RISK & INSURANCE®
SPECIAL REPORT: CLAIMS
APRIL 2011

FACING OFF with paper and laptop. The scope of indemnity clauses within a contract is often a matter of dispute. Adding to the complication is the fact that courts around the country have not applied the issue of indemnification for damages uniformly.

Speaking the Language of Indemnity

The answer to whether an insured is on or off the hook in the event of a claim lies buried within the nuances of the indemnity clause. *By Margaret Suuberg*

Most states recognize two means by which negligent parties, referred to as "tortfeasors", can share liability. Contribution makes two or more "joint tortfeasors" liable for their proportionate share of liability. Indemnity allows potential tortfeasors to assign liability between themselves.

Indemnity may be implied, if certain criteria, which vary by state, are met. Under implied indemnity, one tortfeasor may be held liable for damage assessed against a second tortfeasor if such damages are derived solely from the wrongdoing of the first tortfeasor.

More often, parties attempt to assign liability among themselves within a contract. Such contracts, whether related to construction, lease of premises, or sale of product, may be intended to achieve indemnification of one party for the other's negligence; cross-indemnification of both parties; or indemnification of a party for all negligence except its own.

Despite best efforts, indemnity clauses do not always have the desired effect. This can be due to poor drafting, or because a statute in the relevant jurisdiction limits the indemnity rights of the respective parties.

One question that frequently arises is whether, and to what extent, a party is entitled to be indemnified for damages caused, in whole or in part, by its own negligence.

The issue is not treated uniformly within the United States. Some jurisdictions expressly prelude such indemnity by statute, under certain circumstances. Others permit such indemnity under written contract, but require that the indemnity include specific language or, in a few cases, particular wording. Still others look at factors including the circumstances in which the agreement was made, to determine whether it shows an intent that the indemnitee be covered for his own negligence.

Consider the various ways that different states treat indemnity clauses in two common situations: lease of commercial premises, and construction contracts.

Assume, for example, that your insured is the general contractor in a construction subcontract. Language may read like so:

"Subcontractor shall indemnify and hold harmless contractor from all damages, losses, or expenses, including attorney's fees, from any claims or damages for bodily injury . . . . This indemnification shall extend to claims resulting from performance of this subcontract and shall apply only to the extent that the claim or loss is caused in whole or in part by any negligent act or omission of subcontractor or any of its agents, employees, or subcontractors. This indemnity shall be effective regardless of whether the claim or loss is caused in some part by a party to be indemnified."

In this example, the contractor is indemnified only if the loss is caused "in whole or in part" by the subcontractor. This means that while some negligence by the subcontractor is required, it is not necessary that the subcontractor be solely, or even mostly, responsible for the loss. Note, however, that the indemnity is effective whether or not the contractor itself is negligent.

While parties may agree to such language,

summary

- **One question is whether a party is entitled to be indemnified for damages caused, in whole or in part, by its own negligence.**
- **Some jurisdictions prelude such indemnity by statute. Others permit such indemnity under written contract.**
- **Once a claim arises, the insurer should determine whether an indemnity clause exists and what rights and obligations the agreement gives to the insured.**

not all courts will enforce it as written. Most courts require that an agreement to indemnify a party for its own negligence "clearly" or "unequivocally" evidence that intent by both parties. In such jurisdictions, the language quoted above may be inadequate to protect the contractor for that portion of the damage that results from its own negligence, as the provision could also be interpreted to limit indemnification to those damages caused by the subcontractor's negligence.

Furthermore, a number of states limit a building contractor's right to obtain indemnity for damages caused by its own negligence.

Some state statutes, for example, declare that any language in a building construction contract purporting to indemnify the contractor for his own negligence "is against public policy and is void." Others deem indemnity clauses related to construction void and unenforceable if they purport to indemnify the contractor for damages caused by its sole negligence.

If an indemnity clause contains offending language, some states will construe the contract to eliminate that part of the provision but otherwise enforce the indemnity. Others will strike the entire indemnity provision, often on the grounds that allowing indemnification for the contractor's own negligence will lessen the contractor's incentive to exercise due care. Still others may consider whether the burden imposed on the subcontractor by the indemnity clause is offset by a contractual insurance requirement.

In this example, assume that your insured is the lessor in a commercial lease:

"Tenant will indemnify and hold harmless landlord . . . from and against any and all claims, actions, damages, liabilities and expenses in connection with loss of life, personal injury, bodily injury or damage to property arising from, or out of any occurrence in, upon or at the premises, from or out of the occupancy or use by tenant of the premises or the shopping center or any part thereof, or occasioned wholly or in part by any act or omission of tenant, its agents, contractors, employees, lessees, invitees or concessionaires. . . . "

This language is very favorable to the insured. The tenant fully indemnifies the landlord for all bodily injury and/or property damage that occurs on, or is related to the tenant's use of, the premises. Liability also attaches on a separate basis if such damage is occasioned "wholly or in part" by the tenant's negligence.

Significantly, the agreement does not address the effect of the landlord's negligence. The landlord likely intends that the tenant indemnify for it for all losses, whether or not the landlord contributes to cause the same. While that result is not illegal in most jurisdictions, the language may be deemed ineffective by a court in the event of a dispute. This is because even jurisdictions that recognize the rights of parties to contract away their liability, often require explicit language showing that both parties intend such a broad indemnity.

Statutes may also come into play. Some states would likely enforce the cited language and afford the landlord indemnity where its negligence contributes to the injury. However, others have statutes that prohibit indemnification of a party for its sole negligence in the context of commercial leases. In a third category of states, statutes that prohibit indemnification for one's own negligence in connection with construction or maintenance of a building have been construed to apply to commercial leases. A landlord operating under the cited indemnity provision in those states would not be indemnified by the tenant if the landlord alone causes the injury.

Often, the drafter of an indemnity agreement will seek to avoid rendering it unenforceable by prefacing the clause with words such as "to the fullest extent permitted by law" or by adding language such as, "this indemnification paragraph shall be in full compliance with law as it currently exists and/or the requirement that the owner shall not be indemnified or held harmless for that portion of liability that is due to the owner's own negligence."

Such additions may not save an otherwise nonconforming indemnity agreement. In those states that will enforce the portions of an indemnity clause that do not violate public policy, the addition of "permitted by law" or "compliance with the law" language may permit part of the agreement to stand.

However, in states where the entire indemnity is void and unenforceable if it contains prohibited language, the addition of words indicating that the agreement is intended to comply with the law may well fail to save the indemnity provision.

How should the insured – or its insurer – deal with this uncertainty? The insured must be clear on what the indemnity is intended to achieve, and understand its obligations and those of the other party. The insured should be made aware of the law of whichever state will govern the agreement – the state where the contract is made, the state where it is to be performed, or the state named in the contract's "choice of law" provision, if any – and its effect on the intended agreement.

The drafter must be sure both that the indemnity language accurately reflects the parties' intent, and that it does not contain language that would render it void and unenforceable or cause a court to construe it more narrowly than the parties intend.

Once a claim arises, the insurer should act promptly to determine whether an indemnity clause exists and what rights and/or obligations such agreement gives to the insured. The insurer should obtain and review all contracts between the parties, including drafts thereof, as well as correspondence and documents relating to the indemnity agreement. If there is an indemnity clause favorable to the insured, the insurer should put the potentially responsible party on notice and make a demand for defense and indemnity as soon as possible, in order to minimize defense costs and exposure.

MARGARET SUUBERG *is a partner in the law firm of Burns & Farrey. She can be reached at Firm@burnsandfarrey.*