

Maximizing Contractual Indemnity Rights: Components of an Effective Provision

By: William Kennedy
Insurance Coverage Alert
11.23.15

Tort law is aimed at providing compensation to the victims of negligence. Tort law encourages plaintiffs to cast a wide net, pursuing claims or suits against not only those whose fault seems manifestly primary, but also against defendants whose causal exposure is minimal, against those whose exposure is purely by operation of law. As discussed in the first installment of this series, "Maximizing Contractual Indemnity: Problems with Common Law," three common law principles – vicarious liability, joint and several liability, and common law indemnity – cause some parties to pay in excess of their actual degree of causal fault. Contractual indemnity can remedy that harsh result.

Part Two: Components of an Effective Provision

Properly composed, "broad form" contractual indemnity provisions permit an Indemnitee to shift the full range of financial consequences from tort exposure, including civil damages, defense fees, expert fees, and litigation expenses. Such contracts permit indemnity even where the underlying damage was incurred due to a degree of negligence or fault on the part of the Indemnitee. Such contracts can also allow an Indemnitee to shift to the Indemnitor the risk of loss for someone from whom the Indemnitor would otherwise be immune from suit (e.g., the Indemnitor's employees). A well-written contract can even convert an entity which is an Indemnitor as to one party (e.g., a general contractor which has to indemnify a property owner) into an Indemnitee as to another party (e.g., a subcontractor) for the very same risk.

Detail is the key to writing effective contractual indemnity provisions. When faced with a contractual indemnity dispute, courts presume that the contract-writers composed the business agreement in light of then-existing judicial decisions regarding contractual indemnity. For that reason, effective contractual indemnity provisions include language that courts enforce, while avoiding phrases and clauses that have been held unenforceable.

The contractual obligation for the Indemnitor to indemnify the Indemnitee for the Indemnitee's own, actual, active negligence (act or omission) must be clear, repetitive, and unequivocal. It must avoid language that courts have rejected, and use language that courts have upheld. It must clearly identify the Indemnitor, the Indemnitee, the damages or expenses being shifted, and the underlying claims and claimants.

Intent

Most state courts strive to interpret contracts based on their stated intent. The contractual indemnity provisions should expressly acknowledge that it is the parties' intent that Indemnitor(s) will indemnify Indemnitee(s) for all liability that would otherwise arise from any degree of negligence or other liability-causing act or omission of any Indemnitee that causes or contributes to the causation of any injury or damage to any person or entity, including persons or entities from which Indemnitor would otherwise be liable.

Choice of Laws

A contractual provision should start by stating that the indemnity provisions of the contract will be governed by a jurisdiction (e.g., Pennsylvania) whose law allows for such a wide scope of indemnity. Recognizing that a state's statutory and common law can change after the parties sign the contract and before the indemnity clause is litigated, the parties may want to include language along these lines:

The parties expressly intend for the indemnity provisions of this contract to be enforced by any court in which any claim or dispute may be brought. The parties therefore intend these indemnity provisions to be governed by the law of a state which allows for a party to be indemnified against the consequences of its own negligence, even if the underlying claimant is someone from whom the Indemnitor would otherwise not be liable. As of the time of execution of this Agreement, the law of the Commonwealth of Pennsylvania allows for such broad indemnity. The parties therefore choose that these indemnity provisions be governed by the law of Pennsylvania. In the event that such a provision is not enforceable under Pennsylvania as of the time that any claim for indemnity arises or accrues, the parties choose that these indemnity provisions shall be governed by any state that would enforce the language as written.

Defend, Indemnify, and Hold Harmless

In order for an Indemnitee to successfully tender its defense to the Indemnitor, the contract must specify that the Indemnitee has to "indemnify, defend, and hold harmless" the Indemnitor. To exclude any of these three familiar verbs is to invite a recalcitrant purported Indemnitor to litigate the meaning of the absence of any such word. Don't invite mischief: use the language that courts have approved.

Specificity of Indemnitors, Indemnitees, and Claimants

The contract must also specifically identify all parties deemed to be either an Indemnitor or an Indemnitee. Do not define the Indemnitor or the Indemnitee by relationship – e.g., "the hospital," or "the emergency services practice group" – but rather use the parties actual names: "XYZ Non-Profit, Inc." and "ABC Emergency Services, LLC." The parties should enumerate whether the indemnity obligations are meant to apply to parent companies or subsidiaries. To be comprehensive and avoid future disputes, the parties should define whether the definition of an Indemnitee includes the officers, directors, employees, and agents of the parties to the contract, thereby covering individually named tortfeasors, even if the contracting company itself is not named as a defendant.

If the Indemnitee wants protection from claims for which the Indemnitor would otherwise be immune – e.g., an Indemnitor's own employees by whom workers compensation statutes bar claims against the employer/Indemnitor – the contract needs specific language. Case law is replete with judicial opinions which warn of the need for specificity in this regard. A contract that intends to allocate to an Indemnitee the risk of loss for injuries sustained by employees of the Indemnitor needs express, specific language such as, "It is the express intention of the parties that [name of Indemnitee] shall be indemnified, held harmless, and defended against with respect to claims or suits brought by employees of [the Indemnitor]."

Causation

The contract must specify the alleged cause of the harm for which indemnity is to be provided. Again, don't invite mischief by straying from language that courts have approved. Use language such as the phrase "arising, in whole or in part, from the act or acts, omission or omissions, work, work product, or any other conduct of any or all Indemnitees, their agents, employees, officers, directors, and/or subcontractors..."

Classification of Damages

The parties should specify the kind of damages allegations and claims for which the indemnity obligations exist (e.g., property damage, personal injury, commercial injury, claims of reputational loss or intellectual property, etc.). The contract should specify that the Indemnitor's duties extend to "any and all liabilities, claims, damages, and/or expenses ... including attorneys fees, litigation expenses, investigation expenses, and the costs and fees of expert witnesses..."

Amount of Damages

The contractual parties should specify whether there are financial limits on an Indemnitor's obligation to indemnify the Indemnitee. If the Indemnitor's indemnity obligation is being insured by the Indemnitor's insurer, then to avoid an uninsured exposure on the part of the Indemnitor, the parties may want to define a ceiling on potential exposure that mirrors the insurance agreement.

"Pass-Through Indemnity"

In projects involving many different entities and subcontracts, an entity is both an Indemnitor as to one party and an Indemnitee as to another. For example, a General Contractor may be the project Owner's Indemnitor, and yet the General Contractor may also be a Subcontractor's Indemnitee. If the parties want the Subcontractor's indemnity obligations to the General Contractor to extend – or "pass through" – to the Owner, the contract must explicitly specify such an obligation in each of the contracts in the chain. The subcontracts must be extraordinarily specific in identifying those to whom indemnity obligations passes through to protect, as well as the scope of risks that are being shifted.

Business contracts that contain all of the specificity outlined herein – especially the choice of laws provision – have a high probability of being enforceable in any jurisdiction. For Indemnitees, however, that's only half the battle. Indemnitees – and Indemnitors, too – will want the Indemnitor's obligations to be insured by a solid, reputable insurance company. Part 3 of this series will examine the details of obtaining insurance coverage for an Indemnitor's obligation to indemnify Indemnitees.

For further information or questions concerning contractual indemnity, please contact William Kennedy (215.864.6816; kennedyw@whiteandwilliams.com).

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