Indemnity and Other Risk Shifting Contract Clauses: Lessons for the Geotechnical Engineer

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Lessons Learned in Geotechnical Engineering

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Garry Boehlert focuses his practice on infrastructure projects. Garry has represented engineering and construction firms on complex design-build projects. He regularly assists owners, contractors, geotechnical engineers, specialty subcontractors and engineering/design firms with the drafting, review and negotiation of contracts. He also is effective in the resolution of disputes that frequently arise on infrastructure projects, such as subsurface claims and demands associated with delay, defective work, extra work, incomplete or defective design, acceleration, loss of labor productivity, equipment pricing, alleged defective pricing and lost profits.

When it comes to subsurface engagements, Mr. Boehlert has addressed the full gamut of issues – tunneling, foundation/slurry wall work, subsurface profiles, ground water, highway construction, bridge design/construction, and structural failures. A number of his engagements have involved differing site conditions.

Prior to entering law, Garry worked on infrastructure projects such as the Trans-Alaska Pipeline and construction of an interstate highway, gaining hands-on construction experience.
Q: What is Indemnification?

- Indemnification is a duty to either pay for another's loss or assume their liability.
- In plain English, indemnity is an obligation by one party to make another whole for loss incurred to a third party.
- The essence of indemnification is the shifting of loss.
- The Common Law expected each party to be responsible for their own negligence, no more.
- As construction projects got more and more complex, owners have asked engineering firms and contractors to indemnify them.
- General contractors, in turn, began adding increasingly complex indemnification clauses to their subcontracts.
Who Are The Parties To An Indemnity Contract?

• There are two parties to the contract:
  
  o The *indemnitee* -- the party whose loss or risk is transferred to another party (owner or general contractor in subcontract settings)

  o The *indemnitor* – the party that has promised to assume the indemninee’s risk or loss (general contractor or subcontractor in subcontract settings)

• The duty of indemnity is generally triggered by a third party when they make a claim for personal injury or property damage against the indemnitee

• Increasingly, indemnity is being requested by Owners from engineers and contractors for first party claims – even for breach of contract actions between the parties to the contract
How is Risk Shifted Between The Parties?

- Risk is shifted by the express and unique language of the parties’ contract

- The indemnity provision is often that lengthy and densely worded clause that most people would like to ignore – because it deals with possible problems in the future

- Indemnity deals with the transfer of loss in its entirety

- Indemnity, unlike contribution, does not contemplate the partial shifting of losses
Are All Contractual Indemnity Obligations The Same?

A: No!!!

• When a Court construes an indemnity contract, it attempts to reimburse all losses, damages or liabilities that reasonably appear to have been within the intention of the parties

• The precise text of the contract provision governs the scope and reach of the indemnity obligation
How Are Indemnity Clauses Categorized?

A: They Can Be Broad or Narrow

- **Narrow** clauses are generally triggered only by negligence or fault on the part of the indemnitor
  - Fault arising from the indemnitor’s “acts or omissions”

- **Broad** clauses are sometimes known as “work-related” and can even cover instances where the indemnitee is partially or wholly negligent
  - The claim need only “arise out of”, “be occasioned by”, “be due to” or “in connection with” the indemnitor’s work on the project
When Does A Cause of Action For Indemnity Accrue?

A: It Depends

• Some clauses require indemnity only after the indemnitee has actually incurred a loss (settled or satisfied a judgment)

• However, when the indemnitor has agreed to indemnify against liability the indemnitor may be required to perform even before payment has been made

• Words such as “liabilities” and “hold harmless” suggest that the clause was intended to cover both loss and liability

• When the contract is silent, the default rule is that it covers only loss
Is a Duty of Indemnity the Same as a Duty to Defend?

A. No

• Duty to Defend a party from a claim or lawsuit is a distinct and separate duty from the duty to Indemnify

• Some contracts will specifically grant the indemnitee the authority to participate in its own defense

• If the contract is silent on the indemnitee’s participation in defending itself, the indemnitor generally retains the right to provide the defense
What is the Duration of an Obligation to Indemnify?

A. This is an area where things can get scary

• The obligation lasts for a duration either expressly or impliedly provided for in the contract

• If the clause is based on loss, it could possibly last forever

• If no end date is specified in the contract and the language is unclear, Courts will consider the circumstances and nature of the contract to determine when the obligation should cease

• Statutes of Limitation can help – however, they can be over-ridden by the language of the indemnity clause

• Statutes of Repose can help – however, may not be applicable if clause does not require negligent or deficient work
Can an Owner Require that A Contractor Indemnify It Against its Own Negligence?

A. Yes and No

• Most states have an Anti-Indemnification Statute
  ▪ For Public Policy reasons, owners and general contractors should not be shielded from the effects of their own negligence
  ▪ Particularly if bodily injury results
  ▪ A party with greatly superior bargaining power should not be allowed to use it to transfer a disproportionate amount of risk to the weaker party

• So why isn’t this the end of the story?
Some Courts Will Read Any Anti-Indemnification Statute Very Narrowly

• The Court will consider that the general rule is that a party *can* contract away its negligence; since the statute changes this default rule, it should be read very narrowly
  ▪ It can be up to you to show that the statute applies

• The Court may consider that the contract is not an indemnity agreement at all
  ▪ See *e.g.* *Smith v. Seaboard Coast Line R. Co.*, 639 F.2d 1235 (5th Cir. 1981) (contract was a “lease”, not a contract involving “construction or maintenance”, and therefore Anti-Indemnity Statute did not apply)
Q: Even if These Statutes Apply, Who Decides “Sole Negligence”?

- Anti-Indemnification Statutes typically bar any contract requiring one party to indemnify losses covered by the other’s “sole” negligence.

- But this can lead to satellite litigation to determine if the other’s “sole” negligence is at issue.

- Other courts will look closely to the underlying Complaint – so indemnification is in the hands of the Plaintiff’s attorney, who may not use the “magic words” – “sole negligence”.

- Other courts will attempt to apportion negligence, and require indemnification for losses arguably not the result of the other party’s sole negligence.
First Party Claims – Including Indemnity for Breach of Contract

• When indemnity is mentioned, we usually think of protection from third party claims asserted by parties with whom they have no contractual privity

• However, depending on the language used, indemnity provisions also can cover first party claims asserted by parties in privity of contract

• To the surprise of many, such clauses may cover actions for breach of contract in addition to claims for negligence

• The wording of the indemnity clause determines the scope of coverage

• Most states follow the common law "American Rule" which provides that a prevailing party generally must bear its own attorneys' fees.

• An exception in many states is the ability of an indemnitee to recover attorneys' fees incurred in defending against a third party claim.

• Another exception to the American Rule under which a prevailing party may be awarded attorneys' fees is when the parties have a contractual agreement to that effect.

• Increasingly, courts are looking to indemnity clauses in deciding whether the parties have agreed that attorneys' fees will be recoverable in first-party actions. Recent decisions from the Courts of Appeals of Maryland and the District of Columbia have given broad interpretation to indemnity provisions, allowing the recovery of attorneys' fees in first-party breach of contract actions.

• Another important consideration, especially for designers, is that reimbursement of an adversary's attorneys' fees may not be insurable under a standard errors and omissions policy.
Limitations on Liability

EXAMPLE CLAUSE

To the fullest extent permitted by law, the total liability of Geotechnical Engineer, its officers, members, directors, agents, consultants, and employees, to Owner, and to anyone claiming by, through or under Owner, for any and all injuries, claims, losses, expenses or damages whatsoever (including attorneys’ fees and costs) from any cause or causes whatsoever, including but not limited to negligence, errors, omissions, strict liability, breach of contract and/or breach of warranty shall not exceed the total compensation received by Engineer under this Agreement or $50,000 whichever is less. Upon Owner’s request, Engineer may negotiate an increase to this limitation in exchange for an additional agreed consideration for the increased limit.
Case Study – Lesson Learned

Let’s Put Some of this Information to Use

- A New Bridge Is Being Built In Your Area
- You’re The Go-To Geotechnical Engineer
- You Bid, Negotiate, Seal the Deal, And Ink the Contract for Geotechnical Services
- You Do A Great Job, Your Work Is Accepted And You Get Paid
- Time To Move On – Right?
• Years later, concrete in the bridge piers begins to crack

• The bridge is closed for inspection and repairs

• The state sues the general contractor seeking damages

• Site-work and geotechnical issues don’t appear to have anything to do with the cracking – but you get served with a court document demanding you defend and indemnify the general contractor
The general contractor points to “boilerplate” in your contract that he says requires you to defend and indemnify them and the owner from any claims “related to” the Project.

- The general contractor hires an expensive law firm that bills hundreds of dollars an hour.
- The general contractor sends you its legal bills for payment.
- There appears to be no end in sight.
What Went Wrong?

A: It starts with the contract

• It obliged you, as the geotechnical engineer, to indemnify for any claim related to the Project
• “Project” was defined as the whole construction, not just your component
• “Related to” means virtually any claim connected to the bridge
• The clause is written in a way that suggests that you have to defend even if the claim is the result of the state’s or general contractor’s sole negligence
• Even if state law prohibits this, then you must defend until it is established that the claim was the result of the state’s or general contractor’s sole negligence
What Might Be Considered “Fair” Or “Unfair” Indemnification Provisions?

“Fair”
- You agree to indemnify
- The owner and/or general contractor
- For claims arising out of your negligence or defective work on the Project
- Including a proportionate share of liability
- Ideally capped at a dollar amount and limited in time

Should Give You Pause
- You must defend and indemnify
- The owner and/or general contractor
- For claims “relating to” or “arising out of” “the Project”
- Including where the owner or general contractor’s sole negligence is at issue
- No time or cost limitations
How Can Geotechnical Engineers Protect Themselves When it Comes to Indemnification Obligations?

1. Account for indemnification obligations in your negotiating checklist, and factor them into your pricing.

2. Determine if you are willing to indemnify another party’s negligence, and if so, to what extent.

3. Consult with counsel on applicable statutes and appropriate contract language.

4. Ensure field employees are trained to check with superiors before signing forms with “boilerplate legalese” that will implicate indemnification.

5. Check with your insurance broker and bonding company to determine if the proposed clause fits with your insurance and surety obligations.
LESSONS LEARNED

6. Consider the indemnification implications of choice-of-law or choice-of-venue provisions in your contract

7. Consider the indemnification implications on the recoverability of attorneys’ fees – especially for first party claims

8. Consider duration: seek a time restriction for your indemnification obligation

9. See if you can negotiate a cap on the dollar amount of your indemnification obligation

10. Negotiate for ability to control the defense and defense costs if you have agreed to defend
Questions?
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