



Tipsheet 1

Indemnity Clauses – What are they?

Client version
May 2009
Updated January 2011

Indemnity and ‘hold harmless’ clauses are commonly found in commercial contracts. We take a look at their impact for clients who are seeking cover under their insurance policy.

What is an indemnity clause?

Indemnities are often given when one party (*a supplier*) agrees to provide a product or service to another party (*a recipient*) and the recipient is relying on the supplier to do this properly.

Indemnity clauses can be found in a broad range of commercial and legal documents including leases, loan agreements, construction contracts, professional services contracts, supply agreements, bills of lading, licensing agreements and many others.

An indemnity is provided where the supplier agrees to “indemnify” or exempt the recipient from the recipient’s Common Law liability in a written contract.

Example Indemnity Clause: “The Contractor indemnifies the Principal against all loss, damages, claims, liability, expenses, payments or outgoings incurred by or awarded against the Principal arising directly or indirectly from:

- *Any breach by the Contractor of this agreement;*
- *Any act or omission of the Contractor (including any negligence, unlawful conduct or wilful conduct) by the Contractor relating to this Agreement or arising as a consequence of the performance or non-performance of the Services.”*

In most cases, the indemnity is designed to help the recipient cover any costs or payments that they need to incur or make as a consequence of the supplier not performing the service properly – ie usually those costs incurred due to the supplier’s errors or mistakes.

However the extent of the indemnity depends on how it is written.¹ Often indemnities in construction contracts will seek to pass 100% of responsibility for something from the recipient to the supplier simply as a form of “risk transfer” between the contracting parties.

Example: A developer usually tries to transfer 100% of the project’s construction risk to the building contractor, regardless of who causes the loss or damage, or who would be responsible at law.

Indemnities are commonly sought (and provided) for the following:

- Claims for loss, compensation or damages due to personal injury or property damage;
- Liability for negligence or for breach of contract;
- Other legal actions and proceedings (eg, intellectual property infringement, breach of confidentiality, misleading and deceptive conduct or other legal liability);
- Costs, charges, outgoings, expenses and other payments (eg legal costs);
- Reductions in the value of something, loss of profit and other consequential economic loss; and
- Taxes and interest payable by one of the parties as a consequence of the default.

Disclaimer

This Tipsheet contains general information about contractual liability issues. It is not tailored to your individual circumstances and is not a substitute for obtaining specific insurance and legal advice about the contractual liability issues that arise in your business.

What is a 'hold harmless' clause?

A 'hold harmless' clause is similar to an indemnity but it prevents the supplier from holding the recipient responsible for any loss or damage suffered by the supplier. This deprives the supplier of any legal rights it may have to recover damages or a contribution towards damages from the recipient.

Example Hold Harmless Clause: "The Contractor holds the Principal harmless from any actions, claims, liability or loss in respect of the performance of the services."

Again depending on the way the clause is written, it can provide the recipient with extensive protection from a legal claim.

Example: The supplier is sued by a third party for personal injury, the supplier cannot seek recovery of any compensation it has paid to a third party from the recipient – the recipient is held harmless for that incident even if the recipient contributed in some way to the injury that was suffered.

What is the impact of these types of clauses?

Often indemnities and 'hold harmless' clauses shift legal responsibility from one party to another in a way that is different to the liability each party would have under the Common Law.

Example: The supplier has agreed to indemnify the recipient against claims, loss, liability, expenses and costs arising from the supplier's supply of a particular product. A third party sues the recipient because that party sustains an injury using the product designed by the supplier. The injury was caused partly by faulty design of the product and partly due to the recipient failing to use the product according to the supplier's specifications.

The indemnity results in the supplier indemnifying the recipient for 100% of the

compensation paid to the third party even though faulty design contributed to 70% to the injury suffered by the third party.

This means that one party is assuming more than their share of actual legal responsibility.

How does this impact the insurance?

When an insured agrees to pick up 100% of someone else's liability without any adjustment to take account of the extent to which the other party was negligent or at fault, this can trigger certain policy exclusions in liability policies.

In particular:

- Contractual liability exclusions;
- Compromise and settlement exclusions; and
- 'Subrogation' clauses.

The insurer's rights of subrogation are the rights the insurer has to 'step into the insured's shoes' and sue or claim against others who have some responsibility for the loss or damage. The right of subrogation is a key component of insurance because it allows the insurer to recover some of what they have paid to the insured by way of the insurance claim.

If you agree to indemnify or hold harmless another person who is responsible, this can trigger exclusions and breach policy conditions. It can also result in the insurer reducing the amount of the claim or denying a claim altogether.

What to do about this?

It is important for you to:

- Have indemnity clauses and 'hold harmless' clauses reviewed to make sure they do not trigger insurance policy exclusions or breach policy conditions.

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- Negotiate changes to the clauses to ensure that the relevant proportionate liability legislation in that State or Territory applies.

Proportionate liability legislation allows a court to 'apportion' certain legal claims between two or more wrongdoers taking into account the extent to which each party contributed to the loss or damage.ⁱⁱ In some cases, it may be illegal for the parties to agree to indemnify one another on terms which are different to this legislation.ⁱⁱⁱ

Insurance policies are more likely to respond to claims for indemnity where the clause is drafted so that this legislation will apply or contributory negligence can be raised (as a defence) to reduce the amount of the insured's liability under the contract.

Example Indemnity Clause with 'Contributory Negligence' Adjustment or 'Proportionate Liability':

"The Contractor indemnifies the Principal against all loss, damages, claims, liability,

expenses, payments or outgoings incurred by or awarded against the Principal arising directly or indirectly from:

- *Any breach by the Contractor of this agreement;*
- *Act or omission of the Contractor (including any negligence, unlawful conduct or wilful conduct) by the Contractor relating to this Agreement or arising as a consequence of the performance or non-performance of the Services,*

but such liability shall be limited to the share of responsibility the Contractor has according to the extent to which the acts, errors or omissions of the Contractor contributed to or caused the loss, damages, claims, liability, expenses, payments or outgoings incurred by or awarded against the Principal."

Note: It is important to obtain specific legal advice on the suitability of any examples before using or incorporating them into your own contracts.

Contact your broker and they can arrange specialist legal advice for you.

ⁱ Whether liability has been successfully transferred from one party to another depends on the drafting of the indemnity clause in terms of whether the language is wide enough and whether in the context of the negotiations between the parties they intended for the clause to operate as a reflexive indemnity. A reflexive indemnity is one which extends to the negligence or wrongdoing of the indemnified party (recipient).

ⁱⁱ Ask your broker for our Tipsheet 3 for more details about proportionate liability.

ⁱⁱⁱ For example in Queensland, it is unlawful to contract out of the proportionate liability legislation using an indemnity clause or other term which affects an 'apportionable claim'. See our Tipsheet 3 for more details about proportionate liability. Ask your broker for a copy.

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