Loss Control Information Bulletin

NUMBER 8

Hold Harmless Agreements

Why "hold harmless" agreements?

Contractual arrangements are an everyday part of life for businesses. They can range from the mundane to the extremely complex. Even the simplest contracts – like a lease of premises – must be carefully reviewed and thoroughly understood to protect your rights and inform you of your duties.

Hold harmless agreements, also referred to as indemnification agreements, are commonly-found clauses in contracts. Their **purpose** is to **transfer** or **assume** another's **liability.** They are found in the following types of contractual arrangements, as well as many others:

- Contractor/subcontractor arrangements
- Lease of premises or equipment
- Easements with utilities, railroads, etc.
- Purchase orders
- Maintenance or service agreements
- Production contracts

Anticipate their effects

Hold harmless agreements frequently serve a useful purpose in clarifying the obligations of both parties. However, there are a number of ways they can significantly add to the costs of doing business if their effects are not anticipated.

Example: In some cases, one party may be in a superior bargaining position, allowing the other party little real opportunity to negotiate specific contract terms. The party with less leverage (or the one more anxious to "sign the deal") is often left with less desirable terms. Too often, the realization of the consequences of the obligation comes only after the provision has been activated by an injury or damage.

Recognize which type is being used

In order to gauge the likelihood of liability transfers, it is helpful to know which type of hold harmless agreement is being used. There are three basic types:

- Limited

The indemnitor (person or organization assuming liability) agrees to hold someone harmless against claims arising from the indemnitor's own operations and negligence and that of the employees/subcontractors.

- Intermediate

The indemnitor agrees to hold the indemnitee (person or organization whose liability is being assumed) harmless for negligence which is jointly caused by the indemnitee and indemnitor. In other words, if the entity being held harmless is 99% at fault for the ensuing damage, the party 1% at fault will be contractually obligated to pay 100% of the damages.

- Broad form

The indemnitor agrees to hold the indemnitee harmless from all damages, including those arising from the sole negligence of the indemnitee. Using the above example, if the other party to the contract is 100% at fault, the indemnitor will still pay 100% of the damages for the other entity.

In many states, broad from transfers of liability are not allowed. The state may still allow use of an intermediate type of indemnity provision, however, which may be potentially just as costly.

Insurable or not?

In most situations, the indemnification agreement will result in an additional cost to the indemnitor in the form of additional insurance to cover that part of the contract which is insurable under an insurance policy.

Many types of contractual assumptions of liability are legal but not insurable under a standard Commercial General Liability policy. For example, the CGL policy will not provide broader coverage to an indemnitee than it provides for its own insured, so many contractual transfers are beyond the scope of CGL coverage.

A few examples of uninsurable contractual assumptions are:

- Loss of profits
- Failure to perform
- Certain assumptions of liability which hold the indemnitor liable for damages he/she would not otherwise have been liable for, in the absence of the contract.

In order to gain a thorough understanding of your rights and duties under any contract, we strongly recommend that you consult with both your attorney and your insurance agent or broker.

Workers Compensation

Liability under Workers' Compensation laws require employers to compensate employees for injuries incurred on the job. In exchange for this strict liability imposed on the employer, the amount of the recovery from the employer or insurer is fixed generally by a predetermined scale. The employer must either insure this liability or qualify as a self-insurer.

The limited liability of the employer under Workers' Compensation laws provides a strong incentive for the injured employee and his/her attorneys to seek third party damages in cases of serious injuries. Often this third party will have a contractual arrangement with the employer, where in the employer agrees to hold the third party harmless.

This is often seen in construction contracts where subcontractors hold general contractors harmless, in the event that an injured employee of the subcontractor sues the GC under "safe place to work" statues. The GC turns the suit back over to the subcontractor via the hold harmless agreement. The subcontractor must then defend the GC and pay whatever damages are assessed, in addition to the Workers' Compensation benefits owed.

This situation may also occur when a manufacturer purchases a piece of equipment for use in the factory and, through the sales agreement, agrees to hold the equipment seller harmless. If an injured factory worker sues the equipment manufacturer, they may then pass the suit back to the factory to defend their interest. This type of transfer (if covered by the terms of the CGL policy) may then reduce or exhaust the liability limits available to the factory for their own benefit if they are sued directly themselves.

Establish an administrative program.

Regardless of the size of your organization, you need a structured administrative program for control of hold harmless liability.

Responsibility: One individual (or department) should be responsible for administering each of your organization's contracts. Since contracts often involve many members of an organization, a constant awareness of all activities of the firm must be maintained by the person(s) responsible for the identification of assumed liability.

Legal consultation: Contracts should always be reviewed by an attorney, especially those containing hold harmless clauses. Management can then make the appropriate decisions in response to the liability involved.

It cannot be stressed strongly enough that indemnity agreements:

- are not always easy to spot
- are less easy to evaluate
- can present great financial costs – enough to threaten the solvency of your business itself.

This bulletin is intended only as a reminder and is offered solely as a guide to assist management in its responsibility of providing a safer working environment. This bulletin is not intended to cover all possible hazardous conditions or unsafe acts that may exist. Other unsafe acts or hazardous conditions should also be noted and corrective action taken.

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