the Hold Harmless Agreement — a primer

BY CRAIG STANOVICE, CIC, CPCU, AU

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Hold harmless agreements are found just about everywhere—including (but not limited to) construction contracts, lease agreements (real estate and equipment leases, for example), service and maintenance contracts (such as equipment servicing), and purchase order agreements. The liability implications of hold harmless agreements can be enormous—and therefore tend to attract the attention of anyone charged with protecting an organization’s assets, e.g., the CFO, risk managers, insurance agents and brokers, risk management consultants, and attorneys. Because they insure some or all of the liability being transferred, insurance company underwriters also have a keen interest in hold harmless agreements.

This article is intended to explain the basics of hold harmless agreements, and discuss some fundamentals to promote a better understanding of the ubiquitous hold harmless agreement.

What is a Hold Harmless Agreement?

Hold Harmless Agreement—A contract in which one party agrees to indemnify the other. See Indemnity. [Black’s Law Dictionary—Eighth Edition]

Indemnity Clause—A contractual provision in which one party agrees to answer for any specified or unspecified liability or harm that the other party might incur. Also termed hold harmless clause. [Black’s Law Dictionary—Eighth Edition]

The key to hold harmless agreements is the notion of answering for the liability of another. Put another way, a person or organization (the indemnitor) has agreed to assume the liability of another (the indemnitee) to third parties. For a hold harmless to be activated, the indemnitee must have (or alleged to have) liability to a third person or organization who is not a party to the hold harmless agreement. In most cases, the liability of the indemnitee must be imposed on the indemnitee by the third party in tort. That is, for the hold harmless to apply, the source of the indemnitee’s liability to the third party is not based on contract, but is instead based on tort theories of liability such as negligence or strict liability.

What is Not a Hold Harmless Agreement?

To further reinforce the concept of answering for the liability of another as being the essence of a hold harmless agreement, it is important to recognize that certain promises to indemnify may not be considered hold harmless agreements. For example, a tenant may agree in a real estate lease to be responsible (regardless of fault or cause) to the landlord for any damage to the building.

In this case, the tenant is not answering for the liability of the landlord to a third party, but is answering to the landlord for an uncertain event—damage to the building. The tenant has not (in this example) promised to be responsible for liability the landlord may have to a third party. Thus, as the liability to others has not been assumed, this is not a hold harmless agreement.

Why Use a Hold Harmless Agreement?

One obstacle to learning how hold harmless agreements work is the concept that a person or organization would voluntarily accept responsibility for what someone else does—responsibility that might not otherwise be theirs. Why would anyone do that? People do. Routinely. Failure to recognize this reality will inhibit any meaningful appreciation of hold harmless agreements.

It is the custom and practice, for example, of the construction business to use numerous hold harmless agreements, such as between the owner and the general contractor and between the general contractor and subcontractors. The goal is simple: push as much liability to others as possible. While certainly all organizations do not strictly follow this approach, it is a widespread risk management approach.

But why would a person or organization assume the liability of another in a hold harmless agreement?

The most common reason for accepting a hold harmless is that you want to do business with another organization. And, because of their superior bargaining power, you agree to their terms—

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including assuming their liability. In other words, it is perceived as a “take it or leave it” proposition; an attempt to negotiate the wording of the hold harmless may result in loss of the job or work.

All too often, however, the hold harmless agreement is simply ignored by the indemnitor. The assumption of the liability of another is accepted by default. Unknowingly or recklessly assuming risk is the antithesis of prudent risk management.

Yet, those who have little or no understanding of the significance of hold harmless agreements are authorized to enter contracts—putting their organizations at risk.

How Much Liability Has Been Assumed?
Hold harmless agreements are often categorized by how much liability of the indemnitee (the one whose liability is being assumed) is being transferred to the indemnitee (the one who is assuming liability). The following categories by no means include all hold harmless agreements, just the most common types.

Broad Form Hold Harmless
The indemnitee has assumed all liability of the indemnitee, even in situations where the indemnitee is solely negligent in causing injury or damage to a third party.

Intermediate Form Hold Harmless
The indemnitee has assumed all liability of the indemnitee except when the indemnitee’s sole negligence causes injury or damage to a third party. In other words, if the combined negligence of both indemnitee and indemnitee cause injury or damage to a third party, the indemnitee will be liable to the indemnitee for 100 percent of the third party’s damages. This is the case even if the indemnitee is 99 percent negligent and the indemnitee is one percent negligent; the indemnitee has agreed to be liable for 100 percent of the damages to the third party, even though the indemnitee is only one percent negligent.

A subset of Intermediate Form is Comparative Fault Indemnity. The indemnitee will only be required to indemnify the indemnitee for the indemnitee’s relative fault, which would be one percent in the above example, instead of 100 percent. Such hold harmless agreements normally contain the phrase “but only to the extent” or similar restrictive wording.

Limited Form Hold Harmless
The indemnitee has only assumed responsibility for its own negligence. While enforcement of contracts that are “clearly and unequivocally” intended to indemnify an indemnitee for the indemnitee’s sole negligence.

Why would courts or state legislatures allow such a dramatic shifting of liability? It is often overlooked that a person’s or organization’s right to enter private contracts has to be balanced against other public policy considerations. In other words, it is mistaken, and potentially very costly, to assume that sole negligence indemnity will not be enforced because it does not seem fair or equitable. Public policy does not necessarily mean courts will unmake a bad deal.

Savings Clause
Considering that large national or regional organizations usually do not use separate contracts in each state in which they conduct business, their contracts often contain their standard hold harmless wording, which may not be enforceable in some states.

To prevent courts from voiding the entire hold harmless, many such agreements begin with the phrase “to the extent permitted by law” or similar wording. This so-called savings clause is intended to allow enforcement of at least that portion of hold harmless that is not in conflict with statute or case law. Failure to use a savings clause may render the hold harmless wording without effect, even those portions that would normally be enforceable.

Conclusion
Hold harmless agreements are complex and should not be taken lightly. Legal counsel should be sought, particularly in drafting or interpreting hold harmless agreements.

About the Author: Craig Stanovich, CIC, CPCU, AU
Craig is co-founder and principal of Austin & Stanovich Risk Managers, LLC, a risk management and insurance advisory consulting firm. Services include fee-based risk management outsourcing, expert witness and litigation support, and educational support to insurance companies and agencies. Craig is a national faculty member for The National Alliance and was vice president of commercial insurance for a regional insurance broker.