Hold Harmless and Indemnity Provisions…What Did I Agree To Do?

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One of the most misunderstood provisions in a construction contract is the indemnity provision. An indemnity provision, which usually includes a requirement to hold harmless and defend another party, is included in nearly all construction contracts. Generally speaking, the upstream party (a general contractor or owner for example) is attempting to shift risk to a downstream party (the general contractor or a subcontractor). In simple terms, subject to certain parameters, the downstream party is agreeing to be responsible for the upstream party.

As an insurance broker focused on the development and construction businesses, we get asked frequently: "If we sign this, are we insured?" It would be great if this could be answered "Yes" or "No," but life is rarely that straight forward. In order to understand whether or not a specific indemnification provision is insurable, we have to drill down in to an actual indemnity.

A typical indemnity provision might read as follows:

"To the fullest extent permitted by law the Contractor shall indemnify, defend and hold harmless the owner, architect, architect's consultants and agents and employees of any of them from and against any claims, damages, losses and expenses, including but not limited to attorneys' fees, arising out of or resulting from performance of the work whether caused in whole or in part by the contractor, a subcontractor, anyone directly or indirectly employed by them or anyone for whose acts they may be liable."

This type of provision requires the contractor (downstream party) to indemnify, defend and hold harmless the owner (upstream party). In layman's terms:

- Indemnify means that the contractor will compensate the upstream party for a loss.
- Defend means the contractor will provide the upstream party with a legal defense.
- Hold Harmless means the contractor will relieve the upstream party from liability for a loss.

The next question is to whom the contractor owes this obligation? The provision is clear, the contractor has an obligation to "the owner, architect, architect's consultants and agents and employees of any of them…" Needless to say, this is overly broad.

Having determined what the contractor's obligations are, and to whom they are owed, we now need to determine when the obligation arises. The obligation arises when there are "any claims, damages, losses and expenses, including but not limited to attorneys' fees, arising out of or resulting from performance of the work…" The challenge with this provision is twofold. First of all, "any claims damages, losses or expenses" is overly broad. The provision could extend to "any claim" the owner or another upstream party may have against the contractor. This, for example, could make the contractor responsible for legal fees that he might not have been otherwise responsible for. Secondly, the phrase that reads "resulting from

performance of the work…" does not require any link at all to the contractor's performance. All it requires is that it results from the "work."

The final phrase of the provision "whether caused in whole or in part by the contractor, a subcontractor, anyone directly or indirectly employed by them or anyone for whose acts they may be liable" makes it clear that so long as the contractor is even remotely at fault, that they will be responsible for 100% of the damages. Although each state may have specific indemnity laws that prohibit an indemnity this broad, the first part of this provision makes it clear that if the indemnity in question is broader than what is allowed under current law that this indemnity will interpreted "to the fullest extent permitted by law."

Our construction clients are asked to sign provisions like this all the time and, as mentioned above, it is not uncommon for them to ask us if such provisions are insurable. In order to determine if a provision is insurable, you need to understand the coverage provided by a contractor's Commercial General Liability (CGL) policy (professional liability is another story altogether). In classic insurance industry style, contractual liability coverage is provided by an exception to an exclusion. Here is the Contractual Liability Exclusion for the standard Commercial General Liability form published by the Insurance Services Office (Form #CG 0001).

Contractual Liability-"Bodily injury" or "property damage" for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:

1. That the insured would have in the absence of the contract or agreement; or
2. Assumed in a contract or agreement that is an "insured contract", provided the "bodily injury" or "property damage" occurs subsequent to the execution of the contract or agreement. Solely for the purposes of liability assumed in an "insured contract," reasonable attorneys' fees and necessary litigation expenses incurred by or for a party other than an insured are deemed to be damages because of "bodily injury" or "property damage", provided:

a) Liability to such party for, or for the cost of, that party's defense has also been assumed in the same "insured contract"; and
b) Such attorneys' fees and litigation expenses are for defense of that party against a civil or alternative dispute resolution proceeding in which damages to which this insurance applies are alleged.

Based on a review of the exclusion, we know that contractual assumptions of liability are not covered, unless the insured would have been responsible any way (even in the absence of the contract) or if the contract is considered an "Insured Contract." The applicable section of the definition of "Insured Contract" reads as follows:

9. "Insured contract" means:

f) That part of any other contract or agreement pertaining to your business (including an indemnification of a municipality in connection with work performed for a municipality) under which you assume the tort liability of another party to pay for "bodily injury" or "property damage" to a third person or organization. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.

So back to the question that started this discussion: "If I sign this indemnity, am I insured?" Well I know what I would say (I'll tell you in a minute) but I wanted to find out what the insurance companies who specialize in construction would say. Not surprisingly, I didn't get a good answer. The typical response

was something like “Every situation is different and has to be evaluated on its merits.” Unfortunately, the underwriters are correct; the answer isn’t black and white. Contractual coverage is often endorsed and coverage can be restricted. You need to understand the specific coverage you have under your commercial general liability policy. In addition, there are indemnity laws in every state that affect this coverage. For example, in California it is illegal to indemnify another party for their sole negligence. It is acceptable, however, to indemnify someone for their contributory negligence.

“OK, great, but we still want to know if the above indemnity is insurable?” Fair enough, if you’ve read this far, you are entitled to one man’s opinion and here it is: Subject to the qualifiers above, if you are covered by the standard ISO Commercial General Liability Policy (CG 0001) and the contractual coverage has not been modified, you would be covered for the contractual assumption of another’s tort liability or negligence that results in either bodily injury or property damage.

There are two key caveats built in to this statement. First of all, the indemnitor (the contractor in this case) must have been at least partially at fault (negligent). Secondly, the damages must involve either bodily injury or property damage.

Final Comments: Just because an indemnity is legal and may be insurable, doesn’t mean it’s fair. While occasionally we come across reasonable indemnification agreements, most, like the one above, are written to strongly favor the upstream party who drafted the contract. The good news is that every contract can be negotiated (okay, most contracts can be negotiated…some clients may tell you to “take it or leave it”) and we strongly suggest when faced with an onerous indemnity that you seek to negotiate a more equitable agreement. The benefits of a good contract attorney and a knowledgeable insurance broker should not be overlooked.

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