

Understanding Indemnification Clauses

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Introduction

Construction projects are risky. Contracts allocate risks between the parties. Indemnification clauses shift risk from one party to another. Many parties pay little attention to their contracts' indemnification clauses because the language seems obscure. This article is intended to help participants understand the key issues.

Indemnification

Let's begin by defining "indemnification clauses." To "indemnify" is to compensate someone for injury or losses incurred (or to be incurred) as related to an event or incident. <https://www.law.cornell.edu/wex/indemnify>. Indemnification clauses are contractual provisions that require one party (the "Indemnitor") to indemnify another party (the "Indemnitee") for losses that the Indemnitee may suffer. In prime contracts, the owner usually is the Indemnitee and the contractor is the Indemnitor. In subcontracts, the contractor usually is the Indemnitee and the subcontractor is the Indemnitor.

Types of Indemnification Clauses

Indemnification clauses come in all shapes and sizes. The most common ones in construction contracts require the Indemnitor to indemnify the Indemnitee for losses related to the Indemnitor's work. Clauses vary based on how closely the Indemnitor's loss must relate to the Indemnitee's scope of work, whether the Indemnitee must prove that the Indemnitor was negligent, whether the Indemnitor's negligence is a defense, whether the recoverable losses must relate to personal injury or property damage other than the work itself, and other factors.

Below is a sample indemnification clause, including deletions an Indemnitee might propose to increase the Indemnitor's liability:

To the fullest extent permitted by law, the Contractor shall indemnify and hold harmless the Owner, Architect, and their agents and employees from claims, losses, and expenses, including attorney fees, arising out of or resulting from performance of the Work or a breach of this agreement provided that such claim, damage, loss, or expense is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the Work itself), but only to the extent caused by the negligent acts or omissions of the Contractor or any of the Contractor's employees, subcontractors, or suppliers.

Construction lawyers often classify general indemnification clauses as "broad," "limited," or "intermediate," depending on whose actions caused the losses. Broad indemnification clauses require the Indemnitor to indemnify the Indemnitee for all losses related to the Indemnitor's work, even losses caused solely by the Indemnitee. Intermediate indemnification clauses require the Indemnitor to indemnify the Indemnitee for all losses, except when the Indemnitee is 100% responsible for the loss. Limited indemnification clauses require the Indemnitor to indemnify the Indemnitee only to the extent the Indemnitee's injuries and losses were caused by the Indemnitor.

Anti-Indemnity Statutes

Many states have adopted statutes limiting the enforceability of indemnification clauses. The statutes limit the Indemnitor's obligation to indemnify the Indemnitee for the Indemnitee's own negligence. The policy reason for regulating indemnity clauses is that society needs everyone to act non-negligently to prevent harm to persons or property. According to his logic, the indemnification clause creates a moral hazard by reducing the incentive for the Indemnitee to act reasonably to avoid loss.

Both North Carolina and South Carolina have anti-indemnity statutes. North Carolina's anti-indemnity statute (N.C. Gen. Stat. § 22B-1) invalidates indemnification clauses in construction contracts that purport to require the Indemnitor to indemnify the Indemnitee for injuries or losses that result from the Indemnitee's own negligence. South Carolina's statute (S.C. Code § 32-2-10) invalidates only indemnification clauses that purport to require the Indemnitor to indemnify the Indemnitee for injuries or losses that result from the Indemnitee's **sole** negligence.

Anti-indemnity statutes are the reason most indemnification clauses contain the phrase, "To the fullest extent allowed by law." Such phrases are called "savings clauses." Savings clauses ask the court to remove the portions of indemnification clauses that violate a statute but to enforce the remaining language. Most courts honor savings clauses.

Considerations for the Parties

Indemnitors prefer narrow indemnification clauses that limit their risk. Limited clauses expose Indemnitors to less liability. Clauses that require indemnification only for negligence that results in personal injury or damage to property other than the work itself provide the added benefit of tracking the language of a typical CGL insurance policy. This tracking can allow the Indemnitor to pass risk to an insurer.

Indemnitees prefer broad indemnification clauses because they want to avoid suffering losses that result from improper performance of work. Many Indemnitees expect Indemnitors to absorb all the risks associated with the performance of the contract.

In negotiating construction contracts, many parties look to industry-form contracts as an arbiter of “fairness.” What do industry form contracts say about indemnification? Both AIA A201 (2017 - §3.18) and ConsensusDocs 200 (§10.1.1) contain indemnification provisions that require the contractor to indemnify the owner for losses that arise from the contractor’s performance of the work, with two important limitations:

1. The losses must be attributable to personal injury or damage to property other than the work, and
2. The contractor is liable only to the extent the losses resulted from the negligence of the contractor (or the contractor’s employees or subcontractors).

Under the form contracts, negligence by the Owner does not provide a defense (but an anti-indemnity statute might).

Conclusion

Understanding indemnification clauses helps construction industry participants and their counselors negotiate better contracts and evaluate their contractual risks with coverage under their insurance programs.