



Construction Indemnification

Indemnification Provisions in Construction Contracts

Indemnity is an obligation to pay for the loss of another party. Thus, the purpose of an indemnification provision is to shift this loss payment obligation in accordance with the agreement of the contracting parties. The party that assumes the loss payment obligation is the indemnitor, while the party that receives the benefit of that loss payment obligation is the indemnitee.

(a) Different Types of Indemnification Provisions

Whether an indemnitor's loss payment obligation is triggered by the occurrence of a loss, and the extent of that loss payment obligation, depends on the type of indemnification provision at issue. There are three generally recognized forms of indemnification provisions—broad form, intermediate form, and limited form. Importantly, different states have different laws governing these provisions, known as anti-indemnity legislation. Accordingly, to ensure an indemnification provision is enforceable, it is necessary to determine the state law governing the contract, and the forms of indemnification provisions prohibited by that state's law.

Broad form indemnification provisions are the most widely prohibited of the indemnity agreements. Under a broad form provision, the indemnitor assumes the loss payment obligation for all liability, regardless of who is at fault for the loss. In other words, the indemnitor assumes the entire risk of loss.

Intermediate form indemnification provisions are not quite as onerous as broad form provisions,

but they are often prohibited by anti-indemnity legislation, depending on the type of intermediate form provision used. Under "full" intermediate indemnification provisions, the indemnitor assumes the loss payment obligation for all liability, so long as the indemnitor is just partially at fault. Put another way, if the indemnitor is only one percent at fault for the loss, it has an obligation to pay for the entire loss. On the other hand, under "partial" intermediate indemnification provisions, the indemnitor assumes the loss payment obligation only to the extent of the indemnitor's fault. Thus, for instance, if the indemnitor is fifty percent at fault, it has an obligation to pay for fifty percent of the loss. Full intermediate indemnification provisions are widely prohibited, while partial intermediate indemnification provisions are typically permissible.

Finally, limited form indemnification provisions are permitted under the law of any state. Under limited form provisions, the indemnitor assumes the loss payment obligation only if it is solely at fault. In other words, the indemnitor is not liable to the indemnitee if the indemnitee is even partially at fault.



(b) Defining the Scope of Indemnification Provisions

In addition to confirming the indemnification provision form is legally permissible, an understanding of the elements of indemnification provisions, and how to articulate each element clearly and unambiguously, is necessary to ensure such provisions are enforceable and function as intended. The typical indemnification clause contains the following elements:

The obligor (indemnifying party) promises to reimburse (and/or defend and/or hold harmless) the obligee (indemnified party) from and against any and all "losses, liabilities, claims, and causes of action" (recoverable damages) incurred by the indemnified party that "cause," "arise from," or are "related to" (nexus phrase) the specified events giving rise to the indemnity obligation (covered events).

Due consideration must be given to each element to craft an effective indemnification provision.

(i) Identify the Indemnified Parties

Indemnification provisions should define the party or parties assuming and receiving indemnity obligations. Importantly, either or both parties to a construction contract may be an indemnitor and an indemnitee, depending on whether the indemnification is unilateral or mutual. For instance, in a unilateral indemnification clause, only one party agrees to indemnify the other, and there is no reciprocation. In a mutual indemnification clause, however, each party agrees to indemnify the other to the extent set forth in the agreement.

In either case, it is important to use precision in defining the indemnified parties. Some contracts define indemnified parties to include officers, directors, managers, members, employees, agents, sub-contractors, or affiliates, among others. The breadth or narrowness of this definition often affects the extent of indemnity obligations in the event of a loss.

(ii) Define the Indemnification Duties

Not only do indemnification provisions shift obligations to pay for the loss of another party, but they also often include obligations to defend or hold harmless. Contracting parties often mistakenly conflate the duties to indemnify, defend, and/or hold harmless and treat them as a single obligation. These terms, however, may give rise to distinct duties.

For instance, the duty to indemnify and the duty to defend are not always coextensive. Some states imply a duty to defend in every indemnification provision unless that duty is expressly excluded (e.g., California), while others do not (e.g., Alabama). Further, although the duty to defend typically includes the right to control the defense, including the choice of counsel, an indemnification provision should explicitly address those issues to avoid any confusion.

Additionally, the duty to indemnify and duty to hold harmless are not synonymous. The duty to indemnify is offensive, while the duty to hold harmless is defensive. That is, the duty to indemnify allows the indemnitee to seek indemnification from the indemnitor. The duty to hold harmless, on the other hand, merely prevents the promisor from suing the promisee.

(iii) Define the Recoverable Damages

The terms used to define the recoverable damages may also have a significant impact on the scope of the indemnification provision. For instance, indemnity against loss or damage is different from indemnity against liabilities, and may affect when an indemnification obligation will be held to commence. If the indemnification provision provides for indemnity against losses, the indemnitee may not recover until it has suffered an actual loss. If the indemnification provision provides for indemnity against liabilities, the indemnitee may recover as soon as liability is legally imposed (e.g., judgment entered), even though it sustained no actual loss.

Indemnification provisions may also broadly define damages to include both direct and indirect damages. Indirect damages include consequential, incidental, punitive, and special damages, and therefore may significantly increase the scope of the indemnitor's liability. To avoid taking on more risk than it can afford, the indemnitor should request that the indemnification provision include a waiver of indirect damages.

The parties should also expressly address whether attorneys' fees are part of the indemnity obligation. In some states, absent language in the indemnification provision allowing for recovery of attorneys' fees, the indemnitee is not entitled to recover attorneys' fees incurred in connection with lawsuits relating to matters for which the indemnitee is entitled to be indemnified.

(iv) Define the Covered Events

The triggering of an indemnification provision is also dependent on the events covered by the provision. Typically, indemnification provisions only cover third-party claims (i.e., claims by a third party against the indemnitee) unless the language clearly reflects an intent to cover direct claims (i.e., claims by the indemnitee against the indemnitor). Thus, the parties should expressly outline the claims the indemnification provision covers. Additionally, the events covered by an indemnification provision may be broadly or narrowly defined. For instance, a broad definition may include indemnity for all negligent acts or omissions of the indemnitor, while a narrow definition may include indemnity only for specific claims or liabilities.

(v) Pay Attention to Nexus Phrases

Another often ignored element of indemnification provisions is the nexus phrase. The nexus phrase refers to the words that link the list of recoverable damages (e.g., losses or liabilities) to the covered events (e.g., the indemnitor's negligence).

The indemnitee should request a broad nexus phrase, such as "related to" or "arising out of" in order to increase the scope of losses for which it may seek indemnity. The indemnitor, on the other hand, should request a narrow nexus phrase, such as "caused by" or "resulting from" in order to narrow the scope of losses covered by its indemnity obligations. In determining the nexus phrase to be used, it is important to bear in mind that courts interpret such phrases differently depending on the governing law.

(vi) Consider Including Deductibles and Liability Caps

A final consideration that affects the scope of indemnity obligations is the inclusion of deductibles and liability caps. Where a deductible exists, the indemnitor is only liable for losses in excess of the deductible amount. As for liability caps, they function to limit the indemnitor's potential liability to a fixed amount. Importantly, liability caps often appear in a general limitation of liability clause covering all contract liabilities (including indemnity). Accordingly, it is important to consider all relevant contract terms in drafting indemnity provisions.

For more information contact:

Robert N. Lane, Esq.
Executive Vice President, Alliant
Robert.Lane@alliant.com

Kevin B. Dreher, Esq.
Partner, Reed Smith
kdreher@reedsmith.com

John D. Shugrue, Esq.
Partner, Reed Smith
jshugrue@reedsmith.com

Alliant note and disclaimer: This document is designed to provide general information and guidance. Please note that prior to implementation your legal counsel should review all details or policy information. Alliant Insurance Services does not provide legal advice or legal opinions. If a legal opinion is needed, please seek the services of your own legal advisor or ask Alliant Insurance Services for a referral. This document is provided on an "as is" basis without any warranty of any kind. Alliant Insurance Services disclaims any liability for any loss or damage from reliance on this document.