to insure the shopping centre as a whole with recoveries of the landlord's insurance premiums paid for by all tenants through operating costs. This creates an implied release in favour of the tenant, and any damage to the shopping centre caused by the tenant's negligence is thought to be funded by the landlord's insurance. As mentioned above, the existence of an implied release will also prevent the insurer from subrogating against the negligent party that was responsible for the loss or damage.

It is therefore extremely important for both parties to the commercial lease to clarify the intended risk allocation regime by using clear and express language in the insurance and release clauses. Absent clear and express language, the common law principle of immunity will apply.

The Third-Party Beneficiary Rule

Because both landlords and tenants are, either at law or by contract, responsible for the acts and omissions of various third parties, releases are generally drafted to extend the protection of the release to such third parties, such as officers, directors, agents, employees and property managers.

Despite efforts of commercial lease drafters to expressly describe such benefits in a release clause, the common law doctrine of privity may prohibit third parties that are not party to the contract from enforcing the contract to their benefit unless an exception to this rule applies. This is generally known as the third-party beneficiary rule, and the common exceptions are agency or trust. To gain exception to the third-party beneficiary rule, commercial lease drafters insert language whereby the release applies to various intended third parties, and that the released party (who is also a party to the lease) acts as trustee or agent for such third parties to enforce the release.

The third-party beneficiary rule applies to both express and implied releases, but the willingness of the court to extend the benefit of the release to third parties is determined by the applicable facts. For example, the Supreme Court of Canada[7] has carved out an exception to the doctrine of privity if (i) the parties to a contract intended that the benefit of a release extend to the third-party seeking to enforce the benefit of the release, and (ii) the activities performed by such third-party are the very activities falling within the scope of the contract. In other cases,[8] the courts have not extended such a benefit where the parties seeking to enforce the release were complete strangers to the contract and not intended third party beneficiaries. In other instances, the court has made an exception to the third-party beneficiary rule when doing so would not respect the risk allocation among parties to commercial contracts.[9]

---

[7] See *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*, [1999] 3 S.C.R. 108, 176 D.L.R. (4th) 257.
[8] See *Greenwood Shopping Plaza Ltd. v. Neil J. Buchanan Ltd.*, [1980] 2 S.C.R. 228, 111 D.L.R. (3d) 257.
[9] See *Williams-Sonoma Inc. v. EllisDon Corporation*, 2012 ONSC 5448 (this case involved water damage to certain a tenant at a Toronto shopping centre. The damage was caused by vandals entering a section of the centre under construction, leaving a fire hose uncapped which led to flooding. Ellis Don was the general contractor for shopping centre renovations in charge of this space and the tenant commenced an action against it for damages suffered. The court held that, while the doctrine of privity holds that a person must be a party to a contract in order to benefit from it, such doctrine did not apply in this case. To prevent a third party from relying on a release clause, as was found in the tenant's lease, would ignore the practical realities of insurance.)

Drafters of commercial leases should insert agency and trust language if third parties are intended to rely on the release clause; however other clear language may also be of assistance should agency and trust not be determined.

Waiver of Subrogation

Most commercial leases that are drafted on landlord forms include a waiver of subrogation in favour of the landlord. This waiver from the tenant's insurer will prevent the insurer from subrogating against the landlord after a claim is paid out where the loss arises from the landlord's negligence. Some larger tenants may also try to negotiate a waiver of subrogation in their favour. The tenant, who under a net lease is making contributions to the landlord's insurance premiums, has already, in effect, "paid" for its share of the premium so it is understandable that paying again for an insured loss would be unpalatable. However, the landlord's insurance policy may not allow for waivers of subrogation, or if such waivers are available, the cost of the landlord's premiums may increase. This scenario would be unacceptable to the landlord. Additionally, the tenant's argument based on contribution to operating costs fails to consider the investment the landlord has made that makes available premises for the tenant to earn its profits.[10]

Including "waiver of subrogation" language in the tenant's insurance clause of a commercial lease is not entirely sufficient for landlords for the following reasons: the tenant may not actually obtain the waiver in its insurance policy (this must be verified by the landlord upon review of its tenant's insurance policy or certificate); waivers of subrogation only apply to insured losses (again, it is the

[10] Maurice Audet, paper titled "Mutual Waivers and Leases", delivered in the 2015 International Council of Shopping Centers Canadian Law Conference.

landlord's responsibility to review its tenant's insurance policy or certificate to confirm that all required coverages in the required amounts have been obtained); the loss may be lower than the tenant's deductible or exceed the insurance proceeds; or the policy may no longer be valid. For these reasons, the landlord should ensure that there is express release language in its form of lease.

Releases

A typical net commercial lease is designed to have insurance fund the majority of losses. But what if insurance is not applicable, or if the loss exceeds the insurance proceeds available? A waiver of subrogation will protect the party causing the loss from being sued by the insurer paying the insurance claim, but will not otherwise be sufficient. Therefore, the release clause should be drafted consistently to apply the same concepts. There is a presumption that the release clause will not release the releasee from negligence unless it is specifically stated so within the language.

As mentioned above, the release clause language often expressly includes a large variety of potential events, in addition to general release language, to best ensure wide interpretation. Express language is commonly inserted to apply the release to negligent acts and even to gross negligence, although that latter term is a question of fact that has been given various interpretations by the courts. If specific language is not included, the releasee will likely not be released if it negligently causes loss or damage. Additionally, because of the case law relating to the third-party beneficiary rule, the release should extend to specific third parties with the primary releasee acting as a trustee or agent on such parties' behalf.

There is some leeway for the drafter of release clauses to follow the risk allocation regime of the lease and/or shopping centre. Releases can be mutual or unilateral. They can be unqualified or limited, and the limitation can be in the form of type of loss (i.e. losses or damages that are required to be insured against or not) or value (often the limit of insurance coverage).

Prior to the Trilogy, most commercial leases allocated risk based on fault with negligence rather than cause determining who bore the risk of loss. Now that implied waivers are generally accepted by courts, reciprocal releases are more common and are geographical in nature. When preparing mutual releases in respect of insured loss, thought must be given to the insurance clause of the lease so that all intended losses are insured for. But it does not end there. The lease is a long-term governing document. It is important to confirm that the coverage has all been obtained and is maintained throughout the term. Further, if a mutual release of this nature only refers to insurance proceeds *received*, the released party would be exposed should the releasing party void its insurance coverage for some reason. The parties should clarify if the release is intended to apply to the deductible amount as well.

In multi-tenanted shopping centres, landlords still tend to allocate risk to the tenants in order to keep insurance premiums low. A single event with damages payable to all tenants would be calamitous for a landlord, which is why releases in the tenant's favour are typically qualified. When releases are unilateral in favour of the landlord, the tenant's indemnity should be drafted consistently and broadly to cover all losses which the parties have allocated to the tenant.

Indemnities

As briefly discussed above, indemnities are transfers of risk between two parties to compensate for a loss that may occur in which the indemnifying party would not otherwise be liable. They are used as a further method of allocating risk. As with release clauses, indemnity clauses should be drafted clearly to apply to specific situations.[11] Also, similar to releases, unless the indemnity is drafted to include the negligence of the indemnified party, protection will not likely be extended to losses from such causes. In some situations, landlords will insist on being indemnified even for their own negligence, and if the lease is consistent and the tenant has obtained a contractual liability endorsement to its commercial general liability clause, and if the landlord is added as an additional insured under such policy, the tenant's insurer would respond to a claim for the landlord's negligence.

It should be noted that, unless drafted into the indemnity clause:[12]

(i) The party that will benefit from the indemnity is under no obligation to mitigate its damages or to involve the party who has provided the indemnity in the settlement of an action;

(ii) There is no control over legal costs;

(iii) In cases when the damage is caused by a third party, the party that granted the indemnity has no rights to sue the third party;

---

[11] See the *Canada Steamship* case, *supra*, footnote 5, where the Supreme Court of Canada narrowly interpreted a broad indemnity clause. Also see *Agnew-Surpass Stores Ltd. v. Cummer-Yonge Investments Ltd.* [1976] 2 S.C.R. 221, 55 D.L.R. (3d) 676, where the Supreme Court of Canada refused to enforce a broad indemnity where the indemnity clause conflicted with the general repair covenant of the lease.

[12] Dawn Michaeloff, *supra*, footnote 1, at p 88.

(iv) The party that granted the indemnity could be required to indemnify for damages caused by the tortious acts of persons for which it would not ordinarily be liable for at law; and

(v) The party that granted the indemnity could be exposed to greater damages than it would otherwise be exposed to at law.

It has been recently held by the Ontario Court of Appeal[13] that the principle of immunity developed by the Trilogy would prevail over an explicit indemnity in the lease. In that case, there was an implied release in favour of the landlord due to the tenant's covenant to insure. This implied waiver governed over an explicit indemnity by the landlord in favour of the tenant.

Often landlord forms of commercial leases will contain tenant indemnity clauses covering "any and all loss", which includes both foreseeable losses such as property damage, and unforeseeable consequential damages. This expands the indemnitor's exposure from what it otherwise would be at law. A limitation inserted by tenant's counsel would not be unreasonable, but would be highly dependent on bargaining power. Most landlords will not agree to indemnify the tenant, however based upon bargaining power, a limited indemnity (damages not within the leased premises where the landlord is at fault) may be available for some tenants. Lastly, in leases using mutual releases, the indemnities provided should be subject to the release clause to maintain the intent of the mutual release.

[13] *Deslaurier Custom Cabinets Inc. v. 1728106 Ontario Inc.*, 2016 ONCA 246.

Conclusion

Drafters of commercial leases must pay careful attention to the insurance, release and indemnity clauses, and the interplay between them, especially in light of the principle of immunity, which is not always expressly stated. The lease should be negotiated carefully to ensure that the consistency among these clauses is maintained.