

Liability Insurance and Indemnification

by Quenda Behler Story

A contractor recently approached me with the following question: "My liability insurance company says I must have indemnification or hold-harmless clauses in all of my contracts with my customers and my subs. What's the deal with that?"

Financial Tag

Hold-harmless and indemnification agreements are basically the same thing: risk management devices that manage risk by passing it off onto somebody else — kind of like a game of financial tag. One person gets another person to accept his or her risk of having to pay a liability claim. Sometimes the contractor promises to indemnify (hold harmless) the property owner. Sometimes a sub promises to indemnify the contractor. Sometimes the property owner or the contractor promises to indemnify the architect.

The point is that if you include a clause in your contracts requiring property owners and subs to indemnify you for liability claims, you've passed the risk of a claim on to them — and your insurance company is off the hook.

For example, suppose some passing stranger is injured by falling debris on the job site and successfully sues the property owner for negligence. That's a liability claim. If Sam the Contractor has agreed to indemnify the property owners for third-party liability claims (by third party, I mean deliverymen, building inspectors, wandering children, trespassers, and so forth), Sam has to pay the claim. (If Sam's contract had required the property owners to indemnify *him*, the property owners would have to pay that claim, whether they were sued or Sam was sued.)

Reasons for Indemnifying Others

Why on earth would Sam agree to this? Why would anyone? The first rea-

son has to do with who's got the most clout in a negotiation. In other words, if you're a contractor, how badly do you want the job? If you're a property owner, how badly do you want the job done? Indemnification of the other party can be a bargaining chip.

Another reason is to make an honest effort between the parties to apportion the cost of an accident to the person who's most likely in a position to prevent it. In effect, the parties agree about that in advance.

Tougher Insurance Requirements

Until recently, contractors didn't have to worry particularly about indemnity promises, because most liabilities incurred by a contractor were paid by his or her liability insurance. Indemnity agreements worked as a sort of liability musical chairs to see whose insurance company — the property owner's, the contractor's, or the sub's — would wind up paying a claim. Nowadays, however — especially with certain kinds of risks — that buck doesn't always stop at the insurance company, so the party promising indemnity might have to pay a claim out of his own pocket.

How could that happen? After all, paying off liability claims is what liability insurance is for, and it costs some pretty back-breaking premiums, too.

Here's how it could happen: By excluding certain kinds of claims from their coverage — like claims about mold, lead, and some types of exterior cladding — insurance companies are reducing the risk that they might actually have to pay out some money. Insurance companies do not want to pay if you are sued by a homeowner because, for example, after you installed an exterior insulation finish system, a lot of ugly mold

grew under it and the homeowner's children developed asthma.

What You Can Do

So what can you do to protect yourself? First, review what your insurance actually covers. Don't assume that because you had an insurance review a few years ago, you're okay. Second, read your contracts to see exactly what you're promising to whom. Don't skip over the legalese. If you aren't sure what something means, ask your attorney.

While you're reading that legalese, see who pays the legal bills if someone claims to have been injured and sues. Even if you promise someone indemnification, you don't want to also promise to pay his legal bills — especially if the injured party loses in court.

In the following example, the legal language is unacceptably broad from the standpoint of the contractor because it includes words like "every" and "claim" in addition to "liability":

The contractor shall at all times indemnify the property owner harmless from every claim, demand, liability, and loss....

This means that the contractor might have to pay a settlement or even an invalid claim. Also, the contractor seems to be accepting the obligation to pay the property owner's attorney fees and, depending on state law, the obligation to pay claims occasioned by the property owner's negligence.

Even though the next example doesn't use the magic terms "hold harmless" or "indemnity," it is nevertheless an indemnity promise, because the contractor is promising to reimburse the property owner if the property owner is forced to pay a claim relating

► Legal

to an injury on the job site, even if it's the property owner who was negligent:

The contractor will pay and discharge any and all liability against the property owner rising out of the subject matter of the contract....

On the other hand, you do want to be sure the legalese gives you the right to get involved in the court battle if you need to. For example, suppose the property owner's father-in-law comes over to check on the work, and he falls into the excavation and hurts himself. You want the right to defend against the father-in-law's lawsuit yourself, because the property owner might not be willing to vigorously defend himself by doing what amounts to calling his father-in-law an idiot.

The sample clause that follows gives the contractor the right to get involved early on if he or she chooses:

The property owner shall immediately notify the contractor of every claim that has potential liability, and the contractor shall have the option to intervene at any level to resolve any claim with potential liability.

What Else Can You Do?

Sometimes you will want to be the beneficiary of an indemnity clause. If there's an iffy situation on the job site — if, for instance, the property owners are still living there — you want to be sure the homeowners have agreed to indemnify you (in case their five children have friends over on the weekend and they all play in the excavation).

The next example requires the property owner to indemnify the contractor if the property owner is careless or negligent; it also gives the contractor the right to intervene if the property owner does not defend himself adequately:

The property owner shall indemnify and hold the contractor harmless from all claims, demands, liability,

and losses which result from the carelessness, negligence, or failure of the property owner to act in a careful and prudent manner. The contractor shall have the option to intervene in the claim at any level.

Also, make sure your subs have agreed to indemnify you in case you have to pay a claim for their negligence. Get and keep copies of their insurance certificates so you know they can pay you if their negligence costs you money.

A last word of warning: There is, in tort law, a concept called *implied indemnification*, which means that you could be on the hook for indemnification without having anything about it in your contracts. So get out those liability insurance policies and read them carefully to make sure you're covered in the event someone demands indemnification from you.



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