2019 Annual Conference
March 13-15, 2019
Orlando, FL

Shifting the Risk: How to Properly Draft Enforceable Indemnification and Limitations of Liability Clauses

I. INDEMNIFICATION IN GENERAL

This is a loaded word, filled with expectation and implications. In reality, it's not a scary as it sounds. Indemnification is simply a risk shifting mechanism, one party's promise to protect another party from any loss. It is a common provision in commercial contracts and often used to lure one party into closing a deal, allowing them to feel protecting in case something in the future relationship goes awry. We often see these risk shifting clauses in construction contracts and also in agreements between a property management company and their landscaping/snow plow vendors. They also play a prominent role in contracts between suppliers and distributors of commercial goods and services. More recently they have cropped up in the context of personal services in health care between the health care facility and a provider.

Unfortunately, the relationship between indemnitor and indemnitee is not always fair or based on equal bargaining power in the business relationship. One party may have the superior bargaining power when the other party is seeking to solidify the customer or client business relationship. Some have classified this as a "bully's tool." For example, a small software vendor "SmallSoft" seeks to get business from a big university customer. "Big U" may promise "SmallSoft" a $10,000 contract with a promise of more ("this is the start of big things!"). Big U insists on indemnification in its favor, to secure the contract, and "Smallsoft" agrees. Later, a third-party lawsuit for data breach is filed, and lo and behold there are legal fees of $48,000 and then a settlement for $120,000, representing the damages for actual loss and identity monitoring. "Smallsoft" is potentially put out of business thanks to the indemnification clause it felt compelled to accept in order to get the deal signed.

II. ANTI-INDEMNITY STATUES: IS THERE A LEGISLATIVE OPTION TO CLARIFYING THIS RELATIONSHIP

Some states have enacted anti-indemnity statutes. There is a patchwork of laws around the 50 states that pertain to indemnity and its limitations. Some states prohibit indemnity for sole negligence only, while others have enacted laws that prohibit indemnity for sole or partial negligence. Some states also prohibit additional insured provisions.

Indemnity acts take three approaches. Approach #1, sole negligence, the parties can agree to indemnity, but the provision will not be enforced if the indemnitee is 100% negligent. As a practical matter, the

issue of sole negligence does not get sorted out until the jury apportions liability. Thus, you are likely going to trial and the indemnity provision does nothing for you. Another addressed both sole and partial negligence. The indemnitor can only indemnify indemnitee for indemnitor's negligence. This protects non-negligent parties from the recklessness of others; i.e., it might cause indemnitees to be less careful if they know that someone else is footing the bill. It actively tries to protect parties with weaker bargaining positions and its practical application is that the indemnitee's carrier will be paying for its own defense. Finally, some states have not addressed indemnity and allow prevailing case law to address the enforceability of such clauses.

Be aware of the additional insured loophole in any state. Some commercial contracts require the indemnitor to also obtain insurance coverage for the indemnitee, adding them as an "additional insured." Example:

> § 11.1.4 The Contractor shall cause the commercial liability coverage required by the Contract Documents to include (1) the Construction Manager, the Construction Manager's consultants, the Owner, the Architect, and the Architect's consultants as ***additional insureds*** for claims caused in whole or in part by the Contractor's negligent acts or omissions during the Contractor's operations; and (2) the Owner as an ***additional insured*** for claims caused in whole or in part by the Contractor's negligent acts or omissions during the Contractor's completed operations.

However, anti-indemnity acts do not apply to the insurance contract itself in almost every jurisdiction, with a short list of exceptions:

1. Colorado
2. Georgia
3. Montana
4. Oklahoma
5. Oregon
6. Texas

Here are examples these "anti indemnification" laws in New York and Connecticut. Connecticut's statute addresses sole or partial negligence. Conn. Gen. Stat. 52-572k(a) provides:

> "Any covenant, promise, agreement or understanding entered into in connection with or collateral to a contract or agreement relative to the construction, alteration, repair or maintenance of any building, structure or appurtenances thereto including moving, demolition and excavating connected therewith, that purports to indemnify or hold harmless the promisee against liability for damage arising out of bodily injury to persons or damage to property caused by or resulting from the negligence of such promisee, such promisee's agents or employees, **is against public policy and void**, provided this section shall not affect the validity of any insurance contract, workers' compensation agreement or other agreement issued by a licensed insurer." Emphasis added.

52-572k(a) as explained by one Connecticut court: "In the context of a construction contract, then, suppose that B has agreed to indemnify A. In the indemnification context, the agreement will be triggered only if A is found to be liable to P, that is, where the underlying case sounds in negligence, only

where negligence of A is a substantial factor in causing injury to P A, whose negligence has been found to have been a substantial factor in causing injury to P, seeks indemnification from B Suppose, as above, that B's negligence is also a substantial factor in causing P's injury. If B were to indemnify A., B would necessarily be holding A harmless against A.'s own negligence. The elimination of the word "sole" modifying negligence in 2001 broadened the reach of the statute: prior to 2001, the prohibition extended only to situations where P's injury was caused by the "sole negligence" of. A. Patt v. Metro. Dist. Comm'n, No. X04CV044003558S, 2006 Conn. Super. LEXIS 3788, at *10 (Super. Ct. Dec. 20, 2006).

Conn. Gen. Stat. § 52-572k did not apply to an action where the agreement at issue was a lease agreement; for the statute to have applied, the agreement between the parties would have had to have arisen out of a construction contract. Maldonado v. Protech Secs, 1999 Conn. Super. LEXIS 2596 (Conn. Super. Ct. Sept. 9, 1999). It also did not apply in an action where a contractor filed a third-party complaint against one if its subcontractors in a personal injury suit where the contractor sought indemnification, because the indemnification language did not purport to indemnify the contractor for acts which it might be held solely negligent. Kinney v. Gilbane Bldg. Co., 2004 Conn. Super. LEXIS 2671 (Conn. Super. Ct. Sept. 21, 2004).

Like Connecticut, New York has adopted a similar statute under the “sole or partial negligence” category. N.Y. Gen. Oblig. Law Sec. 5-322., entitled Agreements exempting owners and contractors from liability for negligence void and unenforceable; certain cases- provides in relevant part:

> A covenant, promise, agreement or understanding in, or in connection with or collateral to a contract or agreement relative to the construction, alteration, repair or maintenance of a building, structure, appurtenances and appliances including moving, demolition and excavating connected therewith, purporting to indemnify or hold harmless the promisee against liability for damage arising out of bodily injury to persons or damage to property contributed to, caused by or resulting from the negligence of the promisee, his agents or employees, or indemnitee, whether such negligence be in whole or in part, is against public policy and is void and unenforceable; provided that this section shall not affect the validity of any insurance contract, workers’ compensation agreement or other agreement issued by an admitted insurer. This subdivision shall not preclude a promisee requiring indemnification for damages arising out of bodily injury to persons or damage to property caused by or resulting from the negligence of a party other than the promisee, whether or not the promisor is partially negligent.

CLS Gen Oblig § 5-322.1 bars enforcement of indemnification agreement between general contractor and subcontractor when general contractor is found partially negligent in action brought by subcontractor’s employee and agreement contemplates full, rather than partial, indemnification. Itri Brick & Concrete Corp. v Aetna Cas. & Sur. Co., 89 N.Y.2d 786, 658 N.Y.S.2d 903, 680 N.E.2d 1200, 1997 N.Y. LEXIS 760 (N.Y. 1997). It places burden of proof of property owner’s actual negligence on employer of injured workman and, in absence of such proof, statute is inapplicable. Walsh v. Morse Diesel, Inc., 143 A.D.2d 653, 533 N.Y.S.2d 80, 1988 N.Y. App. Div. LEXIS 9467 (N.Y. App. Div. 2d Dep't 1988). While it is true that CLS Gen Oblig § 5-322.1 renders void agreements to indemnify negligent parties against their own negligence, agreement to provide insurance does not offend statute. Williamson v Borg Florman

Dev. Corp., 191 A.D.2d 335, 594 N.Y.S.2d 778, 1993 N.Y. App. Div. LEXIS 2601 (N.Y. App. Div. 1st Dep't), app. denied, 81 N.Y.2d 711, 601 N.Y.S.2d 580, 619 N.E.2d 658, 1993 N.Y. LEXIS 1796 (N.Y. 1993).

III. A LIMITATION OF LIABILITYCLAUSE IS ANOTHER WAY TO LIMT AND AVOID -

This is a clause or language in a contract that is meant to act as a disclaimer to limit conditions under which the disclaiming party can be held liable for damages or a loss. It can operate to limit certain types of liability such as incidental damages, special damages and punitive damages. It can also limit the amount of liability with caps on damages and certain fees.

For example, in *Gaynor Elec. Co. v. Hollander*, 29 Conn. App. 865, 868-69, 618 A.2d 532, 534 (1993), the court held the contract was enforceable although did not bar incidental damages, at issue in the case. General Statutes § 42a-2-719 (1) permits parties to limit a buyer's remedy for breach. Under § 2-719 (1) (b), however, if such a limited remedy is designed to be exclusive, such as the plaintiff's claim in this case, it must be clearly expressed. . Here, the contract states that the seller's liability "shall not exceed the cost of correcting defects in the goods. Despite the plaintiff claim that these words create an exclusive remedy limited to the physical repair of the goods. Absent more specific language, we cannot find that these words create the limitation claimed, and, to the contrary, find that in their plain meaning these words include the type of damages sought by the defendant.

That “limitation of liability" clause read: "The liability of the Seller to the Buyer arising out of the manufacture, sale, delivery, use or resale of the goods, whether based on warranty, contract, negligence or otherwise, shall not exceed the cost of correcting defects in the goods as herein provided. Upon the expiration of the warranty period, all such liability shall terminate. The Seller shall not be liable to the Buyer or ultimate users of the equipment into which the goods are incorporated for loss of anticipated profits, loss by reason of plant shutdown or service interruption, nonoperation or increased expense of operation of other equipment, loss of use of revenue, cost of capital or other consequential loss or damage of any nature arising from any cause whatsoever by reason of the manufacture, sale, delivery, use or resale of the goods covered hereunder."

Notable exclusions in limitations of liability clauses are: willful misconduct; intentional wrongdoing; gross negligence and criminal behavior. Also please take note of the Second Restatement of Torts, which provides in 195 (Term Exempting From Liability for Harm Caused Intentionally, Recklessly or Negligently) (1) A term exempting a party from tort liability for harm **caused intentionally or recklessly is unenforceable on grounds of public policy.** A term exempting a party from tort liability for harm caused negligently is unenforceable on grounds of public policy if: (a) the term exempts an employer from liability to an employee for injury in the course of his employment; (b) the term exempts one charged with a duty of public service from liability to one to whom that duty is owed for compensation for breach of that duty; or (c) the other party is similarly a member of a class protected against the class to which the first party belongs.

Here are some suggestions on making these limitations of liability clauses enforceable. Just like any contract provision- use **clear and unambiguous** language. Ensure the clause as drafted is not “unconscionable.” When determining whether contract language is “unconscionable” courts will look to whether the contract is procedurally and substantively unconscionable. To be procedurally and substantively unconscionable, the court will examine whether a party lacked meaningful choice and entered into a contract with terms that unreasonably favor the other party. Also try to draft a clause that does not violate public policy. If both parties are sophisticated parties, especially in the commercial

context, courts will typically find that there is no violation of public policy and will enforce the clause. Bralite Holdings, LLC v. Dryfoos Envtl. Consulting, LLC, No. HHDCV116022797S, 2013 Conn. Super. LEXIS 563 (Super. Ct. Mar. 12, 2013). A public policy concern may arise when one party is a professional service provider dealing with the general public. SNET Info. Servs. v. O'Neal, No. CV076001656, 2011 Conn. Super. LEXIS 664 (Super. Ct. Mar. 15, 2011).