Pay Attention to the Indemnification Clause in the Subcontract

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Most subcontracts contain indemnification clauses, also sometimes referred to as "hold harmless clauses." Their purpose is to transfer the risk of certain losses or expenses on construction projects from the GC to the subcontractor. Usually (but not always), the losses or expenses which trigger the subcontractor's duty to indemnify are those involving bodily injury or property damage. Because they are often composed of complex language or "legalese," these clauses are sometimes overlooked by subcontractors during the negotiation stage. Or, the parties assume that they are boilerplate clauses which do not require careful scrutiny or revision to their language. Failing to appreciate the significance of these clauses can be costly and perilous. Indemnification clauses often require the subcontractor to defend and reimburse (indemnify) the GC against certain losses or expenses. Indemnification clauses often originate in the owner/contractor agreement and the GC attempts to push down to the subcontractors as much of the indemnification risk that he has assumed toward the owner as possible.

Standard industry contract forms like those prepared by the AIA and ConsensusDocs contain what is often referred to as a "narrow indemnity obligation" in which the duty to defend and indemnify arises only if the subcontractor's *negligence* caused the injury or damage. Clauses like this often state that the subcontractor shall defend and indemnify the GC for claims, losses, damages and expenses incurred by the GC due to claims made against the GC by third parties for bodily injury or property damage, *but only to the extent caused by the subcontractor's negligence*. First, language of this type requires a subcontractor to indemnify the GC only for loss or damage caused by the subcontractor's negligence. It also involves a comparison of the degree of the subcontractor's fault in causing the damage. Many losses are caused by multiple different causes with various entities at fault and contributing to the loss or damage. If the subcontractor is adjudged to be 50 percent responsible for the loss or damage under this type of clause, it will be responsible for half the damages. If the subcontractor is only 10 percent responsible, it will be liable for 10 percent of the defense costs and 10 percent of the loss or damage, and so on.

Unfortunately, these and other standard subcontracts do not always reflect actual industry practices in many areas. Many subcontracts do not track the AIA and ConsensusDocs language and contain much broader defense and indemnity obligations. These broader types of provisions typically require the subcontractor to defend and indemnify the GC if the claim, loss, damage or injury arises out of or is related to the subcontractor's work. In other words, the subcontractor does not have to be at fault or negligent in any respect in order to be required to defend and indemnify the GC. This type of clause usually has language using words stating that the subcontractor is required to defend and indemnify the GC for losses and damages which *arise out of the subcontractor's work*, or *in connection with the subcontractor's work*, or similar phrases. Note how it differs from the narrower defense and indemnity obligation described above which limits the duty to the subcontractor's negligence and only to the extent of that negligence. Under this type of clause, if a person is injured at the site and if it has any connection whatsoever to the subcontractor's work, and the GC incurs costs, losses or damages, the subcontractor must defend and indemnify the GC. The duty arises regardless of whether the subcontractor is negligent. This type of clause clearly presents more risk for subcontractors. For example, when a subcontractor's employee is injured on the job site, that injury usually is connected to the subcontractor's work. Who or what caused the injury does not matter—the subcontractor is still required to defend and indemnify the GC under a clause like this.

Another common indemnification clause is one which requires the subcontractor to indemnify the GC for damages caused "in whole or in part" by the subcontractor's negligence. These are often referred to as "intermediate indemnity clauses." Under them, the subcontractor is required to indemnify the GC for all the GC's damages if the subcontractor was at fault in any way. Even a small percentage of subcontractor fault requires the subcontractor to pay all the GCs defense costs and reimburse all its losses. If the subcontractor was only 10 percent at fault, it must indemnify for 100 percent of the loss or damage.

Some clauses go even further and require the contractor to indemnify the GC for all the loss or damage "*even if such injury or damage is caused solely by the GC's negligence*" or contain words to that effect. These types of clauses are often referred to as

"broad indemnity clauses" (although they won't be labeled as such in the subcontract). The category into which they fall can only be determined by carefully studying the entire clause and determining the scope of the duty it requires. Under these broad clauses, the subcontractor is required to indemnify the GC even though the subcontractor is without fault and the GC's negligence caused all the damage. The expense of defending and reimbursing the GC when the GC or others were entirely at fault and you were not can be hard to swallow and very expensive. These clauses run counter to the widely accepted principal that liability typically follows fault. About two-thirds of the states have enacted so-called "anti-indemnity" laws to prevent such an inequitable result. These anti-indemnity laws state that a party cannot be required to indemnity another party for the latter's own negligence. If the subcontract attempts to require the subcontractor to indemnify the GC for loss or damages caused by the sole negligence of the GC, it might not be enforced in one of these states. Check with your attorney to find out if your state has an anti-indemnity statute.

Subcontractors might consider insisting on the inclusion of the following language in the subcontract in order to make it more likely that the subcontractor's obligation will be narrowly tailored to the subcontractor's negligence and only to the extent of its negligence:

Notwithstanding anything to the contrary, Subcontractor's duty to defend, indemnify or hold the Contractor harmless for any claim, loss, damage or expense, etc. shall exist only to the extent caused by the negligent acts or omissions of the Subcontractor.

Subcontractors should also seek to remove the word "defend" from the provision. If the GC refuses, propose a compromise by offering to modify the provision requiring you to pay the attorney fees incurred by the GC in defending the claim in proportion to your percentage of fault. Thus, if it is determined that you were 30 percent responsible, you pay only 30 percent of the attorney's fees. You might also seek to limit your obligation to indemnify the limits of your insurance coverage to the amount of the subcontract (e.g. "Subcontractor's obligation to indemnify contractor shall not exceed the limits of subcontractor's actual insurance coverage for such claim or loss, or the amount of this subcontract, whichever is less").

Subcontractors 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 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 always cover your defense and indemnity obligations. It might, but general liability insurance policies contain a whole host of exclusions, which may operate to deny coverage leaving the subcontractor having to pay the defense and indemnity obligations out of its own pocket. In other words, the fit between a subcontractor's insurance and its indemnity obligation is not precise. Subcontractors need to understand the coverage they have under their general liability insurance policies and try to avoid or close gaps in the coverage. Likewise, do not assume that naming the GC as an additional insured will ensure insurance covers any loss that the GC might incur so that it will not seek indemnification from the subcontractor. Prudent subcontractors will have their insurance brokers and attorneys review the indemnification language in the subcontract during the bidding stage to evaluate the likelihood that insurance will cover any defense and indemnification obligations you are undertaking in the subcontract. Finally, it should be noted that indemnity provisions are not always limited to loss or damage relating to bodily injury or property damage. The duties to defend and indemnify sometimes apply to loss or damage relating to other things. This article only scratches the surface and we recommend that you consult experienced legal counsel to review these clauses before entering into the subcontract.

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