Negotiating Indemnification Provisions and Agreements

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Indemnity is the "duty to make good any loss, damage, or liability incurred by another and the right of an injured party to claim reimbursement for its loss, damage, or liability from a person who has such a duty."[i] In its simplest usage in insurance, the term indemnity refers to the compensation necessary to reimburse for loss.[ii] The goal of inclusion of an indemnification provision is to transfer the risk of loss from one party to the other.[iii] Therefore, when one party suffers a loss, the other party pays proceeds or a benefit to the other in an amount that offsets the loss.[iv] This arrangement is based upon the assumption that the value of the benefit paid to the indemnitee will not exceed the amount of the loss; that is, it aims to reimburse and to do nothing more.[v] As such, while a party may pay an amount less than the loss, it would be inconsistent with the principle of indemnification if the party is paid a benefit greater than the loss.[vi]

Interpretation of Indemnification Provisions

Indemnification provisions are "construed in accordance with the rules for construction of contracts generally."[vii] Therefore, the plain meaning of the language will prevail and courts will typically look to the intent of the parties to interpret the provision.[viii] However, when the "meaning of the clause is ambiguous, … the clause should be strictly construed against" the" drafter of the provision.[ix]

Indemnification for Negligence

Traditionally, contractual indemnity focuses on claims or losses brought by third parties against the indemnitee.[x] Absent contractual indemnity, a party cannot seek indemnification for their own wrongdoing (i.e. you can only seek indemnification for liability you incurred due to someone else's wrongdoing). However, indemnification provisions can vary widely and may

include claims caused, in whole or in part, by the indemnitee's own fault or negligence or breach of contract.[xi]

Generally speaking, these contractual indemnification provisions that seek indemnification for one's own fault either are not permitted or are disfavored and are subject to a strict construction compelling an interpretation against the party seeking such protection. For example, Arkansas law prohibits indemnification provisions in construction contracts for damages "arising out of the sole negligence of the indemnitee."[xii] In North Carolina, though, the law prohibits indemnification provisions in construction contracts for damages "proximately caused by or resulting from the negligence, in whole or in part, of the" indemnitee.[xiii]

In most jurisdictions where parties may lawfully contract to indemnify one party from the latter's own acts of negligence without violating public policy, an indemnity agreement for one's own negligence is generally not enforced unless the agreement spells out the indemnitor's obligation in clear and unequivocal terms.

Indemnification for Negligence – New Jersey

Even if a state permits indemnification for the indemnitee's sole or partial negligence, the indemnification provision may be invalid unless it clearly and unequivocally provides indemnification for that negligence. In New Jersey, the State's Supreme Court held that

> A contract will not be construed to indemnify the indemnitee against losses resulting from its own negligence unless such intention is expressed in unequivocal terms. The court observed that this general rule is fortified by N.J.S.A. 2A:40A-1, which specifies that an indemnification agreement in a 'maintenance' or 'construction' contract purporting to hold harmless the indemnitee for losses or damages resulting from its sole negligence is a violation of public policy. Although the court recognized that N.J.S.A. 2A:40A-1 was not applicable to *Geralnik* because both PBS and Newport Mall were found to be at fault, the panel stated that the statute emphasizes that there is a presumption against indemnifying an indemnitee for its own negligence that can be rebutted only by plain language clearly expressing a contrary intent.[xiv]

The New Jersey Supreme Court in another decision further held that indemnification provision must be explicit and "unequivocal on the subject of the indemnitee's negligence."[xv]

Indemnification and "Hold Harmless" Agreements

Indemnification is "a duty to make good any loss, damage, or liability incurred by another and the right of an injured party to claim reimbursement for its loss, damage, or liability from a person who has such a duty."[xvi] A "hold harmless" clause is "a contractual arrangement whereby one party assumes the liability inherent in a situation, thereby relieving the other party of responsibility."[xvii]

Most courts hold that "indemnity" and "hold harmless" are synonymous. For example the Eighth Circuit recently stated that "[a]n indemnity clause, also termed hold-harmless clause or save-harmless clause," is a contractual provision in which one party agrees to answer for any specified or unspecified liability or harm that the other party might incur.[xviii]

Other courts disagree, however, and hold that a "hold harmless" clause is an exculpatory provision releasing the indemnitee from liability to the indemnitor (as opposed to third parties).[xix]

Interplay Between Indemnification and Additional Insured Provisions

In addition to contractual indemnity clauses, contract will often include insurance clauses. These clauses spell out the type and amount of insurance and other insurance-related obligations required by the various parties to the contract. However, while insurance is often considered a "backstop" to indemnity, it does not necessarily follow that the scope or nature of the insurance protection is coextensive with or limited to that provided by indemnity.[xx] Therefore, because they are separate provisions and absent any terms of incorporation, the indemnity clause does not determine the scope of insurance coverage, and the insurance clause does not determine the scope of indemnity coverage. As such, parties must be wary of the language that is placed in both the indemnification and insurance provisions.

In many of these cases, to help transfer the risk, a contract requires that a party obtain coverage under the other party's insurance policy (i.e. add them as an additional insured under their policy). Additional insured coverage allows a third-party to have direct access to the named insured's policy in certain situations. One benefit is that it provides coverage to the additional insured without eroding the additional insured's limits under its own policy, regardless of whether the indemnitor has sufficient assets to indemnify the indemnitee under a contractual indemnitee provision.[xxi]

Whether an additional insured clause provides the same protections as an indemnity clause depends on the language of the insurance policy. For example, as set forth above, some states prohibit or limit an indemnification provision from covering a party's own negligence. However, this same limitation may not apply to an insurance policy. For example, the 5th Circuit recently confirmed the principle that even where an indemnification provision may be unenforceable, coverage could be provided under the insurance provisions. Specifically, the Court held:

> [Insurance company] argues that the [Agreement] is not an insured contract because its indemnity provision is unenforceable under Texas law, and therefore [the indemnifier] never actually assumed any tort liability. Because indemnity provisions effect an extraordinary result—"exculpat[ing] a party from the consequences of its own negligence" before that negligence even occurs—Texas imposes a fair notice requirement. Specifically, the fair notice requirement incorporates the express negligence doctrine and the conspicuousness requirement. A contract that fails to comply with either requirement is unenforceable under Texas law. [Insurance company] argues that the [Agreement] does not comply with the express negligence doctrine, which requires that the intent to indemnify a party from the consequences of its own negligence "must be specifically stated in the four corners of the document."
>
> We assume, without deciding, that the [Agreement]'s indemnity provision is unenforceable under Texas law. We therefore must decide whether the [Agreement] can still be an insured contract under the policy. Although the Texas Supreme Court has never addressed this precise issue, it is largely resolved by our opinion in *Swift*. There, *Swift* sought coverage in an underlying negligence case as an additional insured under a policy. The policy defined "insured contract" to include a contract under which the insured "assume[s] the tort liability of another party." The insurance company argued

> that it had no duty to defend because the master service agreement between the contractor and Swift violated the Texas Oilfield Anti–Indemnity Act. As such, the insurance company contended that the agreement was unenforceable and not an insured contract because it did not assume any liability. We first noted that, when an insurer seeks to deny coverage, the terms of an insurance policy should be construed broadly in favor of coverage. Based on that principle and the lack of relevant precedent, we held that the agreement was an insured contract within the context of interpreting the policy because Mid–Continent had intended to assume Swift's tort liability. The indemnity provision therefore qualified as an insured contract, and Swift qualified as an additional insured.
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> Here, as in *Swift*, [Insurance company]'s argument relies on the policy language defining an insured contract as one that "assume[s] the tort liability of another party," and concludes that an unenforceable provision does not actually assume liability. However, as we explained in Swift, the additional insured question turns not on enforceability, but on whether [the indemnifier] agreed to "assume the tort liability of another party." In the [Agreement], [the indemnifier] contracted not only to indemnify [the indemnitee], but also to secure insurance on its behalf; by doing so, it agreed to assume [the indemnitee]'s tort liability. That provision is not rendered void by the indemnity provision, even if it is unenforceable. As such, [the indemnifier] agreed to assume [the indemnitee]'s tort liability, and [the indemnitee] qualifies as an additional insured.[xxii]

Some states have recently enacted legislation prohibiting coverage for the additional insured's own negligence where that negligence could not be transferred via an indemnity agreement. In states where additional insured status is within the jurisdiction of the anti-indemnity statute, an additional insured's coverage cannot be broader than its protection as an indemnitee.

For example, Kansas law provides:

> An indemnification provision in a contract which requires the promisor to indemnify the promisee for the promisee's negligence or intentional acts or omissions is against public policy and is void and unenforceable.
>
> A provision in a contract which requires a party to provide liability coverage to another party, as an additional insured, for such party's own negligence or intentional acts is against public policy and is void and unenforceable.[xxiii]

Similarly, Oklahoma law holds:

> Any provision in a construction agreement that requires an entity or that entity's surety or insurer to indemnify, insure, defend or hold harmless another entity against liability for damage arising out of death or bodily injury to persons, or damage to property, which arises out of the negligence or fault of the indemnitee, its agents, representatives, subcontractors, or suppliers, is void and unenforceable as against public policy.[xxiv]

In a recent decision by the New Jersey Appellate Division, the court found that a policy providing additional insured coverage for liability "caused, in whole or in part, by [the Named Insured's] acts or omissions" did not cover the additional insured's sole negligence.[xxv] In that case, the plaintiff was seriously injured when he fell approximately fifteen feet from the mezzanine level of a warehouse to a concrete floor below.[xxvi] At the time of the accident, the plaintiff was employed by WillStaff, a temporary employment agency.[xxvii] Plaintiff was working at a Toys'R'Us warehouse located in Flanders, New Jersey, under a service agreement between WillStaff and Toys'R'Us.[xxviii] The plaintiff testified at his deposition that he was guiding a pallet of Toys'R'Us merchandise from a forklift onto a roller conveyor system when he slipped on one of the wheels" that was part of the roller conveyor and that caused him to fall.[xxix] Plaintiff also testified there were no guardrails or any safety precautions of any sort in the area where he fell.[xxx] Following the accident, plaintiff filed a workers' compensation claim against WillStaff and received workers' compensation benefits.[xxxi] Plaintiff also commenced a lawsuit alleging that the negligent and intentional misconduct Toys'R'Us caused his injuries.[xxxii] In a third-party complaint, Toys'R'Us' asserted an indemnification claim against WillStaff and an insurance coverage claim against Hartford based on the Agreement between WillStaff and Toys'R'Us, which required WillStaff to obtain a general liability policy with Toys'R'Us named as an additional insured.[xxxiii]

Among other terms in that agreement, Toys'R'Us agreed to hold WillStaff harmless for any claims stemming from the operation of vehicles or machinery during its work.[xxxiv] The policy that WillStaff eventually obtained from Hartford under the agreement covered Toys'R'Us as an additional insured for injuries caused by the acts or omissions of WillStaff, according to the

opinion.[xxxv] WillStaff and Hartford moved for summary judgment after discovery.[xxxvi] Agreeing with the trial court, the Appellate Division held that WillStaff did not agree to cover Toys'R'Us for its own actions or omissions, or liability arising from the operation of that company's equipment and machinery.[xxxvii] The Appellate Division further held that the additional insured coverage only applied to "claims alleging liability based on WillStaff's acts or omissions."[xxxviii]

Limitation of Liability

Limitation of Liability ("LOL") clauses, like indemnification provisions, are used to limit and allocate risks in commercial relationships. LOL clauses: (1) place limitations on certain categories of liability; and (2) place limitations on the amount of liability.[xxxix]

LOL clauses are subject to some limitations. One generally cannot use a LOL clause to exclude liability for third party claims under indemnification provisions, breach of confidentiality provisions, gross negligence, intentional conduct, or fraud. LOL clauses, similar to other contract terms, cannot be unconscionable and certain professionals, such as attorneys and physicians, cannot use these clauses to preclude negligence suits. [xl]

An exclusive remedy clause limits the indemnitee's ability to pursue claims not expressly covered by the indemnification provision. Such provisions are generally enforced except in instances of fraud, criminal activity, or intentional conduct. An exculpatory clause—also referred to as "waiver," "release," or "assumption of the risk" may be unenforceable in some states. Exculpatory clauses extinguish or limit liability of a culpable party. Accordingly, they are strictly construed and generally disfavored.

Indemnification vs. Subrogation

Subrogation is the legal doctrine whereby one person takes over the rights or remedies of another against a third party. Typically, it allows an insurance company, after paying a first-party loss to its insured, to succeed to the rights of its insured against any third party that is legally

responsible for the loss. Subrogation is a derivative right and it exists only to the extent the party suffering the loss has rights of recovery against others.[xli]

Limits on Indemnification in Government Contracts

Government agencies (federal and state) may be prohibited from agreeing to unrestrained indemnification provisions due to statutory or constitutional limitations. For example, the United States Court of Claims made clear that "[t]he United States Supreme Court, the Court of Claims, and the Comptroller General have consistently held that absent an express provision in an appropriation for reimbursement adequate to make such payment, [the Anti-Deficiency Act] proscribes indemnification on the grounds that it would constitute the obligation of funds not yet appropriated." Another example comes from the Colorado Court of Appeals, which found that a contractor indemnification claim against a public entity was statutorily barred because the contractor failed to follow the procedures outlined in the statute to obtain indemnification.[xlii]

Notice

An indemnitee is not obligated to notify the indemnitor of a claim unless the indemnification agreement so requires.[xliii] Depending on the nature of the indemnification provision, an indemnitee may need to tender notice of defense to the indemnitor or the indemnitor's insurance carrier. If the indemnitor has been properly notified of or made party to the action, but declines to defend, he will be bound "by any reasonable good faith settlement . . . or . . . judgment that may be rendered against him."[xliv] Along with good faith settlement, the indemnitee need only make a showing of "potential liability."[xlv] If the indemnitor has not been put on notice or made party to the action, the indemnitee must prove actual liability and that the settlement was reasonable.[xlvi]

Statute of Limitations/Trigger

Statute of limitations for indemnity actions vary depending on the State. In New Jersey, for example, an action for indemnity must be commenced within six years after the cause of action accrued.[xlvii]

When an indemnity claim accrues depends on what triggers a particular indemnity obligation (i.e, indemnity for "claims" versus for "liability" versus for "loss"). The New Jersey Appellate Division has found that in indemnification agreements for loss, the cause of action accrues when the liability is discharged by payment and the surety suffers an actual loss.[xlviii] Notably, the agreement in *First Indemnity of America Insurance Co. v. Kemenash* indemnified the surety as to both liability and loss.[xlix] However, the surety did not sue on the indemnity agreement until almost six years after the loss accrued.[l] The defendant-contractor contended that the complaint for loss should be dismissed because it was barred by the statute of limitations due to the surety's cause of action accruing at the point when liability was imposed upon it, which was more than six years before the complaint was filed.[li] The Court disagreed, finding that the surety could maintain an action for recovery for "actual loss," even though the time had expired on an action to recover on the agreement to indemnify based upon the imposition of liability, because the surety's first actual payment for the loss was less than six years before it filed the lawsuit.[lii]

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[i] Black's Law Dictionary 886 (10th ed. 2014).
[ii] *New Appleman on Insurance Law*, Essential of Insurance Law, Volume One, §1.05[4].
[iii] *Id.*
[iv] *Id.*
[v] *Id.*
[vi] *Id.*
[vii] *Mantilla v. NC Mall Assocs*., 167 N.J. 262 (2001).
[viii] *Id.*
[ix] *Id.*
[x] *The Interplay Between Indemnification Provision and Insurance Clauses in Contracts for Goods and Services*, Vickie A. Gesellschap and Ronald L. Hicks. Jr. (March 2014).
[xi] *Id.*
[xii] Ark. Code § 4-56-104.
[xiii] N.C.G.S.A. § 22B-1.
[xiv] *Mantilla v. NC Mall Assocs*., 167 N.J. 262 (2001).
[xv] *Azurak v. Corporate Prop. Investors,* 175 N.J. 110 (2003).

[xvi] Black's Law Dictionary 772 7th Ed. (1999).
[xvii] Black's Law Dictionary 658 5th Ed. (1979).
[xviii] *Praetorian Ins. Co. v. Site Inspection*, LLC, 604 F.3d 509 (8th Cir. 2010).
[xix] *Fernandez v. K-M Indus. Holding Co.*, 646 F. Supp.2d 1150 (N.D. Cal 2009).
[xx] *The Interplay Between Indemnity and Insurance Clause*, Law 360, Jeffrey A. Kiburtz and Clark Thiel (July 31, 2015).
[xxi] *Understanding Additional Insured Coverage and Contractual Indemnity*, RIMS Annual Conference, Tabitha Prestler and Joann M. Lytle (April 12, 2016).
[xxii] *Gilbane Building Co. v. Empire Steel Erectors, L.P.*, 664 F. 3d 589 (5th Cir. 2011) (internal citation omitted).
[xxiii] Kansas Stat. § 16-121 (2011).
[xxiv] 15 Okl. St. Ann. § 221 (2014).
[xxv] *Smith v. Toys "R" Us, Inc.*, No. A-1635-10T3 (N.J. App. Div. Sept. 5, 2012).
[xxvi] *Id.*
[xxvii] *Id.*
[xxviii] *Id.*
[xxix] *Id.*
[xxx] *Id.*
[xxxi] *Id.*
[xxxii] *Id.*
[xxxiii] *Id.*
[xxxiv] *Id.*
[xxxv] *Id.*
[xxxvi] *Id.*
[xxxvii] *Id.*
[xxxviii] *Id.*
[xxxix] *Ironclad Indemnification Provision in Business Agreements*, National Business Institute, Nicholas M. Insua (May 17, 2017).
[xl] *Id.*
[xli] *What Every Leasing Attorney Needs to Know About Insurance: Negotiating Specific Lease Clauses*, Scott B. Osborne (September 28, 2007).
[xlii] *Thyssenkrupp Safway, Inc. v. Hyland Hills Parks and Recreation Dist.*, 271 P.3d 587 (Colo. 2011).
[xliii] *Feuer v. Menkes Feuer, Inc.*, 8 A.D.2d 294 (1st Dep't 1959).
[xliv] *Id.*
[xlv] *One Beacon Ins., LLC v. M & M Pizza, Inc.*, 160 N.H. 638 (2010).
[xlvi] *Gulf Group Holdings, Inc. v. Coast Asset Management Corp*., 516 F.Supp.2d 1253 (S.D. Fl. 2007); *Dunn v. Uvalde Asphalt Paving Co.*, 175 N.Y. 214 (N.Y. 1903).
[xlvii] *N.J.S.A.* 2A:14-1.
[xlviii] *First Indem. of Am. Ins. Co. v. Kemenash*, 328 N.J. Super. 64, 72 (App. Div. 2000).
[xlix] *Id.*
[l] *Id.*
[li] *Id.*
[lii] *Id.*