



— 2018 UT SYSTEM —
LEGAL CONFERENCE

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THE UNIVERSITY of TEXAS SYSTEM | FOURTEEN INSTITUTIONS, UNLIMITED POSSIBILITIES.

Negotiating Contractual Indemnity Obligations
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Friday, September 21, 2018
Session 11b 1:45-2:45 pm
Room 12.106

Contractual Indemnification

Overview of Indemnification Law

Contract law applies to the interpretation of the indemnification obligations – and they are strictly construed. *Ideal Lease Service, Inc. v. Amorous Production Co.*, 662 S.W.2d 1951 [contractor’s obligation to indemnify property owner for injuries sustained by contractor’s and subcontractor’s “employees” did not apply to an independent contractor paid by the contractor].

There are two types of indemnification:

- indemnification against liability; and
- indemnification against damages.

Indemnification against liability:

For the obligation to arise, the amount of the cost or damages and the liability of the indemnitee for payment have to be made certain — for example, by a judgment against the indemnitee. Otherwise liability is a “future hypothetical event.” *Boorhem-Fields, Inv. v. Burlington Northern Railroad Co.*, 884 S.W.2d 530 (Tex. App. – Texarkana 1994, no writ).

Indemnification against damages:

A right to recover does not accrue until the indemnitee has suffered damage or injury by being compelled to pay the judgment or debt. *Holland v. Fidelity & Deposit Co. of Maryland*, 623 S.W.2d 469 (Tex. App. — Corpus Christi 1981, no writ).

Customary provision obligates the indemnitor to “indemnify, hold harmless and defend”

Indemnify – to compensate or reimburse for loss or damage, *D.R. Horton-Texas, Ltd. v. Markel Intern. Ins. Co. Ltd.*, 300 S.W.3d 773 (Tex. App.—Hou. [14th District.] 2006), order withdrawn and judgment aff’d in part and rev’d in part, 300 S.W.3d 740 (Tex. 2009)

Hold harmless – In general, a hold harmless agreement is a release which extinguishes any claim the releasing party might have against the party released without regard to liability to third parties. But: Some courts have held that a “hold harmless” provision is merely an indemnification.

***Bank of El Paso v. Powell*, 550 S.W.2d 383 (Tex. App. – El Paso, 1977) illustrates distinction.**

- Customer had bank issue a check for \$20,000 then asked bank to stop payment.
- Bank required customer to sign an agreement with hold harmless language.
- Bank held funds pending suit between customer and payee.
- Court found:
 - Payee entitled to \$11,000 plus \$4,000 interest that accrued while bank held the funds.
 - Customer entitled to \$9,000 plus \$5,000 in accrued interest.
- Court ordered:
 - Bank to pay these amounts.
 - Customer to reimburse bank for the \$4,000 in interest plus \$2,000 in bank's attorney's fees (\$6,000 total) **LESS** an offset for the \$5,000 in interest the bank earned (net \$1,000).
- Bank appealed arguing that customer signed a hold harmless, which released bank from any claims of liability which customer could assert against it. Therefore, customer could not assert a claim to the interest.
- Court held:
 - hold harmless agreement was indemnity only, and not a discharge of the liability of the bank.
 - Indemnitor is only entitled to be protected from actual loss sustained, and is accountable for any benefits received.

Defend – to pursue the legal defense of the indemnified parties.

The obligation to indemnify does not necessarily include the obligation to defend. *D.R. Horton-Texas, Ltd. v. Markel Intern. Ins. Co., Ltd.*, 300 S.W.3d 773 (Tex. App-Hou. [14th District.] 2006), order withdrawn and judgement aff'd in part, rev'd in part, 300 S.W.3d 740 (Tex. 2009).

Indemnification against Indemnitee's acts

The indemnity can be written to shift the risk for claims caused in whole or in part by the indemnitee, provided that the Fair Notice requirements are met. Courts have upheld indemnifications against:

- negligence of the indemnitee, *Ethyl Corporation v. Daniel Construction Company*, 725 S.W.2d 705 (Tex. 1987);
- strict liability of the indemnitee, *Houston Lighting & Power Company v. AT&S Railway Company*, 890 S.W.2d 455 (Tex. 1994);
- gross negligence of the indemnitee, *Webb v. Lawson-Avila Construction*, 911 S.W.2d 457 (Tex. App. – San Antonio 1995, writ dismiss'd).

Fair Notice

Fair notice consists of two components:

Express Negligence – intention to indemnify against indemnitee’s negligence or strict liability has to be clearly stated within the 4 corners of the contract, *Ethyl Corporation v. Daniel Construction Company*, 725 S.W.2d 705 (Tex. 1987).

Conspicuousness – the provision must be set off in such a way as to attract the attention of a reasonable person. *Dresser Industries, Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505 (Tex. 1993) Ex. Language in capitals, bolded, underlined.

Fair notice requirements also apply to releases.

Drafting Considerations

- In *Webb*, Court found that the obligation to indemnify against indemnitee's negligence included all degrees of negligence, including gross negligence. If indemnification is intended only for ordinary negligence, expressly exclude the obligation to indemnify against indemnitee's gross negligence and intentional misconduct.
- When representing the indemnitee, keep in mind that decisions are mixed as to whether an indemnification against the gross negligence or intentional misconduct of the indemnitee is enforceable as against public policy. The Supreme Court has not decided the issue. *Atlantic Richfield Company v. Petroleum Personnel, Inc.*, 768 S.W.2d (Tex. 1989) "We do not decide whether indemnity for one's own gross negligence or intentional injury may be contracted for or awarded by Texas Courts."

Drafting Considerations

- Obligation to indemnify does not necessarily include an obligation to defend. Expressly require defense obligation if required and cover court costs, attorneys fees, and other costs.
- Address how the obligations are affected, or not affected, by other conditions such as the indemnitee's insurance, or by statutory provisions, such as comparative negligence, and worker's compensation.
- Provide for the survival of the obligation, if the obligation is intended to survive termination of the contract.
- Be aware of any statutory limitations on indemnification or statutory requirements to indemnify.

Example:

Landlord agrees to indemnify, defend and hold tenant harmless from any injury and any resulting or related claim, action, loss, liability, damage or reasonable expense, including Attorney's Fees and other Fees and Court and other costs, occurring in any portion of the Common Areas. **THE INDEMNITY CONTAINED IN THIS PARAGRAPH (I) IS INDEPENDENT OF LANDLORD'S INSURANCE, (II) WILL NOT BE LIMITED BY COMPARATIVE NEGLIGENCE STATUTES OR DAMAGES PAID UNDER THE WORKER'S COMPENSATION ACT OR SIMILAR EMPLOYEE BENEFITS ACTS, (III) WILL SURVIVE THE END OF THE TERM, AND (IV) WILL APPLY EVEN IF AN INJURY IS CAUSED IN WHOLE OR IN PART BY THE ORDINARY NEGLIGENCE OR STRICT LIABILITY OF THE TENANT, BUT WILL NOT APPLY TO THE EXTENT AN INJURY IS CAUSED BY THE GROSS NEGLIGENCE OR WILLFUL MISCONDUCT OF THE TENANT.**

Statutes Affecting Indemnity

- Texas Anti-Indemnity Act
Indemnification obligations in construction and related contracts
(Tex. Ins. Code Sec. 151.001 et seq.)
- Architect/Engineer Anti-Indemnity Statute
Obligation of Contractor to indemnify architect against its own negligence
(Tex. Civ. Prac. & Rem. Code Sec. 130.001 et seq.)
- Texas Oilfield Anti-Indemnity Act
(Tex. Civ. Prac. & Rem. Code Sec. 127.001 et seq.)
- Products Liability Indemnity Statute
Requires indemnification by manufacturer
(Tex. Civ. Prac. & Rem. Code Sec. 82.001 et seq.)
- Sec. 2254.0031 Texas Government Code
State agencies prohibited from requiring contractor to indemnify state agency against negligent acts of agency or its employees.

Insurance Coverage

Commercial General Liability Insurance

The indemnitor's general liability insurance may cover the costs sustained by the indemnitor if the policy has coverage for contractual liability.

- It is important that the indemnification obligations are clearly written.
- It is important to know what the insurance policy or endorsement will cover. Have to read the policy and all endorsements.

Example, if the indemnitor is obligated to indemnify against the indemnitee's "sole negligence", the indemnitor's CGL policy will not cover costs if the policy limits assumed liability to injury or damage "caused in whole or in part" by the insured (i.e. the indemnitor).

Additional Insured Endorsements

The indemnitee can obtain additional protection by requiring an additional insured endorsement to the indemnitor's CGL policy.

The additional insured endorsement requires the insurer to defend the indemnitee, if suit is brought against the insured and the indemnitee.

The language of the additional insured endorsement should be checked for coverage. Some endorsements may not provide defense obligations unless the injury was caused “in whole or in part” by the insured (i.e. indemnitor).

Negotiating Contractual Indemnity Obligations

Identify the risks to the client:

- Is there a substantial risk of liability due to some act of the other party, or the party's agent?
- Can the client be protected by an indemnification?
- Can the client get protection through insurance – either own policy or as additional insured?

In negotiating the client's indemnification obligations, evaluate:

- The amount of exposure the client has from obligations.
- Whether there are ways to limit the exposure through the indemnification provisions.
 - “to the extent caused by indemnitor”
 - “injury or property damage proximately caused by”
- Whether insurance is available to cover the exposure.

Negotiations are more difficult when one party cannot/will not indemnify.



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Contractual Indemnification Issues

Friday, September 21, 2018
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State Agency Inability to Execute Contractual Indemnity Agreement

Threshold issue – State agencies probably cannot agree to contractual indemnity obligations – see [AG Opinion MW-475](#) (1982):

“In light of the restrictive constitutional prohibition against state debt, especially when coupled with the "cash basis" requirements of article III. section 49a of the constitution, **a state agency will ordinarily be unable to execute an enforceable indemnity agreement in favor of another party.**”

The opinion is based on the limitations on the ability of state agencies to create debt in [Article III, Section 49 of the Texas Constitution](#).

- Note: The Texas Constitution includes “savings provisions” identifying specific circumstances (Article XI, [Section 5](#) and [Section 7](#)) under which cities and counties to incur debt so long as provision is made at the time to levy and collect a tax to (1) pay interest on the debt and (2) provide a “sinking fund” of 2% of the debt. However, such savings provisions are **not** provided to Texas state agencies.

So, Why Would a State Agency Ever Agree to a Contractual Indemnity Obligation?

- Contractor insistence (part of our standard contract terms; attorney insists)
- Contractor resistance to a state agency only being able to contract “to the extent authorized by the laws and Constitution of the State of Texas – see [*Vitapro Foods*](#) opinion:
 - In general, only persons authorized by the Constitution or a statute can make a contract binding on the State. All state officers' powers are fixed by law, and all persons dealing with them are charged with notice of the limitations on those powers. Only persons having actual authority to act on behalf of the State can bind the State in contract.
- Need for state agency to be indemnified by the contractor (and possible claim for damages if contractor refuses to provide required indemnity.)

So, Why Would a State Agency Ever Agree to a Contractual Indemnity Obligation? Cont'd

- Risk of a change in law/AG opinion

Note that AG Opinion MW-475 provides that such an indemnification would be considered a “severable provision”:

An indemnity agreement negotiated by a state instrumentality in violation of law is unenforceable and void, **although an invalid indemnity clause in an otherwise enforceable contract will not ordinarily invalidate the remainder of the contract.**

Legally Qualifying State Agency Indemnity Obligations

If a contract term requires UT to indemnify, hold harmless, or defend a contractor, then it must be revised to qualify that obligation “to the extent authorized by the laws and Constitution of the State of Texas”.

- Insert the above clause directly into the contract term, or
- Include the “Limitations” paragraph from the UT contract templates:

Limitations. THE PARTIES ARE AWARE THERE ARE CONSTITUTIONAL AND STATUTORY LIMITATIONS (**LIMITATIONS**) ON THE AUTHORITY OF UNIVERSITY (A STATE AGENCY) TO ENTER INTO CERTAIN TERMS AND CONDITIONS THAT MAY BE PART OF THIS AGREEMENT, INCLUDING TERMS AND CONDITIONS RELATING TO LIENS ON UNIVERSITY’S PROPERTY; DISCLAIMERS AND LIMITATIONS OF WARRANTIES; DISCLAIMERS AND LIMITATIONS OF LIABILITY FOR DAMAGES; WAIVERS, DISCLAIMERS AND LIMITATIONS OF LEGAL RIGHTS, REMEDIES, REQUIREMENTS AND PROCESSES; LIMITATIONS OF PERIODS TO BRING LEGAL ACTION; GRANTING CONTROL OF LITIGATION OR SETTLEMENT TO ANOTHER PARTY; LIABILITY FOR ACTS OR OMISSIONS OF THIRD PARTIES; PAYMENT OF ATTORNEYS’ FEES; DISPUTE RESOLUTION; INDEMNITIES; AND CONFIDENTIALITY, AND TERMS AND CONDITIONS RELATED TO LIMITATIONS WILL NOT BE BINDING ON UNIVERSITY EXCEPT TO THE EXTENT AUTHORIZED BY THE LAWS AND CONSTITUTION OF THE STATE OF TEXAS.

Don't Indemnify the Other Party for Its Own Acts, Negligence, Etc.

Do not agree to indemnify, hold harmless, or defend the other party against its own negligence, misconduct, etc. (or that of its employees/subcontractors/agents.)

- Note that [Section 2254.0031 of the Texas Government Code](#) prevents a state governmental entity from requiring a professional services contractor to indemnify, hold harmless, or defend the state for claims or liabilities resulting from the negligent acts or omissions of the state governmental entity or its employees.
- With respect to state agencies, agreeing to this would probably violate the prohibition against state debts and grants of public money to private individuals, associations, or corporations that is set forth in Article III, Sections [49](#), [51](#), and [52](#) of the Texas Constitution.

Making a One-Sided Indemnity Mutual

When presented with an indemnification clause that only benefits the other contracting party, at a minimum modify it to apply to you as well. For example, from this:

CLIENT WILL INDEMNIFY SUPPLIER FROM AND AGAINST ALL LAWSUITS CAUSED BY CLIENT IN ITS PERFORMANCE UNDER THIS CONTRACT.

to this:

~~CLIENT~~ TO THE EXTENT AUTHORIZED BY THE LAWS AND CONSTITUTION OF THE STATE OF TEXAS, EACH PARTY (THE “INDEMNIFYING PARTY”) WILL INDEMNIFY ~~SUPPLIER~~ THE OTHER PARTY (THE “INDEMNIFIED PARTY”) FROM AND AGAINST ALL LAWSUITS TO THE EXTENT CAUSED BY ~~CLIENT~~ THE INDEMNIFYING PARTY IN ITS PERFORMANCE UNDER THIS CONTRACT.

Note: Before doing this, ensure that the existing indemnity language adequately covers the likely risk.

Approval of Indemnity Defense Counsel

UT contract template states:

CONTRACTOR WILL AND DOES HEREBY AGREE TO INDEMNIFY, PROTECT, DEFEND WITH COUNSEL APPROVED BY UNIVERSITY . . .

Contractor modifies such language to delete approval requirement:

CONTRACTOR WILL AND DOES HEREBY AGREE TO INDEMNIFY, PROTECT, DEFEND WITH COUNSEL APPROVED BY UNIVERSITY . . .

Contractor's reasons: If Contractor is providing (and paying for) defense, Contractor should control selection of counsel.

UT response: There's a need to ensure that Contractor-selected counsel has no conflicts. Also, Texas AG has to approve outside counsel ([Sec. 402.0212, Government Code.](#))

Compromise revision:

CONTRACTOR WILL AND DOES HEREBY AGREE TO INDEMNIFY, PROTECT, DEFEND WITH COUNSEL APPROVED BY UNIVERSITY, SUCH APPROVAL NOT TO BE UNREASONABLY WITHHELD . . .

Attorney's Fees

The indemnity provisions in UT contracts may include a clause requiring the Contractor to indemnify UT for attorney's fees:

CONTRACTOR WILL AND DOES HEREBY AGREE TO INDEMNIFY, PROTECT, DEFEND WITH COUNSEL APPROVED BY UNIVERSITY, AND HOLD HARMLESS UNIVERSITY FROM AND AGAINST ALL DAMAGES, LOSSES, LIENS, CAUSES OF ACTION, SUITS, JUDGMENTS, EXPENSES, AND OTHER CLAIMS OF ANY NATURE, KIND, OR DESCRIPTION, INCLUDING REASONABLE ATTORNEYS' FEES (COLLECTIVELY, **CLAIMS**) . . .

However, [Section 2252.904 of the Government Code](#) provides that a Texas governmental contract can't provide for the award of attorney's fees to the governmental entity in a dispute in which the entity prevails unless the contract provides for the award of attorney's fees to each other party to the contract if that party prevails in the dispute.

Attorney's Fees Cont'd

Since the above attorney's fees clause could be interpreted as violating Section 2252.904, and thereby result in UT being unable to obtain indemnification for attorney's fees, it is recommended that such language be qualified so that it is clear that it is not for the award of attorney's fees, but instead for attorney's fees resulting from investigating, defending, or settling the indemnified claim:

CONTRACTOR WILL AND DOES HEREBY AGREE TO INDEMNIFY, PROTECT, DEFEND WITH COUNSEL APPROVED BY UNIVERSITY, AND HOLD HARMLESS UNIVERSITY FROM AND AGAINST ALL DAMAGES, LOSSES, LIENS, CAUSES OF ACTION, SUITS, JUDGMENTS, EXPENSES, AND OTHER CLAIMS OF ANY NATURE, KIND, OR DESCRIPTION, INCLUDING REASONABLE ATTORNEYS' FEES **INCURRED IN INVESTIGATING, DEFENDING OR SETTLING ANY OF THE FOREGOING** (COLLECTIVELY, **CLAIMS**) . . .

However, do not include the above attorney's fees clause in contracts that are capable of being characterized as being for "construction" (even if UT does not believe the work under the contract is a "public work.") This is because contractors have a statutory right to recover attorney's fees in lawsuits for breach of certain construction contracts. (See [Section 114.004 of the Texas Civil Practice and Remedies Code](#).)

Indemnification for Negligence

Standard recommendation is that a party should indemnify for its **negligence and willful misconduct** and that of its employees, subcontractors, agents, etc.

However, a party may wish to limit its obligation to only indemnify for its **gross negligence**.

Risks:

- Proving gross negligence may be more difficult, as it requires showing that the party “knew about the peril, but his acts or omissions demonstrate that he did not care”.
- May result in having to defend against a claim even though caused by the other party’s ordinary negligence.

Indemnification for Users of a Contractor's Products/Services

Contractor indemnification provisions may require UT to indemnify the contractor for breaches/damages caused by users of the contractor's products/services.

- Example: users of the contractor's software.
- Best to avoid this, especially if there are non-UT users (e.g., library online database). Legal issues:
 - sovereign immunity
 - limited state liability for conduct of public servants – only for acts or omissions in the course and scope of employment (see [Chapter 104, Texas Civil Practice and Remedies Code](#))
 - constitutional prohibitions on use of state funds to benefit private individuals/entities (e.g., Article III, Section [51](#) of the Texas Constitution.)

Indemnification for Users of a Contractor's Products/Services Cont'd

- At an absolute minimum, such an indemnity obligation should be qualified:
 - UT only agrees “to the extent authorized by the laws and Constitution of the State of Texas”
 - Inclusion of more specific language:

“This agreement is enforceable only against and by the parties who have executed it; the agreement neither creates nor restricts rights in third parties. Further, if any provision of the agreement provides that University shall enforce the terms of this agreement against third parties, or restricts the legal rights of third parties, that provision shall be void.”
- Alternative approach instead of indemnity:
 - 1) agree to undertake (reasonable, good faith) efforts to require users to acknowledge and comply with the applicable contract terms and
 - 2) agree to work with the contractor to investigate, halt and prevent future occurrences of any user's breach of those contract terms that you become aware of.

Indemnity Carve-Outs

Note any list of exclusions from vendor's responsibility to indemnify (can also apply to limitations on liability):

- No vendor indemnity for claims arising from UT data – especially problematic if UT data is central to the contract (e.g., hosting services)
- No vendor indemnity for claims arising from combination of vendor's software with software provided by UT or third parties – exclude non-vendor software that must be so combined in order to access or use vendor software
- No vendor responsibility for compliance with UT specifications or directions (need to add language ensuring that the agreement doesn't itself constitute such specification or directions?)
- No vendor responsibility for internet problems/outages (but only those beyond their control?)

Interaction of Indemnity and Limitation of Liability Clauses

Contracts frequently have language placing limits on (or even eliminating) the damages for which the contractor will be liable. An example is a clause that limits the total dollar amount of damages for which the contractor will be liable:

Contractor's total liability for damages under this Agreement shall not exceed the license fee paid by the University to Contractor.

However, since an indemnification clause should primarily address the contractor's responsibility for its own (or its employees, subcontractors, agents, etc.) negligence and willful misconduct, then the language limiting or eliminating the contractor's liability for damages should be revised so that it does not apply to its indemnification obligations. For example, the following could be added:

Except for Contractor's indemnification obligations under this Agreement, Contractor's total liability for damages under this Agreement shall not exceed the license fee paid by the University to Contractor.

Outsourcing Indemnity to an Insurance Company

- Contract says that vendor has no responsibility to indemnify to the extent damages are covered by insurance. Example adapted from an actual contract:

Notwithstanding any other provision of this Agreement, the University and Contractor each hereby waive any and all rights of recovery against the other party and its officers, members, agents and employees for all injury, loss or damage to persons or property, including property or employees of either party, occurring on or arising out of this Agreement to the extent such injury, loss or damage is covered or should be covered by the insurance required to be maintained by the other party, including deductibles, retentions or self-insurance applicable thereto . . .

Outsourcing Indemnity to an Insurance Company

- Things to note:
 - Such language may not appear in indemnification provisions, but elsewhere in the contract – for example, it may be part of the insurance terms
 - Probably preceded by language like “Notwithstanding” above
 - May not explicitly mention indemnity – but language like “rights of recovery” might include indemnity obligations
 - May be written to be mutual to both parties
- Not advisable to agree to this:
 - What if insurance is dropped or lost?
 - Brings a third party into any indemnity issue – would probably complicate things.

Some Considerations in Negotiating with Governmental Entities

1. Indemnification Obligation Does Not Have to Be an Unconstitutional Debt

- Cap the amount of coverage
- Have an appropriation to cover up to the limit.
 - Identify funds and reimbursement resolution
 - Dedicated income stream (not taxes)

2. Waiver of Right of Recovery

- Agree that entity won't look to contracting party for payment if claim is covered by insurance, including entity's insurance.

Some Considerations in Negotiating with Governmental Entities

3. Entity obtains insurance policy with contractor as additional insured (?)
 - If contracting party wants protection against suits or liability resulting from entity's negligence, can entity obtain an insurance policy to provide coverage?
 - Can an additional insured endorsement be obtained for contracting party?

Tort Claims Act authorizes local governments to purchase insurance policies to protect it and its employees against claims.

A state government may purchase such insurance if authorized or required to do so under other law. Tex. Civ. Prac. & Rem. Code Sec. 101.027

4. Reduce or eliminate contracting party's indemnification obligations.
5. Other compensation to contracting party – more money, fewer obligations.