Indemnification in Engineering Contracts

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Executive Summary

Although indemnification provisions are included in almost every engineering and construction contract, parties often overlook them, or merely copy and paste them between contracts. Inattention to these provisions can result in catastrophic damages to an engineering firm, as Indiana courts place heavy reliance on the language the parties used in their contract. The distinction between the duty to indemnify and the duty to defend and the ability to contract for indemnification of one’s own negligence is fraught with pitfalls for the careless drafter.

The Law of Torts

Under the law of “torts,” a person is responsible for the damage that they have caused. In many cases, however, a plaintiff’s damages are caused by several different sources, which makes it difficult to allocate damages between defendants. Instead of attempting to figure out which defendant caused which portion of the damage, the plaintiff can file suit against everyone involved. Under Indiana’s Economic Loss Rule, a construction claimant with project damages is restricted to filing suit against the party with whom he or she had a contract. The classic example of this is the case of the project owner suing the contractor and forcing the contractor to go after the subcontractors for damages that the contractor believes they caused.

The Law of Indemnification

Despite this “general” rule, the much more common scenario in the construction and engineering context is indemnification: where one party, the indemnitee, compensates or agrees to compensate another party, the indemnitor, for loss or damage. In the above scenario, the subcontractor may agree to indemnify the contractor against damage that results because of the subcontractor’s work. This is known as express or contractual indemnification, and will likely be the most common type of indemnification encountered in the construction and engineering context.

Under Indiana law, “[a]n indemnity agreement involves a promise by one party (the indemnitor) to reimburse another party (the indemnitee) for the indemnitee’s loss, damage, or liability.”1 Despite this relatively simple definition indemnification provisions in contracts are often referred to as “gotcha” provisions, since a party may not realize the magnitude of obligations it is accepting.

A typical indemnification provision may look like this:

“Party A shall defend, indemnify, and hold Party B, its officers, employees, and agents harmless from any and all claims, injuries, damages, losses, or suits including attorney fees, arising either directly or indirectly from any act or failure to act by Party A or any of its officers or employees, which may occur during or which may arise out of the performance of this agreement.”

This example includes not only a duty to indemnify, but also a duty to defend. These provisions, which appear in a similar form in nearly every construction and engineering contract, may have important and unforeseen consequences given Indiana courts’ tendency to allow parties almost complete freedom of contract.

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Commissioner Hendrickson speaks before ACEC

ACEC Indiana welcomed INDOT Commissioner Brandye Hendrickson as keynote speaker at its Sept. 3 Luncheon. The event, attended by over 120 ACEC members, provided an opportunity to meet Hendrickson and hear an update on activities at INDOT.

Commissioner Hendrickson began her remarks with comments on the Governor’s priorities for INDOT. These priorities are to “take care of what we have, finish what we’ve started, plan for the future… in that order,” said Hendrickson. Due to constrained funding, INDOT’s emphasis will shift to the preservation of roads and bridges. Hendrickson then provided a brief review of major projects currently underway.

Hendrickson concluded by identifying the challenges of “taking care of what we have” and helping everyone understand the need for preservation, safety in the workplace, dealing with more, but smaller projects, improving INDOT efficiency and working better with customers and partners.

For Hendrickson’s full PowerPoint presentation, click here: http://www.acecindiana.org/?page=ACECPost.
As a general principle in Indiana, parties may contract as they desire.2 There are limits to this freedom however. Indemnifying another party against its sole negligence in any construction or design contract is against public policy and is void and unenforceable.3

Courts also disfavor when parties contract away any negligence, and these provisions are “strictly construed and will not be held to provide indemnification unless it is so stated in clear and unequivocal terms.”4 Careful drafting of these provisions is vitally important as a result of Indiana courts’ close scrutiny of them.

In Indiana, the statute quoted above says that the ability of an indemnitee to contract away its sole negligence does not pertain to highway contracts. Through the efforts of ACEC-Indiana and others, the Legislature added limits to this exception.5 Regardless of the exception regarding highway contracts, INDOT may not require an engineer, architect or surveyor to assume any liability or indemnify the State for any amount greater than the actual degree of fault of that firm, regardless of what the INDOT contract says. For example, a project overrun is found to be 60% attributable to the engineer and 40% to INDOT. The engineer is responsible for only 60% of the resulting cost overrun, and INDOT pays its fair share. If the overrun is the result of INDOT’s sole negligence, the engineer is exempt from any indemnification. This provision only applies to professional services of engineers, architects and surveyors. Highway contractors do not enjoy this reprieve of the “highway contracts” sole negligence indemnity provision.

A 2013 case from the 7th Circuit Court of Appeals demonstrates the importance of careful drafting and review of contracts.2 In that case, the plaintiff died while operating a boom lift for his employer; the employer had rented the lift from a rental company. The plaintiff’s family brought suit against the rental company and the rental company sought indemnification from the employer pursuant to a clause in the rental agreement for the boom lift. The indemnification provision reads as follows:

“Indemnity. Customer [employer] agrees to indemnify and hold Company [rental company] harmless against any and all claims, demands, or suits (including costs of defense, attorney’s fees, expert witness fees, and all other costs of litigation) for any and all bodily injury, property damage, or any other damages or loss, regardless of whether such injury, damage or loss is caused in whole or in part by negligence, which arise out of, result from, or relate to the use, operation, condition or, presence of the equipment except where such injury, damage or loss is caused solely by the Company [rental company].”

The rental company argued that this provision required that the employer indemnify them from the plaintiff’s claims of negligence. The Court, in reviewing other Indiana cases discussing similar provisions,7 found that the employer’s obligation to indemnify the rental company for its own partial negligence was only implicit, not explicit as is required. Therefore, the Court held, the employer did not “knowingly and willingly accept the burden of indemnifying [the rental company] for [its] own negligence.” This seemingly innocuous provision caused a shift in responsibility for paying damages likely in the millions of dollars.

Another drafting pitfall is the difference between the duty to defend and the duty to indemnify. Like the duty to indemnify, the duty to defend may be limited in scope to only certain claims, or may be broad, requiring the indemnitee to defend the indemnitee against all actions where damage is related to the indemnitee’s scope of work. A primary distinction between the two is that the duty to indemnify does not arise until the indemnitee suffers an adverse judgment requiring the payment of damages, whereas the duty to defend is broader and, depending on the contract language, arises when the indemnitee initially faces a lawsuit.8

Many indemnification provisions provide for both a duty to defend and a duty to indemnify, but the presence or lack of a duty to defend can make a significant difference in damages. Only through careful review and drafting by counsel can these mistakes, among others, be avoided.

Kroger Gardis & Regas and our Construction Law Group provide counsel to engineers, architects and surveyors across Indiana. You can contact Greg Cafouros at gpc@kgrlaw.com or by phone at 317-777-7411 for consultation and more information.

(Endnotes)

4. GKN, 798 N.E.2d at 552.
5. Ind. Code §8-23-2-12.5
6. NES Rentals Holdings, Inc. v. Steine Cold Storage, Inc., 714 F.3d 449 (7th Cir. 2013)