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When It Comes to Insurance Clauses, Don't Automatically Assume Assumption of Risk

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Commercial contracts frequently include both indemnity and insurance clauses.

An indemnity clause is a provision by which one party (the indemnifier) agrees to compensate another party for financial losses or damage that it may suffer in specified circumstances. Those circumstances vary from contract to contract, but often the indemnity clause will require the indemnifier to cover losses related to claims and lawsuits arising out of the parties' contract or out of the indemnifier's performance of the contract. Indemnity clauses will generally require the indemnifier to defend the other party in the event of litigation, meaning that the indemnifier must cover the other party's legal costs.

Insurance clauses are provisions in which one or more parties agree to take out an insurance policy against certain risks. Often, the insuring party is required to name the other party or parties to the contract as insureds on the insurance policy.

While the indemnifier and insuring party in respect of a particular risk will be the same party in many contracts, that is not always the case. What happens if one party has agreed to indemnify the other for a certain event, but the other party has agreed to insure against that same event? Which party is ultimately responsible for bearing the cost and damage in that case?

In most cases, a covenant to insure will result in an assumption of risk, but the recent decision in *Capital Sewer Servicing Inc. v. Crosslinx Transit Solutions,* 2022 ONCA 10, should encourage contracting parties to take a close look at the interplay between insurance and indemnity clauses.

In this decision, Justice Doherty found that a promise to insure against a risk was not an assumption of any and all damages, should that risk materialize.

Background

The dispute in *Capital Sewer Servicing* involved three contracts.

First, Crosslinx Transit Solutions General Partnership ("Project Co.") entered into a contract with Metrolinx and other government agencies (the "Project Agreement") in which Project Co. agreed to complete work on a light rail transit project in Toronto. Second, Project Co. contracted with its subsidiary Crosslinx to carry out construction projects for the light rail transit line (the "Construction Contract"). Third, Crosslinx retained Capital Sewer Servicing as a subcontractor to perform work relating to the sewer system (the "Subcontract").

Both the Project Agreement and Construction Contract included insurance clauses requiring Project Co. to maintain wrap-up insurance and name all contractors and subcontractors in the insurance policies as insureds, including both Crosslinx and Capital.

The Subcontract incorporated by reference the terms of the Construction Contract, subject to "changes necessary to give full effect to the intent of the Parties…and to the express terms and conditions [of the Subcontract]."

Under the Subcontract, Capital was required to maintain commercial general liability insurance in parallel to the insurance that Crosslinx and its parent company had to maintain under the Project Agreement and Construction Contract.

The Subcontract also included an indemnity clause pursuant to which Capital agreed to indemnify Crosslinx for all claims and related costs.

On February 21, 2018, the sewer system that Capital had completed work on backed up, damaging three private properties. The property owners sued both Capital and Crosslinx.Energy & Utilities

Crosslinx brought an application for a determination that Capital had a duty to indemnify it under the terms of the Subcontract. Capital subsequently brough a cross-application seeking a declaration that it had no obligation to indemnify or defend Crosslinx. Capital argued that Crosslinx had assumed the risk of the damage as the insurance provisions in the Construction Contract were incorporated by reference into the Subcontract.

Application Judge's Decision

The application judge noted that the insurance provisions in the Project Agreement and Construction Contract generally favoured Capital's position, while the indemnity provisions in the Subcontract supported Crosslinx's interpretation of the contracts.

The application judge ultimately concluded that Capital did have a duty to indemnify and defend Crosslinx in the property damage litigation, except to the extent that liability was due to Crosslinx's own negligence.

Capital appealed this decision to the Court of Appeal.

Appellate Decision

On appeal, Justice Doherty acknowledged that in most circumstances, if a party has undertaken to insure against a particular risk, it is reasonable to infer that this party has agreed to cover any damages flowing from the materialization of that risk. He stated, however, that this does not amount to a freestanding legal rule or principle. As a matter of law, the assumption of risk does not always follow an obligation to insure against that risk.

Even where a contract expressly imposes insurance obligations on a party, the court must consider the language of the contract as a whole in the factual context of the dispute to determine the parties' mutual intention with respect to allocation of risk.

In this case, the application judge aptly noted that the insurance clauses in the Project Agreement and Construction Contract were incorporated into the Subcontract, subject to "changes necessary" to give effect to the parties' intent and to the express terms of the Subcontract itself. The parties' shared intent was reflected in the Subcontract's express and "strongly worded" indemnity clause in favour of Crosslinx. Moreover, the Subcontract imposed insurance obligations on Capital, including to take out commercial general liability insurance. Justice Doherty cited with approval the observation made by the application judge when he noted that Capital, by agreeing to take out commercial general liability insurance, had "on its own argument, assumed liability for the risk of its own negligence."

Justice Doherty ultimately upheld the application judge's decision. The application judge had reasonably assessed the interplay between the three contracts before concluding that Capital had a duty to indemnify Crosslinx for the property damage claims.

Key Takeaways

Even where another contracting party has taken out insurance or promised to do so, commercial parties may still have financial and legal exposure for injury or loss to third parties arising out of their business projects.

Parties should therefore carefully review contracts and examine the strength and specificity of any indemnity clauses and insurance provisions. The wording of those provisions may make a world of difference in a court's determination as to allocation of risk.

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