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Watch Out for Dangerous Indemnification Clauses

Virtually **all construction contracts contain indemnification clauses**, which are sometimes also referred to as hold harmless clauses. Their purpose is to transfer the risk of loss on construction projects from one party to another. Because they are often long and complex, these clauses are often overlooked during the negotiation stage. Or, the parties assume that they are "boilerplate" clauses which do not need careful scrutiny. **Failing to appreciate the significance of these clauses can be perilous.** In the current economy, owners are taking advantage of their strong bargaining position to beef up contracts and transfer as much risk to the contractor chain as possible. In turn, the one-sided indemnity clauses are passed down the chain to subcontractors, and subs may not be in a position to handle the risk.

In the past, the duty to indemnify was usually triggered if the contractor's (or subcontractor's) *negligence* caused injury or damage. This standard is still **reflected in the standard AIA documents** where the duty to indemnify is triggered by your negligence and your liability is proportionate to your degree of fault. Now, many contracts impose a much broader duty to indemnify. Often, the duty arises if the damages are "work related." This means that it arises if the claim is related to the work in any way. This type of clause usually has language such as *"arising out of the work," "in connection with the work,"* or similar phrases. If a worker is injured at the site while work is ongoing, and the owner is sued by the worker or her family, the contractor must indemnify the owner, i.e., pay all the owner's costs in defending the lawsuit and pay the judgment. The duty to indemnify is triggered ***even if the contractor was not at fault.*** This can be a crippling expense and hard to swallow if you were not at fault.

Some clauses go even further and require the contractor to indemnify the owner ***"even if such injury or damage is caused solely by the Indemnitee's negligence."*** These are called "broad form indemnity clauses." Under them, the contractor is required to indemnify the owner even though the contractor is without fault and the owner's carelessness caused the damage. About half the states have enacted so-called "anti-indemnity" laws to prevent such an inequitable result, but Pennsylvania is not one of them. Our courts will enforce clauses like this as long as they are clear. For that reason, it is **critical that you read and understand the clause** and attempt to negotiate these clauses out.

Another common indemnification clause is one which requires you to indemnify the owner (or the contractor if you are a subcontractor) for damages caused "in whole or in part" by your negligence. These are referred to as "intermediate indemnity clauses." Under them, the contractor is required to indemnify the owner for all the owner's damages if the contractor was at fault in any way (even a small percentage of fault triggers a full indemnity). These are better than the broad-form indemnity clauses requiring you to indemnify even for the owner's negligence, but still very risky.

The third common type of clause is a narrow-form indemnity in which the duty only arises if the damages are caused by your negligence. This type of clause is embodied in the standard AIA contracts. For good reason, most contractors and subcontractors are satisfied with this type of clause since most do not object to paying for damages caused by their own negligence. When confronted with an onerous, broad indemnification clause, I often strive to modify the clause to bring it into line with the standard AIA language.

Indemnification provisions should be added to the checklist of provisions that you carefully review and negotiate before signing the contract. Onerous indemnification clauses are creeping into more and more contracts. To determine whether one is in your contract, look for phrases like *"regardless of whether caused by the sole negligence of the Indemnified Party."*

Subcontractors and second tiers should not assume that because the subcontract does not contain an indemnification clause, no obligation exists. So-called "flow down" or "incorporation by reference" clauses have the effect of making all provisions of the prime contract applicable to the subcontract, including indemnification. Look for language in the subcontract or PO that contains language such as *"... Subcontractor assumes all obligations and responsibilities that the Contractor assumes toward the Owner."* Failing to spot this language or mistakenly assuming your subcontract is the only source of duties can be a costly oversight.

Do not assume your general liability policy will cover your indemnification obligations. CGL policies contain a whole host of exclusions, which **may operate to deny you coverage leaving you holding the bag and paying the costs of another's negligence.** This article only scratches the surface and we recommend that you consult experienced legal counsel to review these clauses - both in contracts offered to you and in your company's standard contracts and purchase orders.