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Indemnities, Gross Negligence and The 'Accidental Insurer' – A Commentary

"Despite the prevalence of indemnity clauses in modern contracts, it appears that the task of drafting, negotiating, reading and understanding indemnities may be getting more complex." [36]

"Indemnity clauses are within the common contracting experience of Australian business. Despite this commonality, there is little consistency in drafting, and their meaning is often misunderstood." [37]

"Express contractual indemnities are to be found in nearly all leases, contracts for sale, loan documents, security documents, services contracts and in many other agreements…yet despite this, their legal nature and effect are surprisingly nebulous." [38]

Introduction

The genesis of this session of the Conference lies in discussions Professor Carter and I had in the context of a paper I prepared on the subject of indemnities in early 2007.[39]

Without any empirical evidence whatsoever, I would venture to guess that almost every practitioner at this Conference has, in the last month, drafted, negotiated or reviewed a document that contained an indemnity. It may have been a major part of the document, or it may just have been an ancillary clause, sitting quietly, unnoticed and unloved, as part of the so-called "boilerplate".

Most of us in banking and finance practice like to consider ourselves competent and knowledgeable contract lawyers and drafters, who do a fine job for our clients. We know indemnities, we've worked with them for years, we surely have mastered them and their many useful and helpful ways. We know all the tricks and negotiating points, right?

It is trite to say that the main objective of a negotiated indemnity is to allocate risks as between consenting parties in a managed and certain way, but that is certainly the theory. That proposition, of course, assumes that the negotiating parties are aware of the variables, and that the law will support them with clear rules that are consistently applied. After all, business craves certainty.

But we have just heard Professor Carter, a leading contract law academic and commentator, use an analysis of one particular type of indemnity, the "party-party" indemnity, as a vehicle to demonstrate a somewhat worrying fact about indemnities generally - that, despite being widely used in Australian commerce:

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36 Lithgow, C and Neal, L "Contract Law in Practice - 2005 in review - penalties, indemnities and so much more"(2006) 2(10) CMP 148.

37 Gosewisch, D "Difficulties with indemnities between business entities" (2006) 34 ABLR 89.

38 Zakrzewski, R "The Nature of a Claim on an Indemnity" (2006) 22 JCL 54, at 54.

39 Subsequently published as D'Angelo, N, "The Indemnity: It's All in the Drafting" (2007) 35 ABLR 93.

- they have stubbornly defied attempts at precise definition and consistent analysis, largely because they are creatures of almost infinite flexibility;[40]
- the mere use of the word "indemnity" in a clause or document does not assure a certain outcome in relation to effect, operation or remedy;
- the quantity, quality and consistency of available judicial discussion does not reflect their degree of use and importance in Australasian commerce; and
- there is a surprising level of uncertainty at even the most basic level.

This is indeed, as Professor Carter observes, a rather alarming state of affairs.

In his conclusions, Professor Carter has very helpfully pulled together the various and disparate strands presented by the cases into a very useful summary of principles, at least in relation to indemnities where the promise is unqualified.

But, by his own admission, that summary is not, and cannot be, exhaustive - in this area, there are more questions than answers.

Indemnifying someone against their own negligence - including by "accident"

Even as the ripples from Professor Carter's presentation are making their way across the surface of the pond, I propose to throw in yet another stone.

I want to briefly consider further issues around what the Professor describes as "bare" indemnities,[41] using 2 examples in common enough use. The discussion raises the practical questions of whether to include a carve-out for negligence, and the related question whether it is it worth fighting over the difference between "negligence" and "gross negligence" in negotiating such carve-outs.

The core questions are these:

- to what extent can a person be indemnified for their own negligence and what rules apply to the drafting and interpretation of such indemnities?
- is there a difference between negligence and "gross negligence"?
- can you be held to indemnify someone against their own negligence without actually intending to do so?[42]

40 As opposed to, say, "mortgages", a term which, within a narrow range of variation, is universally understood in the English common law world as to meaning and effect.

41 A "bare" indemnity is where 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.

42 Remember that the fundamental basis of contractual construction is the "objective rule", ie the analysis of the intention of the parties, and the legal rights and obligations under the contract, turn on what their words and would be reasonably understood to convey, not upon actual or subjective beliefs or intentions: *Equuscorp Pty Ltd v Glengallan Investments Pty Ltd* (2004) 218 CLR 471. In other words (as counterintuitive as it may seem to commercial persons), in endeavouring to ascertain the intention of the parties, the actual intention of the parties is not only not determinative, it is indeed irrelevant: *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337.

The scenario

These questions come up in the context of qualifications or "carve-outs" (usually indemnifier-initiated) from what would otherwise be **"bare"** indemnities which are in **"third party"** form,[43] in an effort to stop them operating as **"reverse"** indemnities.[44]

In the banking and finance context, this scenario arises in (though not only in) a couple of interesting everyday contexts

- "guarantor indemnities"; and
- indemnities in mandate and engagement letters in favour of investment banks

(each described and exemplified more fully below).

But first - the executive summary:

Stop the presses: "Carve-outs can be bad for indemnifiers and good for financiers"

When it comes to coverage for negligence in indemnities in a financing context, let me make 2 counter-intuitive, and possibly controversial, statements:

- as an intending indemnifier, when faced with a "bare" indemnity (ie widely drafted coverage but with no carve-out for any kind of negligence), you may be better off staying silent and not pushing for a carve-out; and
- as a financier intending to receive an indemnity, you may be better off with a carve-out for "gross negligence" than no carve-out at all.

Why?

If there is no carve-out, and the indemnity is silent as to the matter of negligence, it is impossible to predict, on the current state of the authorities, whether the indemnity will be held to include the financier's own negligence. If an Australian court were asked to resolve the ambiguity today, there is real doubt as to the course it would take, the rules of interpretation it would apply and the result it will deliver - parties could end up with either result.

Of course, if either the word negligence is included in the body of the indemnity or, conversely, there is an express carve-out for it, the matter clarifies and the doubt is removed.

A carve-out for "gross negligence", however, is a different matter, because it raises the risk that the indemnity will apply in the case of "mere" negligence.

So, if you're an indemnifier…..

Thus, an intending indemnifier faced with a request for a "bare" indemnity, is confronted with a Catch 22. Without any sort of carve out at all, there is an opportunity to repel an argument that it has agreed to indemnify the financier against its own negligence. However, if the indemnifier pushes for a carve-out for negligence but fails, and is forced back to accepting "gross" negligence, then it may well be worse off than if it had not mentioned negligence at all. By such a carve-out, the court is given an additional signpost in its task of interpreting the indemnity, and is almost invited to regard the exclusion for "gross negligence" as evidencing an intention that the indemnity should

[43] A "third party" indemnity is where Party A indemnifies Party B against claims brought against Party B by a third person, ie the relevant "event or circumstance" for "bare" indemnity purposes is the making by the third party of a claim against Party B.

[44] A "reverse" indemnity is where Party A indemnifies Party B against losses incurred as a result of Party B's *own acts and/or omissions* eg negligence.

include "mere" negligence. Thus, an indemnifier, may be better off leaving it "bare" and taking their chances with the ambiguity.

And if you're a financier…

On the other hand, a financier intending to receive an indemnity in "bare" form faces an equal but opposite dilemma. It takes the chance that the indemnity may be held not to cover it for its own negligence, for the reasons mentioned above. On the other hand, conceding a carve-out for "gross negligence" significantly enhances its chances of gaining coverage for its own "mere" negligence.

Strange but true.[45]

Let's look at 2 real life examples.

"Guarantor indemnities"

This is the name Professor Carter gives to the more-or-less market standard indemnity which is coupled with and supports a guarantee in a financing context, and operates to protect the financier if the guarantee fails for any reason.46 A typical (short-form) formulation is as follows:

> As a separate undertaking, the Guarantor indemnifies the Financier against any liability or loss arising from, and any costs, charges or expenses incurred in connection with, the Guaranteed Money not being recoverable from the Guarantor under the Guarantee in clause X, or from the Debtor, because of any circumstance whatsoever.

(for the purposes of the following discussion, let's call this the **"Example Guarantor Indemnity"**)

In this form, this would be a classic **"bare"** indemnity, with clear potential for operation as a "reverse" indemnity, ie protecting the Financier from its own acts and/or omissions (including negligence). These indemnities are usually quite widely drafted and do not usually carve out the financier's own negligence. Well advised borrowers who are across the issue will often insist on a carve-out, and the negotiations often settle on something along the following lines:

> …but only to the extent that the liability, loss, costs, charge or expense does not arise as a result of wilful misconduct, fraud or **gross negligence** on the part of the Financier or any of its employees. [47]

A carve-out like this takes it into the realms of what can be described as a **"proportionate"** indemnity.48 In this case, the apportionment out of the indemnity is in respect of conduct which constitutes wilful misconduct, fraud or ***gross negligence***.

This, of course, leaves a question mark over "mere" negligence, ie negligence which is not so culpable as to be "gross".

Mandate letters and indemnities

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45 For completeness, the effect of a carve-out that mentions a range of matters like bad faith, wilful misconduct and fraud, but is silent on any kind of negligence, is unclear. There may be arguments either way, ie on the one hand, by not carving out negligence while they were at it, the parties may have intended the indemnity to include it. On the other hand, it is arguable that negligence wasn't carved out because the parties assumed, mutually, that the indemnity did not include it in the first place.

46 For a detailed discussion, see Berg A "Rethinking Indemnities, Part 1" (2002) JIBFL 360.

47 *En passant*, similar carve-outs are often seen in clauses limiting trustees' personal liability - raising corresponding issues in that context.

48 A term sometimes used to describe indemnities which are the opposite of "reverse" indemnities, ie Party A indemnifies Party B against losses *except* those incurred as a result of Party B's own acts and/or omissions. In other words, those acts/omissions are "apportioned out" of the indemnity.

In mandate or engagement letters for arranging and underwriting services (for both debt and equity fundings), the investment bank providing the services to the appointing company invariably requires a broad indemnity. A common formulation is as follows:

> You agree to indemnify and hold harmless the Arranger/Underwriter, any affiliates, subsidiaries or branches of the Arranger/Underwriter, each other person, if any, controlling the Arranger/Underwriter, and any of their directors, officers, agents, employees, advisers and representatives (each, an **"Indemnified Person"**) from and against any losses, claims, damages, liabilities, actions, proceedings, demands, costs and expenses (including legal fees on a full indemnity basis) **("Losses"**) related to, arising out of, or in connection with, the matters which are the subject of the commitment made under this letter, the Term Sheet, the Financing and the loans thereunder and the performance by any Indemnified Person of the services contemplated in this letter…, whether or not the Transaction is consummated. *You will not, however, be responsible for any Losses that are finally judicially determined by a court of competent jurisdiction to have resulted from the wilful misconduct, fraud or* ***gross negligence*** *of the relevant Indemnified Person.*

(let's call this the **"Example Mandate Indemnity"**)

Absent the last sentence, again this would be a "bare" indemnity, with clear potential for operation as a "reverse" indemnity. Again, the carve-out in the last sentence converts it into a **"proportionate"** indemnity, where the apportionment is in respect of conduct which constitutes, among other things, ***gross negligence***.

But, again, not "mere" negligence.

But is there such a thing as "gross" negligence?

First, let us cut to the chase and assume that "gross negligence" exists in Australasian law as a concept distinct from "mere" negligence. I realise that, in some quarters, a view is still harboured that it is a nonsense, but I do not agree with that view. I say this because:

- there is evidence in the authorities that there is a difference and that gross negligence exists, even if we acknowledge that there are some cases in Australia, UK and Canada that go the other way;[49]
- recently, Finkelstein J of the Federal Court assumed it does exist, saying that gross negligence *"must at least be carelessness of so aggravated a nature as to amount to the neglect of precautions which the ordinarily reasonable man would have observed and to indicate an attitude of mental indifference to obvious risks";* [50]
- other judges, in a variety of contexts (civil and criminal) have used the expression to denote a higher level of culpability than "mere" negligence

[49] The cases are a mix of civil and criminal, and in the civil sphere deal with a range of contexts across professional negligence and personal injuries cases: see *Hinton v. Dibber* (1842) 2 QB 646; *Colonial Bank v. M'Conkey* (1870) 1 AJR 91; *City of Fitzroy v. National Australia Bank of Australasia Limited* (1890) 16 VLR 342; *Paul v Dauphin* [1941] 1 WWR 43; *McCulloch v Murray* [1942] SCR 141; *Scardina v LaRoche* [1951] 1 DLR; *Dalgety & Co. Limited v. Warden* [1954] QSR 251; *Hunter v Hanley* 1955 SLT 213; *Jackson v. Millar* [1973] 1 OR 399; *R v. Stephenson* [1976] VR 376.

[50] *CMG Equity v ANZ Banking Group* (2008) 65 ACSR 650 (3 April 2008), at [28], citing *Hudston v Viney* [1921] 1 Ch 98 at 104.

(some equating it to "recklessness"), often completely unselfconsciously and without feeling the need to justify its use;[51]

- the expression is used in legislation;[52]
- "the market" seems to think there's a difference, because it is an expression in common use in Australasian documents and practice. Charlesworth on Negligence observes that *"[gross negligence] is an expression in regular use among lawyers, and to deny it a meaning would be pedantic. It is intended to denote a high degree of careless conduct…and is of considerable practical utility"*. [53]

There's no *per se* rule against indemnifying negligence - *Qantas v Aravco*

Next, even leaving aside contracts of insurance (such as professional indemnity insurance), there is nothing about a private person contracting to indemnify another for their own negligence that is repugnant in principle to Australasian law. The indemnity in Qantas Airways Ltd v Aravco Ltd[54] is an example of such an indemnity. There, Qantas entered into a contract with Aravco to perform certain services in relation to an aircraft operated by Aravco but owned by BAT Industries Plc ("BAT"). As a result of Qantas' negligence, the aircraft suffered damage. BAT sued Qantas for the damage to the aircraft. Qantas admitted liability for the damage, but, by a cross-claim, sought indemnity from Aravco for the damages that it had to pay to BAT. Qantas' claim for indemnity was based on clause 4 of its contract with Aravco, which provided as follows:

> *The Operator [Aravco] agrees* ***regardless of any negligence on the part of Qantas*** *to release, hold harmless and indemnify Qantas from and against all liabilities, claims, damages, losses, costs and expenses of whatever nature, howsoever occurring which may accrue against or be suffered by Qantas arising out of or in any way connected with the performance of the said services unless caused by wilful misconduct on the part of Qantas or any of its servants or agents acting within the scope of their employment* (emphasis added)

Leaving aside the detailed trade practices arguments which arose,[55] the High Court held that Qantas was entitled to an indemnity from Aravco for its (ie Qantas') liability to BAT.

In that case, the indemnity was quite explicit about the status of Qantas' negligence. But what if an indemnity does not expressly mention negligence, yet is wide enough on a reading of its terms to include it?

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51 See *Vacuum Oil Pty Co Ltd v Stockdale* (1942) 42 SR(NSW) 239*; Mauroux v Sociedade Comercial Abel Pereira da Fonseca SARL* [1972] 2 All ER 1085; *Red Sea Tankers Ltd v Papachristidis (The Hellespont Ardent)* [1997] 2 Lloyd's *Rep 547*; *Rankin v Marine Power International Pty Ltd* [2001] VSC 150; R v De'Zilwa (2002) 5 VR 408; *National Roads and Motorists Association Ltd ACN 000 010 506 v Nine Network Australia Pty Ltd* ACN 008 685 407 [2002] ACTSC 37; *R* v Leusenkamp [2003] VSCA 193; *DPP v Reynolds and Ors* [2004] VSC 533; *In the Marriage of Petrovic and Spanjic* (2004) 190 FLR 10; *Xue Mei Bai v Minister for Immigration (No 2)* [2006] FMCA 129; *Anderson v Hassett (No 2)* [2007] NSWSC 1444.

52 See section 15 of the Law Reform Act 1995 (Qld); section 318(2)(b) of the Crimes Act 1958 (Vic); section 19A(1) of the Occupational Safety and Health Act 1984 (WA).

53 Walton, C et al, *Charlesworth and Percy on Negligence* (London: Sweet and Maxwell, 11th ed, 2006), at [1-11].

54 (1996) 185 CLR 43.

55 This issue does throw up various questions under the Trade Practices Act 1974, including those traversed in this case, ie sections 68 and 74, but also sections 52, 68A and 75AZC(1)(k) and others. *Qantas v Aravco* is sometimes held out as deciding that section 52 liability for misleading and deceptive conduct can be sidestepped by use of a "reverse" indemnity, even if it cannot be excluded via a more traditional exclusion or limitation clause. The logic behind that assertion is flawed. TPA issues are not addressed in this paper.

On their face, what is the effect of the two example indemnities above?

If, as we have seen:

- it is possible under Australasian law to indemnify someone against their own negligence; and
- "gross negligence" does exist as a separate matter from "mere" negligence,

then:

- what is the effect of a "bare" indemnity that does not mention the word "negligence" but is wide enough on its terms, on at least one reading, to capture it anyway (as in the example indemnities set out above, absent the carve-outs)?
- what is the effect of a "gross negligence" carve-out (again, as in the example indemnities)?

Let us first put these questions in their true commercial context so that their impact is not lost in the legal technicalities.

In his paper, Professor Carter makes the startling, but clearly correct, observation that "where A contracts to indemnify B against the occurrence of an event, A is acting as B's 'insurer' in relation to the risk that the event will occur".[56]

On this analysis, the exclusion for "gross negligence" purports, on its face, to deliver a somewhat surprising result - the indemnifier is insuring the financier against its own negligence (so long as it is not "gross"). [57]

So, in the case of the Example Guarantor Indemnity, in effect the Guarantor could be insuring the Financier against its own negligence in, say, an act or an omission which undermines the enforceability of the guarantee,[58] or causes loss or damage to the borrower, so long as that negligence is not so culpable as to constitute "gross negligence".

In the case of the Example Mandate Indemnity, if in undertaking its duties under the arrangement, the investment bank (or any other "Indemnified Person") causes a loss to a third party (eg an intending investor) through its negligence, then provided again that negligence is not "gross", the investment bank might seek indemnification from its "insurer", the appointor.

These results might come as a surprise to the Boards and Senior Management of companies giving these indemnities, and yet these clauses are more or less market practice - and attempts during negotiations to rectify the situation are often met with a firm (and not always polite!) rejection, often on that basis alone. [59]

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56 Note, for example, that professional indemnity insurance constitutes, in effect, an indemnity from Party A (insurer) in favour of Party B (insured professional) against losses arising from a claim made against Party B by a third party (ie the client) as a result of Party B's negligence.

57 While this might seem a surprising result in a banking & finance context, in the building and construction context it has been argued "*there is nothing improbable in a construction which made the [indemnifier] liable to indemnify the [beneficiary] against the consequences of the [beneficiary's] own wrongdoing 'because the obligation would be backed by the insurance policies in the names of the [indemnifier] and the [beneficiary], which [another clause in the contract] required the appellant to effect*": *Ellington v Heinrich Constructions Pty Ltd* [2004] QCA 475. This, of course, assumes a perfect fit between the indemnity and the coverage provided by the insurance - a brave assumption indeed!

58 Noting that indemnities are not necessarily subject to the same fragility and rules regarding release of sureties as guarantees - indeed, as a general proposition, if someone is a "primary obligor", as an indemnifier usually is, then they will not be a "surety": *Heald v O'Connor* [1971] 2 All ER 1105.

59 At least in relation to the indemnities like the Example Mandate Indemnity, the outcome is sometimes justified by investment banks on "agency theory", ie it is consistent with the bank acting as the appointor's agent in going out into the market and seeking interest among investors. The countervailing arguments

"Are you serious? Am I really insuring the bank against its own negligence?"

In short - maybe. Following on from Professor Carter's observations, this is another example where the state of the law on indemnities is in such disarray that neither counsel to the financier nor the indemnifier's lawyers can advise their client with total confidence.

The problem is that the normal rules for contractual construction seem not to apply to indemnities, and some courts have even said that indemnities have their own peculiar set of rules for interpretation. The courts have had many attempts at defining how negligence should be treated in the context of an indemnity.[60] The problem is that, over time, the courts have offered up a multiplicity of "principles" and "rules" and other guidelines, which are inconsistent - indeed sometimes in direct conflict - and can actually lead to opposing results.

It appears that there is something of an internecine war afoot among Australian courts over the correct rules for the interpretation of indemnities, and the issue of negligence is one of the key battlefields.

It is not overstating the argument to say that we are left with an unworkable melange.

Let us now look at these "rules".

The interpretative rules for indemnities + negligence

The core Canada Steamship rule

Let us start with the traditional rule, familiar to us from cases on exclusion and limitation clauses, that, if a person is to be indemnified against their own negligence, the language of the indemnity must do so quite explicitly and unambiguously:

> *[because it is] inherently improbable that one party should agree to discharge the liability of the other party for acts for which [the other party] is responsible … the imposition by the proferens on the other party of liability to indemnify him against the consequences of his own negligence must be imposed by very clear words* [61]
>
> and
>
> *I do not see how a clause can 'expressly' … indemnify the proferens against his negligence unless it contains the word 'negligence' or some synonym for it* [62]

(for the following discussion, let's call this the **"core Canada Steamship rule"**[63]).

Commercial construction

Then we have the critical overlay of the concept of "commercial construction", which has been described as the most significant development in the modern law of contract

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are that (a) if an agent wants coverage for its own negligence, it should ask for it directly, and (b) absent overt agreement, the appointor is unlikely to have intended implicitly to authorise the investment bank to act negligently on its behalf.

60 Those rules are closely related to, and in some cases come from, the rules that apply to exclusion and limitation clauses generally (indeed, indemnities can be and are often drafted to operate as an exclusion or limitation of liability). In *Smith & Ors v South Wales Switchgear Ltd* [1978] 1 All ER 18 the House of Lords stated that the *Canada Steamship rules* (discussed below) which related to an exemption clause, also applied to an indemnity provision: at 25. Similar statements have been made in the Australian courts.

61 *Smith & Ors v South Wales Switchgear Ltd* [1978] 1 All ER 18 per Viscount Dilhorne at 22, applying the principles in Canada *Steamship Lines Ltd v R* [1952] AC 192.

62 Ibid, per Lord Fraser of Tullybelton, at 25.

63 This is, in effect, a compression of the 3 so called "*Canada Steamship rules*", discussed further below.

construction.[64] Its objective is to construe the relevant words according to what a reasonable person would understand them to mean in the broader commercial context, rather than by reference to technical rules, so as to respect the substance of a bargain rather than its form. The incidents of commercial construction include:

- taking into account the surrounding circumstances or "factual matrix" of the contract, in all cases and not only in exceptional cases;
- approaching the matter in a practical manner, so as to give the contract a reasonable business operation;
- asserting a common sense approach, favouring a commercially sensible construction, even if it means ignoring a lack of clarity;
- adopting a construction that seeks to avoid the contract failing for want of certainty;
- adopting a uniform approach to all contracts, regardless of their type or nature (ie avoiding "special" rules for particular types of contract); and
- a preference for rejecting particular construction approaches such as "strict" or "literal" construction, in favour of an approach which a reasonable commercial person would take to be the intended meaning or application of a contract.[65]

(let's give this its correct name, **"commercial construction"**).

Commercial construction is closely related to the concept of "natural meaning" in the interpretation of contracts.[66] For example, the High Court has said, relevantly, that:

> *the interpretation of an exclusion clause is to be determined by construing the clause according to its natural and ordinary meaning, read in light of the contract as a whole…and, where appropriate, construing the clause contra proferentem in the case of ambiguity* [67]

That was a case to do with exclusion clauses generally, but it was acknowledged by the Victorian Supreme Court in 1990 that these principles can and should apply to indemnities.[68]

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64 Peden E and Carter JW "Taking Stock: the High Court and Contract Construction" (2005) 21 JCL 172, at 178.

65 This list is paraphrased from Peden and Carter, fn 64, at 178. Several of the cases on "commercial construction" are insurance cases. Contracts of insurance have been described as "the classic contract of indemnity": Carter JW and Yates D "Perspectives on Commercial Construction and the Canada SS Case" (2004) 20 JCL 233, at 245. See, too, the cases cited by Spigelman CJ in *Gardiner v Agricultural and Rural Finance Pty Ltd* [2007] NSWCA 235, at [7] - [13].

66 See the discussion in Carter JW and Peden E "The 'Natural Meaning' of Contracts" (2005) 21 JCL 277.

67 *Darlington Futures Ltd v Delco Australia Pty Ltd* (1986) 68 ALR 385, at 391.

68 *Schenker and Co (Aus) Pty Ltd v Maplas Equipment and Services Pty Ltd* [1990] VR 834.

(let's call this the **"Delco principle"**).

The Brambles rule

Then we have the High Court's decision in 2004 in *Andar Transport Pty Ltd v Brambles Ltd*[69] (discussed in more detail below), which cut right across the rules of commercial construction[70] and the Delco principle, concluding instead that there are "special" rules for indemnities as follows:

> [There are] *principles of construction applicable to contractual indemnities…Notwithstanding the differences in the operation of guarantees and indemnities, both are designed to satisfy a liability owed by someone other than the guarantor or indemnifier to a third person…[so therefore the principles applicable to construing guarantees are] relevant to the construction of indemnity clauses…Ambiguous contractual provisions should be construed in favour of the surety … A doubt as to the provision in a guarantee should therefore be resolved in favour of the surety* …[Accordingly, an ambiguity in an indemnity should] be construed in favour of [the party providing the indemnity][71]

(let's call this the **"Brambles rule"**)

Even the NSW Court of Appeal does not agree with itself

But wait, there's more. We have two decisions of the NSW Court of Appeal, delivered in 2007, which appear to take opposing views on the Brambles rule and its relationship with the core Canada Steamship rule, the Delco principle and commercial construction.

In *BI (Contracting) Pty Limited v AW Baulderstone Holdings Pty Limited* **[72]** the Court, in supporting and purporting to follow the Brambles rule, added a gloss:

> *where the parties have deliberately chosen to adopt wording of the widest possible import, that wording is not to be ignored, and where wording is susceptible of more than one meaning, regard may be had to the circumstances surrounding the execution of the document as an aid to construction* [73]

In that case, a subcontractor who agreed to *"indemnify the builder against all liability relating to the subcontract works"* was held liable to indemnify the builder for damages paid by the builder to an employee (of the builder) arising out of the builder's own negligence - a result the subcontractor sought to avoid by invoking the core Canada Steamship rule. Thus, despite the fact that the indemnity made no mention of *"the word 'negligence' or some synonym for it"*,**[74]** the subcontractor was, in effect, held to be the builder's "insurer" against its own negligence.

(let's call this the **"BI (Contracting) outcome"**)

What all of the above illustrates, according to Spigelman CJ of the NSW Court of Appeal (in a differently constituted Court from that which decided *BI (Contracting)*), is that there is more than one principle involved in the task of contractual interpretation of indemnities.**[75]** Clearly less than comfortable with the *Brambles*

69 (2004) 206 ALR 387.

70 Including the Court's own decision earlier in the year in *Pacific Carriers Ltd v BNP Paribas* (2004) 218 CLR 451 - see the discussion below under "***The Andar v Brambles decision - the details***".

71 (2004) 206 ALR 387, at [17], [18] and [29].

72 [2007] NSWCA 173.

73 *BI (Contracting) Pty Limited v AW Baulderstone Holdings Pty Limited* [2007] NSWCA 173.

74 See footnote 62.

75 *Gardiner v Agricultural and Rural Finance Pty Ltd* [2007] NSWCA 235.

decision, he thought the task ought be undertaken in accordance with the general approach as applicable to all commercial contracts (ie "commercial construction") rather than by reference to "special rules" applicable to indemnities.[76] His gloss on the Brambles rule was that:

> *the principle for construction of … indemnities that was adopted by the High Court in [Andar v Brambles] does not involve preparing a list of all the possible meanings of a clause that the language can bear without breaking, and choosing the meaning that is most favourable to the … indemnifier. Rather, the choice is limited to choosing amongst meanings that are fairly open by reason of the application of other rules of construction* [77]

He went further, saying that the Brambles rule may not apply to the benefit of an indemnifier if they were the draftsman of the indemnity, ie the contra proferentem rule should operate.[78]

Confused?

These distinctions are more than merely semantic because they can actually deliver opposing outcomes. For example, a bare indemnity that is in wide terms but does not expressly mention the beneficiary's negligence, would probably not cover the beneficiary's negligence under the core Canada Steamship rule or, indeed, the Brambles rule in its purest form. That same indemnity, under the Delco principle, commercial construction or the BI (Contracting) outcome, may well do so.

So - back to our two example indemnities

When taking the benefit of indemnities such as the Example Guarantor Indemnity and the Example Mandate Indemnity a financier might hope to have coverage for its own negligence either:

- (if there is no carve-out) via the use of words of sufficiently wide import to include it, even if not expressly mentioned; or
- (if there is a carve-out) via the exclusion of gross negligence,

rather than by an express inclusion.

Of course, if either indemnity had used, in the body of the indemnity, the expression *"including any losses [etc] that have resulted from the* ***negligence*** *of the Financier / relevant Indemnified Person"* (or its corresponding opposite in a carve-out), the matter would almost certainly be beyond doubt, on any of the "rules". But they do not (and traditionally these indemnities tend not to - perhaps for obvious reasons).

The question parties face is whether the rather opaque techniques of very wide drafting, or "inclusion via exclusion", as it were, can operate to include the beneficiary's own negligence.

I turn now to a more detailed analysis of the High Court's decision in *Brambles*.

The *Andar v Brambles* decision - the detail

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76 Ibid, at [19].

77 Ibid, at 20, quoting Campbell JA in *Rava v Logan Wines* [2007] NSWCA 62.

78 Ibid, at [21]. The *contra proferentem* rule would have it that, if there is ambiguity in terms of a guarantee or indemnity, that term should be construed against the person relying on it and in favour of the guarantor/indemnifier: *Ankar Pty Ltd v National Westminster Finance (Australia) Ltd* (1987) 162 CLR 549. In *McCann v Switzerland Insurance Australia Ltd* (2000) 176 ALR 711 at 726, at 391, Kirby J went so far as to say that *contra proferentem* should only be applied as "a last resort", a sentiment that was echoed by Callinan J in his dissenting judgment in *Andar v Brambles* (2004) 206 ALR 387.

I do not dwell here on the facts and background of the case.[79] The relevant contract (prepared by Brambles) included a combination of indemnities and releases from Andar in favour of Brambles.[80] The critical indemnity (in clause 8) was a "bare" indemnity from Andar in favour of Brambles in relation to the conduct of a "Delivery Round". The indemnity was silent as to whether it included within its scope losses occasioned (or contributed to) by an act or omission of Brambles that was negligent - thus, on one reading, it *could* have operated as a "reverse" indemnity:

> *[Andar] shall 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 … in respect of or arising from … 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]*.

On the other hand, an indemnity from Andar in clause 4.6, which related to losses arising from the "operation of the Vehicle", was "proportionate", in that it expressly excluded certain acts of Brambles:

> *[Andar agrees to] assume sole and entire responsibility for and indemnify [Brambles] against all claims liabilities losses expenses and damages arising from operation of the Vehicle by reason of any happening not attributable to the wilful,* ***negligent*** *or malicious act or omission of [Brambles]* (emphasis added)

The majority of the Court thought that clause 8 was ambiguous with respect to Brambles' own negligence. By application of strict rules of construction (ie rather than the Delco principle or commercial construction), and compressed reasoning that is far from clear, the Court, in effect, implied a "proportionate" limitation (or, putting it another way, a "carve-out" for Brambles' own negligence) in the clause 8 indemnity. This was critical because the courts below had found that the loss in question had been caused by Brambles negligence. By this reasoning, the High Court held that Andar was **not** required to make good Brambles' loss despite the breadth of the indemnity language.

Brambles v the other rules

One of the most puzzling aspects of *Brambles* is the way the Court applied the rules of construction to the terms of the clause 8 indemnity.

The most relevant aspect for present purposes is the absence of any direct discussion of the "rules" in the *Canada Steamship* case - or at least, the status of the contentious "third" rule.[81] These rules, as applied to indemnities, were stated succinctly in

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79 Brambles provided laundry delivery services to a number of hospitals. Those services involved, among other things, the delivery by truck of large trolleys of clean linen. Brambles contracted out its laundry delivery services to corporations that, in turn, employ drivers to load, deliver and unload the linen as directed by Brambles. Daryl Wail was one such driver. He was employed by the appellant, Andar (evidently his own family company). Prior to the change in business practice adopted by Brambles, Mr Wail had been employed directly by Brambles. On 26 July 1993, Mr Wail loaded a truck with 22 trolleys of clean linen at Brambles' laundry premises in Box Hill, Victoria and drove to Cotham Private Hospital in Kew. After reversing the truck into a driveway adjacent to the hospital's delivery bay, Mr Wail opened the rear of the truck and lowered the hydraulic tailgate. He then attempted to remove one of the trolleys. However, that trolley was jammed against another trolley and, in attempting to pull it free, Mr Wail damaged his lower back. Mr Wail commenced proceedings against Brambles alleging negligence, in that Brambles failed to ensure that the trolleys could be manoeuvred without risk of injury and to ensure that the trolleys could be manoeuvred having regard to their excessive weight when fully laden.

80 Set out in (2004) 206 ALR 387 at 391-392.

81 [1952] AC 192. The 3 "rules" are set out at 208.

Schenker and Co (Aus) Pty Ltd v Maplas Equipment and Services Pty Ltd,[82] as follows:

> *1. If the clause expressly provides indemnity for the person in whose favour it is made for the consequence of negligence of that person …, effect must be given to it.*
>
> *2. If there is no express reference to negligence the court must consider whether the words used are wide enough to cover negligence of the person…: if there is any doubt, it must be resolved against the person.*
>
> *3. If the words are wide enough to cover the negligence of the person…, the court must consider whether the words also comprehend some other liability against which the person may have desired indemnity: if there is such a liability, the words are to be confined to it and not extended to negligence.*

This omission by the High Court is surprising because the Court below, consistent with its position over a decade earlier in *Schenker*, expressly rejected application of the "rules", and instead took a purely literal approach, saying that "*the third [rule] is not now the law in Australia in relation to the interpretation of exclusion and limitation clauses*".[83]

Nor is the decision consistent with the method of interpretation adopted in other cases, including other decisions of the High Court.[84] Apparently ignoring the Delco principle and the settled principles of commercial construction, the Court began its analysis by saying "*the proper construction of [the relevant clauses] cannot be undertaken without reference to the principles of construction* ***applicable to contractual indemnities***" (emphasis added),[85] implying that indemnities are indeed "special", with their own particular rules for construction.

Confusingly, in the same year that *Brambles* was handed down (ie 2004), the High Court said, in *Pacific Carriers*[86] (a case described as a "a triumph for commercial construction"[87]):

> *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* [88]

Some might argue that the Court did not need to address the *Canada Steamship* rules since they had long since been pronounced dead. Even apart from the repeated

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82 [1990] VR 834.

83 *Brambles v Wail* (2002) 5 VR 169, at 191 quoting from *Darlington Futures Ltd v Delco Australia Pty Ltd* (1986) 161 CLR 500. Although, with respect, it is arguable that this might be considered *obiter* since the *Canada Steamship* rules may not have been applicable in the case before the court – there was no finding of negligence as between the parties to the contract of indemnity such as would or could have triggered the debate.

84 As stated by Spigelman CJ in *Gardiner v Agricultural and Rural Finance Pty Ltd* [2007] NSWCA 235, "the general approach to the interpretation of commercial contracts applicable in the common law of Australia has been stated in a number of recent judgments of the High Court: see *McCann v Switzerland Insurance Australia Ltd* (2000) 203 CLR 579 at [22]; *Maggbury Pty Ltd v Hafele Australia Pty Ltd* (2001) 210 CLR 181 at [11]; *Pacific Carriers Ltd v BNP Paribas* (2004) 218 CLR 451 at 461–462; *Toll (FGCR) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165 at 179; *Wilkie v Gordian Runnoff Ltd* (2005) 221 CLR 522 at [15].

85 (2004) 206 ALR 387, at 392.

86 Fn 70.

87 Peden and Carter, fn 64, at 180.

88 (2004) 208 ALR 213, at 221.

rejection of the rules by Victorian Courts in *Shenker*[89] and *Brambles v Wail,*[90] several months before *Brambles* was decided in the High Court, Meagher JA of the NSW Court of Appeal stated, with characteristic directness, that:

> *…the decision of the Judicial Committee in Canada Steamship Lines Pty Limited v R [1952] AC 192, in light of Darlington Futures Limited v Delco Australia Pty Limited (1986) 161 CLR 500, is no longer good law.* [91]

But of course, none of those were decisions of the High Court.

BI (Contracting) - same indemnity as Brambles, opposite result

In July 2007, the NSW Court of Appeal concluded, after an exhaustive review of the cases and the history around the issue, both in Australia and the UK, that "*this Court is not obliged to apply the third principle in Canada Steamship SS and must apply the approach adopted by the High Court in [Andar v Brambles]"*.[92] And yet, ironically, the court went on to find that an indemnity in substantively the same terms as that in *Brambles* (ie a "bare" indemnity with no express mention of negligence) **did** include the beneficiary's negligence.

It was unfortunate that the High Court left the *Canada Steamship* issue unresolved when it had the opportunity to deal with it, particularly since one of the authorities embroiled in the debate is its own decision in *Darlington Futures* (see the text around fn 67). At least one superior court has asserted that "*by reason of the judgment in [Andar v Brambles], the approach in Darlington Futures Ltd v Delco Australia Pty Ltd can no longer be relied on in regard to indemnity clauses*" (ie whatever its status in relation to non-indemnity exclusion and limitation clauses).[93] Given the almost complete lack of analysis of the authorities in this aspect of the High Court's judgment in *Brambles*, but (despite that) the inherent "sense" in the outcome,[94] it is hard to resist the conclusion that the Court was "seeking to do justice".[95]

The risk with decisions that are made because they are the "right thing to do", but without the rigour of thorough analysis and due regard to the authorities, is that they appear *ad hoc* and result in uncertainty. They may even lead to what Chief Justice Gleeson has described as "individualised justice".[96]

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89 [1990] VR 834.

90 Fn 83.

91 *State of NSW v Tempo Services Ltd* [2004] NSWCA 4, per Meagher JA at [9].

92 *BI (Contracting) Pty Limited v AW Baulderstone Holdings Pty Limited* [2007] NSWCA 173, at [95]. But she also noted that "there was no reference in … *Andar* to the principles and, in particular, the third principle, in *Canada Steamship SS",* at [89].

93 *F and D Normoyle Pty Ltd v Transfield Pty Ltd T/as Transfield Bouygues Joint Venture* [2005] NSWCA 193, per Ipp JA (with whom McColl JA agreed), at [64].

94 It was an unsurprising outcome in the context of a transaction that was a mere change in status of an individual from employee to contractor (via an interposed company) for the convenience of Brambles, where a patently much stronger party imposed its will (via a standard form document) on a weaker party having no real ability to negotiate, in an attempt to shift liability for matters which, before the transaction, would have been Brambles' responsibility.

95 Certainly, one is left with this impression after reading Kirby J's judgment. It has been observed that "the *Brambles* case shows that a court will find a way around [an overly wide indemnity] clause if it wants to, particularly if it thinks there was an inequality in bargaining power between the contracting parties": Tumiati N and Verdnik A "Do your service contracts include an effective indemnity?" (2004) 7(8) IHC 87.

96 Gleeson CJ "Individualised Justice - the Holy Grail" (1995) 69 ALJ 421. Heydon J's presence in the majority in *Brambles* uncovers an interesting irony. In his article "Judicial Activism and the death of the rule of Law", ((2003) 23 ABR 110, then of the NSW Court of Appeal, published shortly before his elevation to the High Court), he noted, with evident displeasure, that the High Court's position on a whole range of matters has vacillated with changes to the composition of its membership, and argued that "if radical new statements [of the law] are routinely made, and *established law is almost nonchalantly departed from in later cases*, then they can be no more binding, and no more likely to survive, than the earlier statements which have been overthrown" (emphasis added).

Ironically, if it had applied the *Canada Steamship* rules, the High Court in *Brambles* would very likely have reached the same conclusion, since (as acknowledged by the Court of Appeal in the decision below[97]) the application of the rules tends to result in a "bare" indemnity being construed so as ***not to*** indemnify the beneficiary against its own negligence.

On the other hand, the decision of the NSW Court of Appeal in *BI (Contracting) Pty Limited v AW Baulderstone Holdings Pty Limited* [98] militates against that conclusion.

Ellington v Heinrich Constructions - back to the future

Finally, note the following comment of the Queensland Court of Appeal in *Ellington v Heinrich Constructions Pty Ltd*,[99] which involved a "bare" indemnity from a subcontractor in favour of a builder, not dissimilar in substance to that in *BI (Contracting)*, in which the court seemed to hark back to a simpler time when *Canada Steamship* ruled the waves:

> *It is … a fundamental consideration in the construction of contracts of this kind that it is inherently improbable that one party to the contract should intend to absolve the other party from the consequences of the latter's own negligence….It seems to me impossible to suppose that the parties were intending that the appellant should indemnify the respondent against claims based upon the respondent's negligence*. [100]

The court held the subcontractor's indemnity *not* to cover the builder for its own negligence (ie the opposite result to the *BI (Contracting)* outcome decided 3 years later), saying

> *[t]he [builder's] contention would make the [subcontractor] liable for the financial consequences of the [builder's] acts that could be seen to be in respect of the works, though the [subcontractor] had not authorised or performed the act, and was not insured for the loss. This is an unlikely construction*[101]

Conclusion

It is hard to argue with the common sense in the sentiments expressed by in *Ellington v Heinrich Constructions*. If something as intuitively unusual as a "reverse" indemnity has been consciously discussed and agreed between parties, then one might expect the drafting to be explicit in that regard. Even apart from judge-made rules and principles, logic itself operates in favour of a presumption that a person does not intend to indemnify another for his/her own negligence in giving a general indemnity against losses, unless that conclusion is inevitable on the wording.

Being no more than a requirement for absolute certainty, this conclusion is not inconsistent with:

- the observation in *Davis v Commissioner for Main Roads*[102] that, so long as clear language is used, a court is free to find that, say, a contractor has undertaken all the risk of carrying out a contract, including by reference to the other party's actions; or

97 (2002) 5 VR 169, at [68].

98 [2007] NSWCA 173.

99 [2004] QCA 475. The case was decided shortly after *Brambles* (and cited and distinguished it).

100 [2004] QCA 475 per Chesterman J, at [19], quoting, with approval, from Buckley LJ in *Gillespie Brothers & Co Ltd v Roy Bowles Transport Ltd* [1973] QB 400 at 419, and Kitto J in *Davis v Commissioner for Main Roads* (1968) 117 CLR 529 at 534.

101 [2004] QCA 475, at [23].

102 (1968) 117 CLR 529.

- the principle stated in *F and D Normoyle Pty Ltd v Transfield Pty Ltd T/as Transfield Bouygues Joint Venture*[103] that it is not unreasonable for parties contractually to allocate the risk of liability in a given activity from one to the other in the exercise of their normal economic rights; or
- the statement of Sheller JA in *Glebe Island Terminals Pty Ltd v Continental Seagram Pty Ltd*[104] that businessmen are capable of looking after their own interests and of deciding how risks inherent in the performance of various kinds of contracts can be most economically borne.

All of which statements are well and good if the negotiating parties have sufficient knowledge of the variables, the drafting is unambiguous and the law supports them with clear rules that are consistently applied.

In the meantime, it is definitely worth carefully considering the use of carve-outs and fighting over the difference between "negligence" and "gross negligence" in negotiations over indemnities, because you never know…..

103 [2005] NSWCA 193.

104 (1993) 40 NSWLR 206.