



28 NOVEMBER, 2016

UNDERSTANDING INDEMNITIES

INTRODUCTION

Indemnities are legally enforceable promises between parties to a contract where one party agrees to accept the risk of loss that another party may suffer in a particular situation.

Indemnities are used for the purposes of risk allocation and ensure that parties who are able to manage a particular risk are responsible for that risk and can cover situations where a party, in the absence of an indemnity, would otherwise be liable to compensate another party. In addition, indemnities can be observed where a party, in the absence of an indemnity, would not be liable.

SIMILAR EXPRESSIONS

Indemnity clauses do not necessarily use the word "indemnity" or "indemnify". Rather, depending on the construction of the clause, clauses containing phrases such as "hold harmless", "indemnify, defend and hold harmless", "reimburse", "be liable for", "pay" or "make good", may have the same meaning as an indemnity clauses.

TYPES OF INDEMNITIES

1. **Bare indemnities** which provide protection against all amounts and liabilities incurred in particular circumstances. Other bare indemnity

clauses may provide more limited protection, such as protection against personal injury, loss of life and damage to tangible property caused by the indemnifying party.

2. **Proportionate indemnities** which exclude loss arising from the indemnified party's negligence, breach of contract, wilful misconduct, fraud and/or illegal conduct.
3. **Reverse indemnities**, which expressly extend to the indemnified party's acts and/or omissions.
4. **Indemnities for breach** in relation to breach of contract and/or negligence. These clauses often limit the indemnified party's ability to recover compensation for breach of contract or negligence.
5. **Third party indemnities** in relation to claims brought by third parties against the indemnified party. Finally, there are also indemnities protecting third parties associated with the indemnified parties such as officers, employees, agents and related entities of the indemnified party.

OBJECTIONS

Since indemnities give rise to a contingent liability, parties who are indemnified will often object to indemnity provisions by arguing that:

- they cannot accept responsibility for events they have no control over;
- they cannot accept responsibility for events which are not covered by insurance;
- they cannot agree that its liability is to be determined by rules other than common law; or
- they may refuse to act as the other party's insurer.

MANAGING INDEMNITIES

Companies should policy guidelines outlining their position on indemnities in order to provide their legal counsel with a starting point for negotiations and ensure consistency across agreements.

Companies may agree that they do not provide any indemnity at all or may agree to provide indemnity in relation to particular matters such as personal injury, loss of life and tangible property damage caused by their own negligence where insurance is generally available. Companies may also soften the impact of indemnity clauses through various drafting methods.

UNDERSTANDING THE SCOPE OF INDEMNITIES

In order to understand the scope of indemnity clauses companies should identify the risks proposed to be covered and make an assessment as to whether those risks are manageable or whether the benefits outweigh the risk. Furthermore, companies should explore the availability of insurance coverage for the risks covered in the various indemnity clauses.

MINIMISING THE IMPACT

If a party is seeking to minimise or soften the impact of an indemnity clause they should:

- use the words "reasonably foreseeable" or "direct" in relation to indemnification for loss and damage;
- avoid expressions such as "arising from or in connection with", "arising directly and indirectly in relation to";
- avoid or limit the indemnification of directors, officers, employees and other third parties;

- require the indemnified party to take steps to mitigate loss;
- limit the indemnity to "reasonable" costs and expenses incurred by the indemnified party;
- bring indemnity clauses in line with a broader limitation of liability regime;
- ensure that the indemnified party consults with or gives control to the indemnifying party in relation to the conduct of any third party claim in relation to which indemnity is or may be sought; and
- avoid indemnification for loss and damage caused by the indemnified party's breach of contract or negligence.

Indemnity clauses simplify the recovery of damages and create certainty. However, companies should pay close attention to the wording of indemnity clauses so they do not walk away feeling burdened.

For more information

For more information on indemnities contact our Principal Solicitor/ Director

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