

Indemnification Provisions in Commercial Contracts



A Drafting Primer

BY MARK COHEN

This article offers practitioners guidance on drafting indemnification provisions in commercial contracts.

This article provides an overview of Colorado law governing indemnification provisions in commercial contracts and offers drafting guidance. Indemnity provisions in insurance contracts are beyond this article's scope, but the article cites cases decided in the insurance context where they provide the best available Colorado authority for a proposition.

The Duty to Indemnify

Lawyers use indemnification provisions to allocate inherent risks in transactions. Put simply, indemnification is the right of a party that is legally liable for a loss (the indemnitee) to shift that liability to another party (the indemnitor).¹ The goal is usually to shift responsibility for any damages that occur from the party that is sued to the party that caused the harm. The Colorado Supreme Court has defined an indemnity agreement as “[a]n agreement by one person to hold another person harmless from such loss or damage as may be specified in the agreement.”²

Third-Party and First-Party Claims

Indemnity provisions traditionally addressed only claims by third parties (third-party claims).³ However, an indemnity provision may apply to claims between the parties (first-party claims or direct claims) if the provision clearly applies to first-party claims or is written so broadly that a court interprets it that way.⁴ This is atypical, and in practice parties often limit indemnification to third-party claims and address liability for first-party claims elsewhere (e.g., the limitation of liability, insurance, and attorney fees provisions).

An indemnity provision should clearly state whether it applies to first-party claims. Poor drafting can cause an unintended result, and this danger is magnified when lawyers cut and paste provisions from other documents. In *Hot Rods, LLC v. Northrop Grumman Systems Corp.*, Northrup sold an environmentally compromised property to Hot Rods.⁵ The sales contract addressed environmental indemnity by stating:

Seller hereby agrees to indemnify, defend by legal counsel . . . and hold the Buyer . . . harmless from and against *any*

claims, demands, penalties, fees, fines, liability, damages, costs, losses, or other expenses including, without limitation, reasonable environmental consulting fees and reasonable attorney fees arising out of (a) any Environmental Action(s) and/or Remediation involving an environmental condition or liability involving the Real Property caused by an act or omission of Seller⁶ (Emphasis added.)

When Hot Rods subsequently sued Northrup for failing to reimburse its losses from remediation activities, Northrup argued it was not responsible because the agreement covered only third-party claims. The court disagreed, holding that the phrase “any claims” was broad enough to encompass first-party claims.

To eliminate ambiguity, drafters should address the issue directly by including language stating the parties' intent; for example, “This indemnity provision applies only to third-party claims.”

The Duty to Defend

An indemnity provision may include a duty to defend. A duty to defend, if specified, requires the indemnitor to defend the indemnitee in a legal action. This could be critical because the indemnitee may lack the resources to defend a suit, while the indemnitor may have significant resources. An indemnitee with significant resources sued by a third party may prefer to defend itself and seek reimbursement from the other party for costs and attorney fees after the matter is resolved. Conversely, the indemnitor may prefer to control the defense because the indemnitor will ultimately be liable for any losses the indemnitee suffers.

Although indemnification provisions often include a duty to defend, the duty to defend and the duty to indemnify are separate and distinct.⁷ Because the duties are distinct, and because the scope of a party's duty to indemnify may not be known until the dispute is resolved, the duty to defend is more easily triggered than the duty to indemnify.⁸ A party may have a duty to defend, but not a duty to indemnify.⁹ A party's breach of the duty to defend does not preclude it from contesting its alleged duty to indemnify.¹⁰

When an indemnification provision includes a duty to defend, in the absence of a contrary provision, the indemnitor's duty to defend includes an implicit right to control the defense.¹¹ This right includes the selection of counsel.¹² Courts have applied these rules even when the duty to defend is contained in a commercial contract rather than an insurance contract.¹³

Although an indemnitor with a duty to defend normally has the right to control the defense, in the absence of a contrary provision, the indemnitor may not have the right to settle third-party claims against the indemnitee without the indemnitee's consent.¹⁴ Lawyers drafting indemnity provisions should address this issue to avoid uncertainty. A lawyer representing an indemnitor charged with a duty to defend should also consider the lawyer's possible ethical obligations to the indemnitee.¹⁵

"Hold Harmless" Provisions

An indemnity clause sometimes includes a promise by each party to "hold harmless" the other party. Most courts treat the terms "indemnify" and "hold harmless" as synonymous, but some have held the words imply different obligations.¹⁶ The routine inclusion of "hold harmless" has led to litigation over whether the indemnitor must advance defense costs to the indemnitee.¹⁷ "Hold harmless" language may also open the door to claims that one party agreed to release the other from responsibility for its own negligence.¹⁸

In *Alzado v. Blinder, Robinson & Co.*, the Colorado Supreme Court defined an indemnity agreement as "[a]n agreement by one person to hold another person harmless from such loss or damage as may be specified in the agreement."¹⁹ If "indemnify" and "hold harmless" are synonymous, the term "hold harmless" is unnecessary in an indemnity agreement. If they are not synonymous, lawyers who include "hold harmless" without understanding why run the risk of unintended consequences. The better practice is not to include "hold harmless" unless the parties intend it to signify a release from liability.

The Scope of the Indemnity Provision

The scope of an indemnity includes (1) the covered events, (2) the covered damages, (3)

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the identity of the indemnitees, and (4) the required level of connection between the event giving rise to the duty to indemnify and the indemnitee's damages.

The Covered Events

Does the duty to indemnify arise only from the indemnitor's breach of the agreement, or does it also arise from any act or omission of the indemnitor even if that act or omission is not

a breach? Practitioners should insist on clarity regarding what acts or omissions will trigger the duty to indemnify. Consider a provision such as: "This indemnity provision is not limited to acts or omissions that constitute a breach of this agreement."

The Covered Damages

It is important to identify what the indemnitor must pay. In some cases, the parties may want broad language, such as, "all damages, losses, liabilities, claims and causes of action of any kind." In other cases, they may want to narrow the scope to particular types of claims; for example, "personal injury and death, real and personal property damage, infringement of intellectual property, breach of confidentiality, and/or violations of the law."

"Losses, liabilities, claims, and causes of action" may not be redundant; each may have a different meaning.²⁰ This may be important because, as a general rule, a cause of action for indemnity does not arise until the liability of the party seeking indemnity results in his or her damage, either through payment of a sum clearly owed or through the injured party's obtaining an enforceable judgment.²¹

The Identity of the Indemnitees

Some indemnity provisions require the indemnitor to indemnify the other party, but the intent is often to also indemnify the other party's affiliates, for example, shareholders, officers, directors, employees, or agents. Attorneys should draft this provision clearly; for example: "Where this indemnity provision imposes a duty on a party to indemnify and defend the other party, those duties extend to the other party's affiliates, including its shareholders, officers, directors, employees, and agents." If there are third-party beneficiaries to the contract, the contract should address whether they also receive the benefit of the indemnity provision.

The Required Degree of Connection

Some indemnity provisions may contain broad language establishing a duty to indemnify the other party for all damages "related to" or "arising from" the agreement. Others may be narrower and establish a duty to indemnify only

for damages “caused by” or “resulting from” the indemnitor’s acts or omissions. Generally, the indemnitee wants broad language, while the indemnitor wants narrow language that excludes damages unrelated to the indemnitor’s acts or omissions.

When the Indemnitee is Negligent

In Colorado, indemnification between tortfeasors is allowed only when there is a preexisting legal relationship between them or a duty imposed by law upon one of the tortfeasors to hold the other harmless for the injuries.²² The general rule is that indemnity agreements that purport to indemnify for the negligent conduct of an indemnitee must be strictly construed, but courts have begun to relax this rule, and it is not necessary that an indemnification provision specifically refer to a party’s negligence.²³

Lawyers drafting indemnity provisions in construction contracts should be aware of CRS § 13-21-111.5(6)(b), which places limits on when a contract may purport to release an indemnitee for its own negligence. It provides that, except in certain circumstances,

any provision in a construction agreement that requires a person to indemnify, insure, or defend in litigation another person against liability for damage arising out of death or bodily injury to persons or damage to property caused by the negligence or fault of the indemnitee or any third party under the control or supervision of the indemnitee is void as against public policy and unenforceable.

An indemnity provision purporting to relieve a party of responsibility for its intentional torts or willful wrongs violates public policy and is void.²⁴ In some jurisdictions indemnity provisions purporting to relieve a party from responsibility from its gross negligence also violate public policy.²⁵ The law in Colorado is not clear. In *B & B Livery, Inc. v. Riehl*,²⁶ a horseback rider suffered injuries when she fell from a rented horse. The Colorado Supreme Court, relying on a statute governing equine activities, upheld the validity of a general release agreement, concluding it unambiguously showed the parties’ intent to extinguish the defendant’s liability for negligent

injuries to a rider, but remanded the case for further proceedings on the rider’s willful and wanton/gross negligence claims.

Indemnity Agreements and Attorney Fees

A duty to indemnify applicable to only third-party claims cannot provide the basis for attorney fees in a suit between the parties.²⁷

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The Relationship Between Indemnity Provisions and Limitations on Liability

An indemnity provision must not conflict with other contract provisions, particularly liability limitations. An indemnity provision imposing a duty on one party to indemnify loses much of its value if a court concludes that the duty to indemnify is limited by a cap on damages elsewhere in the agreement. The best practice is to make clear that limitations on damages do not apply to the parties’ indemnity obligations. An indemnity agreement is subject to the same rules of construction governing contracts generally.²⁸ Courts should interpret a contract “in its entirety with the end in view of seeking to harmonize and to give effect to all provisions so that none will be rendered meaningless.”²⁹ Drafters who fail to make clear that damage caps do not apply to indemnity obligations run the risk that a court will construe the agreement as it is written.

Conclusion

Indemnity provisions are a useful tool for allocating risk in commercial contracts; however, lawyers drafting them should understand the different duties often included in such provisions and be alert to how seemingly minor changes in language may impact the parties’ rights and obligations. ^{CL}



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NOTES

1. *Am. Transtech, Inc. v. U.S. Trust Corp.*, 933 F.Supp. 1193, 1202 (S.D.N.Y. 1996).
2. *Alzado v. Blinder, Robinson & Co.*, 752 P.2d 544 (Colo. 1988).
3. “An indemnity provision generally applies to a claim asserted by a third-party against the indemnitee, not to a claim based upon injuries or damages suffered directly by the indemnitor.” *Regency Realty Inv’rs, LLC v. Cleary Fire Prot., Inc.*, 260 P.3d 1, 7 (Colo.App. 2009).
4. *Hot Rods, LLC v. Northrop Grumman Sys. Corp.*, 242 Cal. App. 4th 1166, 1170 (Cal.App. 2015). See also *Hooper Assocs., Ltd. v. AGS Computers, Inc.*, 74 N.Y.2d 487 (N.Y. 1989).
5. *Id.*
6. *Id.* at 1173.
7. *Cyprus Amax Minerals Co. v. Lexington Ins. Co.*, 74 P.3d 294, 299 (Colo. 2003).
8. *Constitution Assocs. v. N.H. Ins. Co.*, 930 P.2d 556, 563 (Colo. 1996).
9. *Id.*
10. *Bainbridge, Inc. v. Travelers Cas. Co. of Conn.*, 159 P.3d 748, 756 (Colo.App. 2006).
11. *Farmers Grp., Inc. v. Trimble*, 691 P.2d 1138,

- 1141 (Colo. 1984).
12. See, e.g., *Cent. Mich. Bd. of Tr. v. Emp’rs Reinsurance Corp.*, 117 F.Supp.2d 627, 634–35 (E.D.Mich. 2000).
13. *MetroPCS Wireless, Inc. v. Telecomms. Sys., Inc.*, 2009 WL 3418581 (D.Md. 2009); *IU N. Am., Inc. v. Gage Co.*, 2002 WL 1277327 (E.D.Penn. 2002).
14. See, e.g., *Mitchum v. Hudgens*, 533 So. 2d 194 (Ala. 1988) (insurance policy granted the insurer the right to settle the case without the insureds consent).
15. See, e.g., *Signature Dev. Co., Inc. v. Royal Ins. Co. of Am.*, 230 F.3d 1215, 1220 (10th Cir. 2000) (insurer breached its duty to defend its insured when it did not respond to settlement overtures, failed to communicate with its insured, and failed to fully cooperate in settlement negotiations).
16. See, e.g., *Queen Villas Homeowners Ass’n v. TCB Prop. Mgmt.*, 56 Cal. Rptr. 3d 528, 534 (Cal. Ct.App. 2007) (“Indemnify” is an offensive right allowing an indemnitee to seek indemnification. “Hold harmless” is defensive: the right not to be bothered by the other party itself seeking indemnification.).

17. See, e.g., *Majkowski v. Am. Imaging Mgmt. Servs., LLC*, 913 A. 2d 572 (Del. Ch. 2006).
18. See, e.g., *Roos v. Kimmel*, 55 Cal.App.4th 573, 582 (1997) (hold harmless provision prevented plaintiff from recovering damages resulting from defendant’s negligence). See also *United States v. Contract Mgmt., Inc.*, 912 F. 2d 1045 (9th Cir. 1990).
19. *Alzado*, 752 P.2d at 553.
20. See, e.g., *Auto-Owners Ins. Co. v. Anderson*, 556 S.E.2d 465 (Ga.App. 2001) (“losses” includes any covered judgments, settlements, fees, costs, and expenses); *Doss & Assocs. v. First Am. Title Ins. Co.*, 745 S.E. 2d 85 (Ga.App. 2013) (“liabilities” includes debts and other legal obligations).
21. *Serna v. Kingston Enters.*, 72 P.3d 376 (Colo. App. 2002).
22. *Ringsby Truck Lines, Inc. v. Bradfield*, 563 P.2d 939 (Colo. 1977).
23. *Public Serv. Co. of Colo. v. United Cable Television of Jeffco, Inc.*, 829 P.2d 1280 (Colo. 1992).
24. *Constable v. Northglenn, LLC*, 248 P.3d 714 (Colo. 2011).
25. See, e.g., *Neighborhood Assistance Corp. of Am. v. Dixon*, 593 S.E.2d 717 (Ga.App. 2004).
26. *B & B Livery, Inc. v. Riehl*, 960 P.2d 134, 135 (Colo. 1998).
27. *Mesa Sand and Gravel Co. v. Landfill, Inc.*, 759 P.2d 757, 760 (Colo.App. 1988), *rev’d in part on other grounds*, 776 P.2d 362 (Colo. 1989).
28. *Trosper v. Wilkerson*, 764 P.2d 375 (Colo. App. 1988).
29. *Copper Mountain, Inc. v. Indus. Systems, Inc.*, 208 P.3d 692, 697 (Colo. 2009).

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