

# So You Want the Claim to Disappear: The Right Indemnification Provisions And Clear Intentions Regarding Beneficial Rights Can Limit Your Liability Exposure

## INTRODUCTION

The construction business is risky. The financial concerns that construction professionals deal with on a day-to-day basis can be staggering. Not the least of which is exposure to liability when there are work site or job related injuries. Following are a few practical tips regarding contractual provisions that should help guide those in the construction site management ranks. This is not intended to be an exhaustive legal review, but rather a sampling of suggestions that may help limit ultimate exposure when accidents and claims do arise.

## THE INDEMNIFICATION PROVISION IN YOUR CONTRACTS

Whether the job is large or small, there is rarely a construction project that does not involve a wide variety of participants. There are owners, architects, engineers, general contractors and subcontractors who are all contractually related either directly or indirectly. Many contracts will require subcontractors to indemnify not only the owners and general contractors, but also the architects and engineers. It is imperative that these professionals take an active interest in the specifics of the provision.

As a preliminary matter, it is helpful to have the key definitions at hand:

“Indemnify – To restore the victim of a loss, in whole or in part, by payment, repair, or replacement. To save harmless; to secure against loss or damage; to give security for the reimbursement of a person in case of an anticipated loss falling upon him. To make good; to compensate; to make reimbursement to one of a loss already incurred by him.” *Black’s Law Dictionary*

“Indemnity – Reimbursement. An undertaking whereby one agrees to indemnify another upon the occurrence of an anticipated loss. A contractual or equitable right under which the entire loss is shifted from a tortfeasor who is only technically or passively at fault to another who is primarily or actively responsible.” *Black’s Law Dictionary*

As the definitions above reveal, indemnification is essentially one party promising to pay for the losses of another. Keeping this in mind, the following is one recommended indemnification provision. This or a modified version of it should be made a part of any prime contract documents or subcontracts so as to fully protect interests of the design professionals.

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**ARTICLE IX: INDEMNIFICATION**

- 9.1. **Indemnification.** To the fullest extent permitted by law, **Subcontractor** shall indemnify, defend and hold harmless the Contractor, Owner, Architect/Engineer, their parents, members, subsidiaries, related corporations and any other entity as provided in the Contract Documents (hereinafter "Indemnified Parties") 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 the loss of use resulting there from, but only to the extent caused or alleged to be caused by the negligent acts or omissions of the Subcontractor, anyone directly or indirectly employed by the Subcontractor or anyone for whose acts the Subcontractor 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.
- 9.2. **No limitation upon Liability.** In any and all claims against the Indemnified Parties, by any employees of the Subcontractor, anyone directly or indirectly employed by the Subcontractor or anyone for whose acts the Subcontractor may be liable, the indemnification obligation under Paragraph 9.1 shall not be limited in any way by a limitation on the amount or type of damages, compensation or benefits payable by or for the Subcontractor under worker's compensation acts, disability benefit acts or other employees benefit acts.
- 9.3. **Additional Indemnification.** Subcontractor shall indemnify, defend and hold harmless the Indemnified Parties from and against any and all claims demands, suits, actions, expenses, judgments, losses and liabilities, including fines and penalties, costs and attorneys; consultants; and experts' fees as a result of Subcontractor's actual or alleged failure to perform the Subcontract in accordance with the terms of this Agreement and the Contract Documents. The foregoing obligations of Subcontractor shall include, but are not limited to, (i) damages and other delay costs payable by Contractor; (ii) Contractor's increased costs of performance, such as extended overhead and increased performance costs resulting from Subcontractor caused delays or omitted or defective Subcontractor's Work; (iii) warranty, rework and repair costs; (iv) liability to third parties, including, but not limited to, other subcontractors of Contractor and Owner's contractors; (v) excess re-procurement costs; (vi) costs to obtain a substitute subcontractor or costs incurred to demand and ensure performance of Subcontractor's surety in the event of Subcontractor default; (vii) Consultants' and experts fees; and (viii) attorneys' fees and related costs. Subcontractor's actual or alleged failure to perform shall include the actual or alleged failure of Subcontractor's lower-tier subcontractors or suppliers to perform. The foregoing indemnity shall also be an obligation of Subcontractor's performance bond surety provided, however, the existence or non-existence of a performance of payment bond shall in no way limit or condition the Indemnified Parties' right of indemnity or remedies against Subcontractor nor shall it limit Subcontractor's responsibilities hereunder.
- 9.4. **Indemnity For Equipment Utilized.** In the event that Subcontractor or any of Subcontractor's agents, employees, suppliers, or lower-tier subcontractors utilize any machinery, equipment, tools, ladders, scaffolding, hoists, lifts or similar items belonging to or under the control of any of the Indemnified Parties, Subcontractor agrees to indemnify, defend and save harmless the Indemnified Parties from and against any and all claims, demands, suits, actions, expenses, judgments, losses and liabilities, including fines and penalties, costs and attorneys', consultants' and experts' fees, arising out of such use, except to the extent such loss or damage shall be caused by the negligence of any of the Indemnified Parties' employees operating any of the indemnified Party-owned or indemnified Party-leased equipment.

- 9.5 Patents. Except as otherwise provided by the Contract Documents, the Subcontractor shall pay all royalties and license fees which may be due on the inclusion of any patented materials in the Subcontractor's Work. The Subcontractor shall defend all suits for claims for infringement of any patent rights arising out of the Subcontractor's Work, which may be brought against the Contractor, Owner, or Architect/Engineer and shall be liable to the Contractor, Owner, or Architect/Engineer for all loss, including all costs, expenses, and attorney's fees.
- 9.6. Work. Subcontractor hereby assumes the entire responsibility and liability for work, supervision, labor and materials provided hereunder, whether or not erected in place, and for all plant, scaffolding, tools, equipment, supplies and other things provided by Subcontractor until final acceptance of Subcontractor's Work by the Owner as defined by the Contract Documents. In the event of any loss, damage or destruction thereof from any cause, Subcontractor shall be liable therefore, and shall repair, rebuild and make good said loss, damage or destruction at Subcontractor's sole cost.
- 9.7. Duty to Defend. Subcontractor shall: (i) at Subcontractor's own cost, expense and risk, defend all claims defined in this Article that may be brought or instituted by third persons, including, but not limited to, governmental, state, or local agencies, or employees of the Subcontractor against any of the Indemnified Parties or their agents or employees or any of them; (ii) pay and satisfy any judgment or decree that may be rendered against the indemnified parties or their agents or employees, or any of them arising out of any such claim; and, (iii) reimburse the Indemnified Parties or their agents or employees for any and all legal expense incurred by any of them in connection herewith or in enforcing the indemnity granted in this Article; (iv) at the option of an Indemnified Party it may engage counsel of its choice with respect to any action which the Indemnified Party contends involves Subcontractor's indemnity obligations, and Subcontractor's insurer is obligated to accept such counsel and Subcontractor shall pay all the fees and expenses thereof as provided above.
- 9.8. Indemnification independent from Insurance. Subcontractor's indemnification obligations are independent from, and not limited in any manner by the Subcontractor's insurance coverage required by Article 10.

A typical situation where this provision will come into play is when there is an injury on a job site involving an employee of a subcontractor in the trades. In addition to filing his workers' compensation case there is a good chance he will be filing a lawsuit against the rest of the construction team—including the engineers—alleging negligent acts and/or omissions which proximately caused the injuries.

In this scenario the engineer will usually have been named as an additional insured on the subcontractor's general liability policy. Accordingly, the engineer will tender its defense to the subcontractor and its insurer. If the insurer accepts the tender outright, there is little to worry about. But if the tender of defense is denied or accepted with a reservation of rights or is subject to monetary limitations, the engineer is now potentially exposed to unnecessary losses that were not contemplated prior to beginning the job. It is the terms of the indemnification provision that may now offer the engineer a shield should there be an election to file a third-party suit for contribution and indemnification against the subcontractor.

The first issue to be addressed in filing a suit for contribution and indemnification is whether the indemnification provision violates the *Construction Contract Indemnification for Negligence Act* 740 ILCS 35 et seq. The Act States:

"With respect to contracts or agreements, either public or private, for the construction, alteration, repair or maintenance of a building, structure, highway bridge, viaducts or other work dealing with construction, or for any moving, demolition or excavation connected therewith, every covenant, promise or agreement to indemnify or hold harmless another person from that person's own negligence is void as against public policy and wholly unenforceable."

The purpose of the Act is to protect industry workers and the public from attempts to avoid the consequences of liability through the use of agreements that indemnify one party for their own negligence and to ensure motivation for accident prevention measures. *W.E. O'Neil Construction Co. v. General Casualty Co. of Illinois*, 748 N.E.2d 667. In other words, the Legislature has recognized the construction industry is inherently dangerous and those involved in construction should take extra care to prevent accidents and injury. An incentive to take extra care is the knowledge that the public policy of this state is to not allow one party to take responsibility for the negligence of another.

This does not mean that indemnification agreements are automatically void or without meaning. They must, however, be worded correctly so as not to run afoul of the Act. If the indemnification agreement is worded to provide recovery to the indemnified party for its losses *to the extent they were the proximate result of the wrongful acts or omissions of the indemnitor* then the agreement will be upheld. *Liccardi v. Stolt Terminals, Inc.*, 687 N.E.2d 968 (1997).

Notice that in the recommended indemnification provision above the terms call for the subcontractor to indemnify the parties for losses “arising out of the performance of the work \*\*\* only to the extent caused or alleged to be caused by the negligent acts or omissions of the Subcontractor, \*\*\* regardless of whether or not such claim, damage, loss or expense is caused in part by a party indemnified hereunder.” The subcontractor is not being asked to indemnify a party for the other party’s negligence. Rather, it is requiring indemnification for the amount of the loss that was proximately caused by the subcontractor. Therefore, the indemnification provisions do not, arguably, violate the Act and may be enforced.

The second issue in considering a third-party action is how will insurance being provided to the engineer, albeit with a reservation of rights or with monetary limitations, be effected. If any insurance is being provided, the subcontractor, citing *Briseno v. Chicago Union Station Company*, 557 N.E.2d 196 (1st Dist. 1990), may move to dismiss a third-party action for contribution and indemnification, arguing that they are immune from the action because they are providing protection for the engineer through the insurance policy. In this scenario the subcontractor’s argument would be premature and misstates the holding in *Briseno*. A party cannot argue it has afforded coverage for loss pursuant to a contract and thus be immune from contribution until the amount of the loss is determined. Furthermore, policy limits on the insurance provided and the limited acceptance of the tender of defense are contrary to the express terms of the contract.

The court in *Briseno* upheld the dismissal of a contribution action only *after* the liability of the parties had been determined and satisfied from the proceeds of an insurance policy procured pursuant to a contract. The court held, “Under these circumstances, where liability of the parties has been determined and satisfied from the proceeds of an insurance policy provided by [the subcontractor] pursuant to the parties’ contractual agreement, [the owners] contribution action was properly dismissed.” *Id.*, at N.E.2d 198-199. If a contribution action were to be dismissed prior to the full settlement or adjudication of the case, the indemnified party would be exposed to potential losses not contemplated by the parties. Once the subcontractor’s insurance policy has fully satisfied any settlement or judgment, then it would be acceptable to have the contribution action dismissed.

Continuing in that vein, it is valid to have contract documents wherein the parties agree there is to be no limit on liability for actions brought against, inter alia, the engineer arising out of subcontractor’s work. See *Braye v. Archer-Daniels-Midland, Co.*, 676 N.E.2d 1295 (1997). In our scenario the engineer has not been fully defended, fully protected, nor have the terms or the intent of the contract been fulfilled. So long as the potential for loss is in excess of the policy’s limits, the engineer is at risk of loss and has a right to exert its statutory right to contribution. See *Kehoe v. Commonwealth Edison, Co.*, 694 N.E.2d 1119 (1st Dist. 1998). If the insurance policy procured by the subcontractor has liability limits, the indemnified parties face potential exposure should a judgment exceed the policy limits—an exposure the indemnification provision is designed to help alleviate. Again, a dismissal of a contribution action in our scenario prior to any settlement or judgment being satisfied would be arguably premature and without a basis in fact or law.

Third, the subcontractor may attempt to assert that any contribution to a judgment in the underlying suit would be capped at the amount of workers' compensation payments they provide to their employee. Yet another important reason to make sure the indemnification provisions contain "no limit" language. While true, *Kotecki v. Cyclops Welding Corp.*, 585 N.E.2d 1023 (1992) allows the subcontractor to limit its amount of contribution to the amount of its workers' compensation payments, the subcontractor may contractually waive this limitation. The indemnification provision above specifically states "the indemnification obligation under Paragraph 9.1 shall not be limited in any way by a limitation on the amount or type of damages, compensation or benefits payable by or for the Subcontractor under worker's compensation acts, disability benefit acts or other employees benefit acts." In that the parties have the freedom to contract, this provision is perfectly acceptable and should be given its plain meaning. The courts are clear, an employer may relinquish by contract the liability limitations set forth in *Kotecki*. See *Liccardi v. Stolt Terminals, Inc.*, 6878 N.E.2d 968 (1997).

This ability to waive the *Kotecki* cap is an extremely important issue for both parties in an indemnification agreement. The subcontractors want to be in a position to keep the cap in place, which limits exposure and brings certainty to potential losses. They also want to be able to recoup their losses through a lien on any liability recovery their employees may obtain. The indemnified parties conversely want to be able to deflect the possibility of paying more than their pro rata share of a judgment by having subcontractors waive their caps. If a judgment is greater than the workers' compensation amount and the caps are in place, the indemnified parties could find themselves responsible for satisfying that judgment in an amount exceeding their proportional share of liability as determined by a jury. With the cap in place the subcontractor/employer will simply waive their workers' compensation lien and walk away leaving the indemnified party to pay the remainder of the judgment via joint and several liability. This can make the *Kotecki* cap issue one of the most hotly negotiated terms of any contract. Its potential impact to all the parties cannot be overstated.

In sum, the indemnification provision should be given due consideration and attention when putting together contracts. While the above example is very detailed and individual parties may want to make modifications, it is recommended that its key elements be included in all the contract documents. When construction accidents happen, they can be financially devastating to all involved—the best practice is to limit your exposure before a claim arises.

#### THIRD-PARTY BENEFICIARY

One clause in contracts between architects/engineers and owners or general contractors that is extremely helpful to have when mounting a defense to a general liability claim is one that spells out the intentions of the parties regarding "third-party beneficiaries." While it is not critical to have this in a contract, it can prove to be an important tactical asset against a plaintiff who is not an actual party to a contract. Below is one example of the provision:

"The undersigned agree that this Agreement shall not be construed as, nor is it the intent of any of the parties hereto to give any benefits, rights, privileges, action or remedies to any person, partnership or corporation not a signatory hereto under a third-party beneficiary theory or otherwise."

A common scenario in litigation is a plaintiff will cite to the duties and responsibilities in a contract applicable to the defendant to argue the breach of those duties somehow proximately caused his injury or loss. For example, an injured construction worker may argue the contract between the engineer and the owner made the engineer responsible for certain safety issues. This can be an effective tactic by a plaintiff. The defense, however, must be savvy enough to argue that any duties or responsibilities spelled out in a contract in which the plaintiff was not a party or third-party beneficiary should be of no consequence in the underlying litigation.

A third-party may only sue under a contract if the contract was entered into for the party's direct benefit. If a third-party's benefit is merely incidental, he has no right to recover under the contract. *Alaniz v. Schal Associates*, 529 N.E.2d 832, 834 (2nd Dist. 1988). For instance, in *Rogers v. West Construction Co.*, 623 N.E.2d 799 (4th Dist. 1993) an employee of a subcontractor sued the contractor for injuries sustained while working on a State of Illinois bridge project. The Appellate Court rejected the plaintiff's theory that the language in the Standard Specifications of the contract between the defendant and State created a duty running to him. The Appellate Court found that the regulations contained in the Standard Specifications created a duty owed to the State, not the plaintiff. The contract could not be read to establish beneficiary rights to nonparties to the agreement. *Id.*, at N.E.2d 803-804.

While the *Rogers* Court addressed a government contract, the principle is universal. A duty is not owed the plaintiff by virtue of a contract to which he is not a party or intended beneficiary. In the case of *Rogers v. Clark Equipment Co.*, 744 N.E.2d 364 (1st Dist. 2001), the plaintiff's estate sued the distributor of a forklift after it overturned. The plaintiff alleged there was a duty owed under the terms of a sales agreement. The Appellate Court rejected this theory holding the only way for one who is not a party to a contract to assert rights pursuant to that contract is to claim he or she is a third-party beneficiary. Because the plaintiff was not an intended beneficiary of the contract, he could not assert the duties therein ran to him. *Id.*, N.E.2d 367.

The undisputed law of this State goes back at least as far as 1931 to *Carson Pirie Scott & Co. v. Parrett*, 346 Ill. 252, 257-258, 178 N.E. 498, 501 (1931), which held, to maintain such an action the benefit of the contract must run directly to the plaintiff. There is the strong presumption the intentions of the parties to a contract are that the provisions apply only to them and not to third parties. *Barney v. Unity Paving, Inc.*, 639 N.E.2d 592 (1st Dist. 1994). In order for the plaintiff to have a right to sue "[t]he contract must be undertaken for the plaintiff's direct benefit and the contract itself must affirmatively make this intention clear." *Barney*, at N.E.596 quoting *Waterford Condominium Association v. Dunbar Corp.*, 432 N.E.2d 1009, 1011 (1st Dist. 1982).

In the case of an injured employee on a construction site, at best the plaintiff benefits only incidentally from the various contracts by being employed. Without, however, there being a direct intended benefit by the parties to the plaintiff, he arguably has no standing to sue or assert rights under those contracts. See *Barney v. Unity Paving, Inc.*, 639 N.E.2d 592 (1st Dist. 1994); *Caswell v. Zoya International, Inc.*, 654 N.E.2d 552 (1st Dist. 1995); and *Waterford Condominium Association v. Dunbar Corp.*, 432 N.E.2d 1009 (1st Dist. 1982).

As the case law teaches, it may not be imperative to spell out in the contract documents the specific intention of the parties to not confer any beneficial rights to others; the inclusion of the intentions becomes a powerful tactical tool in repelling plaintiffs.

#### CONCLUSION

The construction professional faces potential exposure on a variety of fronts. By being proactive enough to have some key provisions placed in the contract documents, the exposure can be limited or deflected completely. It is important to place yourself in a position of strength prior to an unfortunate occurrence. Complete and detailed indemnification provisions, along with spelling out the beneficiary intentions of the parties, can help provide that much needed strength.