

HOW TO REVIEW INDEMNITY CLAUSES IN CONSTRUCTION CONTRACTS

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Indemnity provisions are often the longest and most incomprehensible provisions in a construction contract. Even relatively short provisions contain run-on sentences that often exceed 100 words. They also can shift tremendous amounts of risk from one party (the “indemnitee”) to another (the “indemnitor”). Ignore them at your peril.

I. WHAT IS INDEMNITY?

Indemnity is the shifting of liability for loss from one party to another. In a sense, they are similar to insurance, except there is no policy, no automatic duty to defend, and no premiums.

The right of indemnity can either arise out of the express terms of a contract or be implied under common law principles.

A. Contractual or Express Indemnity.

Parties to a contract may expressly provide that one party will hold the other party harmless for any expenses, including attorneys’ fees, incurred in connection with the claim. The parties to an indemnity contract are generally referred to as follows:

the **Indemnitor** is the person who is providing the indemnity and the **Indemnitee** is the person being indemnified. The following general rules apply to indemnity provisions:

Rule One: Contracts that indemnify the indemnitee against his own negligence do not violate public policy under Arizona law. *Estes Company v. Aztec Construction, Inc.*, 139 Ariz. 166, 677 P.2d 939 (1983); *Graver Tank & Mfg. Co. v. The Fluor Corp.*, 4 Ariz. App. 476, 478, 421 P.2d 909, 911 (1966).

Rule Two: A party seeking indemnity from the consequences of his or her own negligence must express that intent in clear and unequivocal terms. Thus, an indemnity provision will be enforced only if it clearly and unequivocally states that a party is being indemnified for its own negligence. *Pioneer Roofing Co. v. Mardian Construction Co.*, 152 Ariz. 455, 474, 733 P.2d 652, 671 (App. 1986).

Rule Three: In interpreting an indemnity clause, the word “negligence” does not actually have to be used in order to find an intent to indemnify the indemnitee for his or her own negligence. *Washington Elementary School Dist. No. 8 v. Baglino Corp.*, 169 Ariz. 58, 817 P.2d 3 (1991).

B. Types of Indemnity Clauses.

Contractual indemnity provisions fall into three general types: broad, intermediate and comparative. Each type is discussed in more detail below.

1. ***Broad Form/Sole Negligence.*** Under a broad form indemnity clause, the indemnitor agrees to hold the indemnitee harmless from loss caused due to the sole negligence of the indemnitee. An example of a broad form indemnity clause wherein a subcontractor agrees to indemnify a general contractor is as follows:

Subcontractor agrees to indemnify and hold harmless Contractor from any and all claims, causes of action, damage or liability due to personal injury or property damage, or both, including loss of use, arising from or on account of the fault of Subcontractor or caused in part or in whole by any act or omission, whether passive or active, of Contractor and anyone directly or indirectly employed by Contractor.

Under this broad form provision, the subcontractor will be liable to indemnify the general contractor regardless of whether the subcontractor participated in causing the wrong for which the general contractor is seeking indemnity. Even if the subcontractor is found blameless, the subcontractor would still be required to pay any damages that the general contractor suffers under the broad form language. As discussed in more detail below, Arizona does not allow broad form indemnity clauses in most construction contracts.

Broad form indemnity clauses are sometimes used when one party allows another to use its property, such as scaffolding, on a construction project. An indemnification clause for scaffolding use is as follows:

For good and valuable consideration, Subcontractor shall indemnify and hold harmless Contractor and its agents, officers, employees and insurers, from and against any claims, damages, losses and expenses, including but not limited to attorneys' fees, arising from or relating to Subcontractor's use of Contractor's scaffold and scaffolding on any building, including such claim, damage, loss or expense caused in whole or in part by the negligent acts or omissions of Contractor or any other party.

2. ***Intermediate Type.*** Under the intermediate type of indemnity agreement, indemnification will arise if the acts of both the general contractor and the subcontractor contribute to causing damage. The indemnitor agrees to hold the

indemnatee harmless from liability arising from acts in which the indemnatee is jointly or concurrently negligent. For example:

Subcontractor agrees to indemnify and hold harmless Contractor from any and all claims, causes of action, damages and liabilities due to personal injury or property damage or both, including loss of use, arising from or on account of the fault of Subcontractor or caused in part by any negligent act or omission of Contractor and anyone directly or indirectly employed by Contractor.

Under this type of provision, the subcontractor will be required to indemnify the general contractor if the subcontractor is also partially at fault.

3. ***Comparative Type.*** A comparative indemnity clause apportions liability based on the comparative fault of the parties. An abbreviated form of this type of provision is as follows:

Subcontractor agrees to indemnify and hold harmless Contractor from any and all claims, causes of action, damage or liability...but only to the extent caused by the negligent acts or omissions of the Subcontractor.

Most commentators agree that the AIA A201-1998 indemnity clause is based on comparative fault.

C. What To Look For In Indemnity Agreements.

There are four basic issues raised by most indemnity clauses: (1) *Who* gets indemnified; (2) *What* gets indemnified; (3) *What triggers* the indemnity; and (4) *What effect* does the indemnatee's partial fault have on the enforceability of the indemnity. When you answer these four questions, you have untangled the indemnity knot.

1. **Who Is Entitled to Indemnity?** This is usually a straightforward issue. Often, indemnity clauses are limited to the other contracting party. However, sometimes clauses broadly cover the owner, architect, engineer, and “their shareholders, directors, officers, partners, employees, agents, subsidiaries, divisions, (and each of their heirs, successors and assigns).”

Typically, general contractors (and subcontractors through flow-down provisions) are asked to indemnify owners and the owner’s design team. It is important that the indemnitee review the contract to make sure that it is not being required to indemnify parties it has little or no expectation of indemnifying.

2. **What Is Being Indemnified?** Historically, indemnity provisions often were limited to indemnifying against only “judgments” or “liabilities” incurred by the indemnitee. Over time, however, most indemnity provisions have grown to include a laundry list of potential harms, including losses, expenses, attorneys’ fees, consultant costs, damages, claims and potential claims, and so on. If your intent is only to indemnify a party after a harm has been adjudicated and reduced to a judgment, for example, then the laundry list should be pared down to only include “judgments.”

3. **What Triggers the Indemnity?** The most typical triggers for indemnity obligations are losses “attributable to bodily injury” or “destruction of tangible property.” This language has been historically used because it conforms to the typical trigger for liability insurance coverage. Thus, for example, a subcontractor would only be taking on indemnity obligations to the extent it was covered by its own insurance.

Today, many indemnity provisions contain a third and broader trigger; namely, when a loss “arises out of the Work.” It is important to understand that this

trigger is broader than the coverage afforded by most liability policies. In other words, by undertaking an indemnity obligation triggered merely if the loss arises out of a contractor's work, a contractor may be taking on a risk that is not covered by insurance.

4. What If the Indemnitee Is Partially At Fault? Finally, the last question is to determine whether the indemnity provision is a broad, intermediate or comparative form. Simply stated, the issue here is what indemnity protection exists if the party seeking indemnity is negligent or at fault, at least in part for the underlying claim.

D. Anti-Indemnification Statutes.

Not all indemnity provisions are enforceable. Arizona, for example, has adopted two separate anti-indemnification statutes.

First is A.R.S. § 32-1159, which applies to "all contracts entered into between private parties." This statute voids an agreement that seeks to indemnify against an indemnitee's "sole negligence." Since this statute only prohibits indemnification for an indemnitee's "sole negligence," intermediate-form agreements that indemnify against joint or concurrent negligence are not affected.

Second, A.R.S. § 34-226 and § 41-2586 apply on public works projects in Arizona. These provisions outlaw any agreement that purports to indemnify or hold harmless the promisee or indemnitee from the negligence of the promisee. These statutes are not limited to "sole negligence." Therefore, on Arizona public works projects, both broad form and intermediate form indemnity provisions are void and against public policy. Copies of A.R.S. § 32-1159 and § 34-226 are attached as Exhibit 3.

EXHIBIT 1

EXHIBIT 2

EXHIBIT 3

§ 32-1159 **Indemnity agreements on construction contracts; void; definitions**

A. A covenant, clause or understanding in, collateral to or affecting a construction contract or architect-engineer professional service contract that purports to indemnify, to hold harmless or to defend the promisee against liability for loss or damage resulting from the sole negligence of the promisee or the promisee's agents, employees or indemnitee is against the public policy of this state and is void.

B. Notwithstanding subsection A, a contractor who is responsible for the performance of a construction contract may fully indemnify a person for whose account the construction contract is not being performed and who, as an accommodation, enters into an agreement with the contractor that permits the contractor to enter on or adjacent to its property to perform the construction contract for others.

C. This section applies to all contracts entered into between private parties.

This section does not apply to:

1. Agreements to which this state or a political subdivision is a party, including intergovernmental agreements and agreements governed by §§ 34-226 and 41-2586.

2. Agreements entered into by agricultural improvement districts under title 48, chapter 17.

D. In this section:

1. “Architect-engineer professional service contract” means a written or oral agreement relating to the design, design-build, construction administration, study,

evaluation or other professional services furnished in connection with any actual or proposed construction, alteration, repair, maintenance, moving, demolition or evacuation of any structure, street or roadway, appurtenance or other development or improvement to land.

2. “Construction contract” means a written or oral agreement relating to the construction, alteration, repair, maintenance, moving, demolition or excavation or other development or improvement to land.

§ 34-226 **Indemnity agreements in construction and architect-engineer contracts void; definition**

A. A covenant, clause or understanding in, collateral to or affecting a construction contract or subcontract or architect-engineer professional service contract or subcontract which purports to indemnify, to hold harmless or to defend the promisee of, from or against liability for loss or damage resulting from the negligence of the promisee or the promisee’s agents, employees or indemnitee is against public policy and is void.

B. Notwithstanding subsection A, a contractor who is responsible for the performance of a construction contract or subcontract may fully indemnify a person, firm, corporation, state or other agency for whose account the construction contract or subcontract is not being performed but who, as an accommodation, enters into an agreement with the contractor that permits the contractor to enter upon or adjacent to its property to perform the construction contract or subcontract for others.

C. In this section:

1. “Architect-engineer professional service contract or subcontract” means a written or oral agreement relating to the design, construction administration, study, evaluation or other professional services furnished in connection with any actual or proposed construction, alteration, repair, maintenance, moving, demolition or evacuation of any structure, street or roadway, appurtenance or other development or improvement to land.

2. “Construction contract or subcontract” means a written or oral agreement relating to the construction, alteration, repair, maintenance, moving, demolition or excavation or other development or improvement to land.

EXHIBIT 4

AIA A201-1987, Article 3.18 **INDEMNIFICATION**

3.18.1 To the fullest extent permitted by law, the Contractor shall indemnify and hold harmless the Owner, Architect, Architect's consultants, and agents and employees of any of them from and against claims, damages, losses and expenses, including but not limited to attorneys' fees, arising out of or resulting from performance of the Work, 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) including loss of use resulting therefrom, but only to the extent caused in whole or in part by negligent acts or omissions of the Contractor, a Subcontractor, anyone directly or indirectly employed by them or anyone for whose acts they may be liable, regardless of whether or not such claim, damage, loss or expense is caused in part by a party indemnified hereunder. Such obligation shall not be construed to negate, abridge, or reduce other rights or obligations of indemnity which would otherwise exist as to a party or person described in this Paragraph 3.18.