Legal Commentary

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Dangerous Liaisons: What to Do Before Things Go Wrong

Contractors must learn to avoid common pitfalls in indemnity provisions

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An indemnification or hold- harmless clause in a construction contract shifts liability and protects parties involved in the agreement.

Take a typical scenario: an owner hires an architect and a general contractor to design and build an addition. The general contractor hires various subcontractors. During construction, a collapse occurs, causing extensive damage and injuries.

The injured workers file lawsuits against the owner, architect, GC and various subs. Immediately, each party looks to the others for protection in their indemnification agreements. This is not a good time to worry whether your agreements have been properly drafted and afford the protection you expected.

When negotiating indemnity, it is easy to get lost in the lengthy clauses and legal descriptions. Often, parties gloss over these provisions, assuming the project will be successful. But it only takes one accident and one lawsuit to bring a company to its knees. If you don't plan ahead, you may be left without the legal protection you need. It is critical to remember your goal: ensuring that the agreement accurately captures and conveys your intentions, particularly with respect to the risk you are willing to bear and want to shift to others.

Although indemnity clauses in construction contracts are fairly standard, be wary of blindly accepting boilerplate language. The wording should clearly reflect the intentions and mutual understanding of all parties. Additionally, ensure that the various agreements are consistent. The general contractor may have a standard contract he uses with subcontractors, which may be entirely different than the contract the owner prefers. Make sure they do not conflict.

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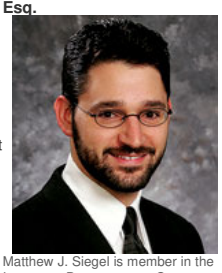

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As a general rule, consider how a court will interpret your agreement. Courts will try to enforce the agreement as written and not read into it language that isn't there, meaning language that you wish you had included.

For example, suppose your indemnity clause contains the following language: "With respect to any claim resulting from injury or loss to any worker on the premises, subcontractor agrees to indemnify and hold harmless contractor from the entire amount of such claim."

This example is silent on whether the contractor is indemnified if found partially at fault. You may want to include language specifying that the subcontractor will indemnify you "for the entire amount of such claim, including liability for injury or loss caused by the negligent acts or omissions of the contractor that result in harm to such employee."

Courts often construe agreements strictly against the party seeking indemnification, so if you are the party needing coverage, the language must be airtight.

So, what do you need to do?

First, make sure all terms are clearly defined, starting with the parties involved. The party seeking indemnification is the indemnitee; the party providing indemnity, the indemnitor. When reading the indemnification clause, substitute your company's name in place of these terms to satisfy yourself that you are defined properly. Pay particular attention to whether subsidiaries, related corporate entities or other divisions are included in those definitions and that they are defined properly.

Second, consider what you are willing to provide to the other parties. Some agreements call for indemnity only, for example, when the indemnitor must reimburse the indemnitee for costs and damages arising from a claim. Others provide a defense obligation—i.e., when the indemnitor agrees to defend and hold the indemnitee harmless.

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In that case, you, as the contractor, may be called upon to assume the defense of the owner. You may want to get the same protection from one of your subcontractors to avoid paying legal fees or, if you have your own counsel and don't feel comfortable giving up that control, you may prefer to supervise your own defense and seek reimbursement at the end of the day. Each carries its own risks, but considering them at the outset can save you a major headache if a lawsuit is filed.

Third, determine the scope of indemnification. Some agreements require the indemnitor to cover the indemnitee, no matter which party causes the loss. Others require coverage only where the loss was caused by the negligence of indemnitor. And still others require coverage for all liability caused "in whole or in part" by the indemnitor, and only relieve the indemnitor when the indemnitee is found solely negligent.

Some jurisdictions refuse to enforce an agreement where a party wants indemnification for its own negligent conduct; others allow it, but only where the intent is absolutely clear from the agreement. It is important to understand exactly what is being asked of you and on the scope of the law in the jurisdiction that may rule on the intent of the contract.

Finally, consider what would happen if workers are injured. Usually, employers are immune from civil-liability employee injuries. That immunity typically extends to third-party claims against the employer seeking indemnity. However, if the parties agree ahead of time, and clearly express their understanding in the written agreement, an employer may assume liability for an injury to one of its employees. If your intention is to accept this liability, make sure that is clearly expressed in the agreement.

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Perhaps the most important message to take away is this: take the time to read your contract carefully and satisfy yourself that it captures your intentions accurately. The simple act of changing a few words in an agreement can save you millions of dollars down the line.