



## Preventing Unintended Consequences

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Precedent governing the recovery of attorneys' fees under indemnity provisions in construction contracts has started to emerge, offering direction about how to craft contracts.



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# Ways to Make Sure the Indemnity Clause You Just Negotiated Is Not Your Enemy

Look within the general conditions of virtually every construction contract and you will find a clause captioned “indemnity” or “indemnity and duty to defend.” Often these clauses have been cut, pasted, and cobbled together

so many times that they become a jumble of concepts and difficult to interpret. Indemnity clauses govern potential future claims and liabilities that mature only if something goes wrong. As a result, indemnity provisions frequently receive relatively little attention while the parties focus on reaching consensus on a host of other terms that seem more central to actual work on the project. Consequently, many owners, contractors, subcontractors, and suppliers enter into contracts and purchase orders in blissful ignorance of the full scope and potential liability inherent in these provisions.

When problems arise—which is altogether too common on multi-year, complex construction projects—the parties inevitably begin to ask their lawyers questions such as:

- What, if anything, does this indemnity clause cover in terms of first-party claims (*i.e.*, disputes between the contracting parties), or does it only cover third-party claims (*i.e.*, disputes concerning parties that lack contractual privity with the indemnitee)?
- To what extent, if any, can I recover my attorneys' fees and litigation expenses under this indemnity clause?
- Will I be able to recover my attorneys' fees under this indemnity provision even though the clause does not mention them and there is no express prevailing party clause in the contract?

Two recent decisions, one from the Maryland Court of Appeals, *Bainbridge St. Elmo Bethesda Apartments, LLC v. White Flint Express Realty Group, Ltd. P'ship*, 164 A.3d 978 (Md. 2017), and the other from

the District of Columbia Court of Appeals, *James G. Davis Construction Corp. v. HRGM Corp.*, 147 A.3d 332 (D.C. 2016), have given broad interpretation to indemnity provisions, allowing the recovery of attorneys' fees in first-party actions for breach of contract (much to the surprise and displeasure of the indemnitors). This article discusses emerging precedent governing the recovery of attorneys' fees under indemnity provisions in construction contracts, identifies pitfalls and traps for the unwary, and offers practice tips on the interpretation and drafting of sound indemnity provisions.

### Indemnity Provisions Covering Third-Party Claims

In its most basic form, indemnity is an obligation by one party (the "indemnitor") to compensate for a loss suffered by another party (the "indemnitee"). Participants in construction projects commonly use indemnification to address exposure to claims asserted against the indemnitee (often the owner) by strangers to the contract (third-party claims). Indeed, public sector owners often rely heavily on these provisions to counterbalance the full scope of potential liability that is posed by a project in relation to the minimal level of control that an owner exerts over that project's day-to-day operations.

For example, if a contractor's plumbing system fails, causing water damage to an adjacent apartment building, the owner will call on the contractor to indemnify the owner against demands made to the owner by tenants of the adjacent building. Similarly, if a contractor's crane collapses, causing death or personal injury to workers or members of the public, the owner will seek indemnity from the contractor to protect the owner from wrongful death and personal injury claims filed against that owner by third parties.

Most construction contracts contain indemnity provisions protecting against third-party claims. Such an example of coverage for third-party claims appears in frequently encountered Article 3.18 of AIA Document A-201-2017 "General Conditions of the Contract for Construction," which provides in pertinent part:

§3.18.1

To the fullest extent permitted by law, **the Contractor shall indemnify** and

hold harmless **the Owner**, Architect, Architect's consultants, and agents and employees of any of them **from and against claims, damages, losses and expenses**, including but not limited to attorneys' fees, arising out of or resulting from performance of the Work, provided that such claim, damage, loss, or expense is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (**other than the Work itself**), but only to the extent caused by the negligent acts or omissions of the Contractor, a Subcontractor, anyone directly or indirectly employed by them, or anyone for whose acts they may be liable, regardless of whether or not such claim, damage, loss, or expense is caused in part by a party indemnified hereunder.

Such clauses are generally interpreted to cover third-party claims, given the "from and against" language in the clause. Courts reason that third-party claims constitute the type of demands that an owner can reasonably expect to be protected "from and against." Similarly, clauses that address property damage "other than the work itself" are generally interpreted to cover third-party claims and the type of injury that is readily insured by the indemnitor's insurer.

Contractual indemnity clauses covering exposure to third-party claims are similar in concept to common law theories of equitable indemnity. Both share the premises that everyone should be accountable for the damages that they cause and that parties without fault should not be held accountable for the financial consequences of the actions of others over whom they have no control. Where the theories differ is that the precise language of contractual indemnity provisions will be strictly construed to determine what the parties agreed is covered in the indemnity obligation, and conversely, what is excluded. A court will not substitute its notions of equity for the actual language adopted by the contracting parties.

### Indemnity Provisions Covering First-Party Claims

In addition to addressing third-party claims, some construction contracts contain indemnity provisions covering the

risk of loss arising from a party's negligence or breach, or both, of the parties' contractual obligations (first-party claims). Courts widely respect the concept of freedom of contract and grant broad flexibility to the parties to specify the nature of their own commercial bargains. Courts will generally enforce the indemnity clauses in those agreements based on

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the precise language chosen by the parties. In interpreting such provisions, courts are constrained by what is contained in the four corners of the parties' written agreement and are reluctant to go beyond those express terms.

The following is an example of an indemnification clause taken from an owner's contract with its design engineer, addressing both first- and third-party claims:

The Consultant is responsible for any loss, personal injury, death and any other damage (including incidental and consequential) that may be done or suffered by reason of the Consultant's negligence or failure to perform any contractual obligations. The Consultant

must indemnify and save the Owner harmless from any loss, cost, damage and other expenses, including attorneys' fees and litigation expenses, suffered or incurred due to the Consultant's negligence or failure to perform any of its contractual obligations.

In this clause, there is no need for damage to occur to a stranger before the con-

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sultant's exposure to damages for breach of the parties' contract, including the payment of attorneys' fees and litigation costs, is invoked.

Although some argue that the concept of indemnity, and therefore, the reach of indemnity provisions, should extend to only third-party claims, there is considerable judicial authority rebutting that argument. For example, courts have explicitly rejected that notion by holding that the definition of "indemnity" itself contains no suggestion that the loss indemnified must involve a third party; rather, an indemnity provision is a comprehensive provision intended to make the wronged party whole. See *Kraft Foods N. Am., Inc. v. Banner Eng'g & Sales, Inc.*, 446 F. Supp.2d 551, 577 (E.D. Va. 2006) (holding that the "plain meaning definition of indemnification does not limit reimbursement to losses suffered as a result of third party claims"); *Rexam Beverage*

*Can Co. v. Bolger*, No. 06 C 2234, 2008 WL 5068824, at \*2 (N.D. Ill. Nov. 25, 2008) (rejecting the argument that indemnification in first-party actions would be an unreasonable result), *aff'd*, 620 F.3d 718 (7th Cir. 2010); *Medcom Holding Co. v. Baxter Travenol Labs., Inc.*, 200 F.3d 518, 519 (7th Cir. 1999) ("An indemnity clause is designed to make the wronged party whole—to put it in the same position it would have occupied had the other side kept its promise."); *Atari Corp. v. Ernst & Whinney*, 981 F.2d 1025, 1031–32 (9th Cir. 1992) (citation omitted) (stating that the word "indemnify refers to compensation for loss in general, not just particular types of loss... [and it] is not to compensate for losses caused by third parties, but merely to compensate").

### Recovering Attorneys' Fees in Third-Party Indemnity Claims

The law of Maryland, similar to that of many other jurisdictions, is clear when it comes to the recovery of attorneys' fees in third-party indemnity claims: the indemnitee is entitled as a matter of law to recover attorneys' fees in defense of an action, irrespective of whether the parties' contract or whether the clause in dispute mentions attorneys' fees. See *Jones v. Calvin B. Taylor Banking Co.*, 253 A.2d 742 (Md. 1969).

*Jones* served as a clear abrogation of the American rule when it established an implied right to attorneys' fees and costs incurred in third-party claims, even when the indemnity clause was silent about attorneys' fees. On appeal, the *Jones* court did not engage in any contract interpretation or construe any contract language to reach its decision. Instead, that court created a new exception to the American rule on the recovery of attorneys' fees by implying a fee-shifting provision for all third-party indemnity claims. *Id.* at 748–49. In Maryland, for more than 45 years, third-party indemnification provisions have impliedly encompassed the recovery of attorneys' fees without the need for any express reference to attorneys' fees in the indemnity provision in question.

More than 55 years ago, the Virginia Supreme Court reached a similar holding in *Hiss v. Friedberg*, 112 S.E.2d 871 (Va. 1960). In *Hiss*, the court found reasonable

attorneys' fees to be recoverable even if the contract was silent on the issue of fees, stating, "where a breach of contract has forced the plaintiff to maintain or defend a suit with a third person, he may recover the counsel fees incurred by him in the former suit provided they are reasonable in amount and reasonably incurred." *Id.* at 876. It is in this context that many have come to understand that attorneys' fees will be recoverable for defending third-party claims.

### Recovering Attorneys' Fees in First-Party Indemnity Claims

The intersection of the American rule and the parties' apparent intent, or lack of it, to include a fee-shifting provision has been the more problematic area for litigants and courts. In contrast to an implied right in many jurisdictions to recover attorneys' fees for the defense of third-party claims, attorneys' fees are recoverable in first-party actions when expressly provided by contract. See *Atl. Contracting & Material Co. v. Ulico Cas. Co.*, 844 A.2d 460 (Md. 2004); *Nova Research, Inc. v. Penske Truck Leasing Co.*, 952 A.2d 275 (Md. 2008). In both *Atlantic Contracting* and *Nova Research*, the Maryland court was examining indemnity clauses that were silent with respect to attorneys' fees in the context of arguments that the right to recover attorneys' fees should nevertheless be implied (as in *Jones*) to first-party indemnity actions. The Maryland Court of Appeals has been consistent, however, that the right to indemnification of attorneys' fees in first-party claims can be contractually manifested by evidence of express intent to encompass recovery for first-party claims—even when the mention of attorneys' fees is lacking in the subject clause.

In *Atlantic Contracting*, the Maryland Court of Appeals determined that the language of the indemnification provision provided sufficient evidence of the parties' intent to encompass potential attorneys' fees incurred in first-party claims, even though the clause at issue was silent regarding attorneys' fees. 844 A.2d at 469–70, 477–79. In *Atlantic Contracting*, the plaintiff acted as a surety for the defendant and brought an action for indemnification for a payment bond made on

behalf of the defendant. *Id.* at 464–66. The plaintiff also sought attorneys’ fees incurred during its pursuit of establishing its right to indemnity. *Id.* The indemnification provision obligated the defendant to “indemnify [the plaintiff] from and against any and all Loss,” and “Loss” was defined as “[a]ny and all damages, costs, charges, and expenses of any kind sustained or incurred in connection with or as a result of: (1) the furnishing of any Bonds; and (2) the enforcement of this Agreement.” *Id.* at 469. The indemnification provision did not mention attorneys’ fees. Therefore, *Atlantic Contracting* expanded the court’s earlier holding in *Jones* pertaining to third-party claims by adding a contractual exception to the American rule that applied to first-party claims.

Similar to the situation in *Atlantic Contracting*, in *Nova Research* the plaintiff was seeking attorneys’ fees incurred in pursuit of its right to indemnity from the defendant, but the indemnification provision was completely silent on the issue of attorneys’ fees. 952 A.2d at 278–79. There, the defendant was obligated to “indemnify and hold harmless [the plaintiff]... from and against all loss, liability and expense caused or arising out of Customer’s failure to comply with the terms of this Agreement.” *Id.* The court found that this language was insufficient compared to the language that the parties used in *Atlantic Contracting*, and as a result, the court refused to imply a fee-shifting provision when the indemnity clause did not otherwise mention attorneys’ fees. *Id.* at 285, 289. The court explained:

Because of our holdings in *Jones*, that the indemnity agreement need not contain the express phrase “attorney’s fees,” and *Atlantic*, where indemnifying against loss “including in the enforcement of the agreement” encompassed first party attorney’s fees, we adopt the approach... that the contract provide expressly for recovery in first party enforcement actions.

*Id.* at 289.

The court’s holding in *Nova Research* is consistent with *Atlantic Contracting* in that the holding refused to imply a fee-shifting provision when there was no explicit

inclusion of the phrase “attorneys’ fees” or sufficiently broad language to support a conclusion that the parties intended first-party claims to be covered.

In *Bainbridge St. Elmo Bethesda Apartments, LLC v. White Flint Express Realty Group Ltd. P’ship*, the Maryland Court of Appeals recently affirmed an award of \$3,931,648 of attorneys’ fees and expenses in a breach of contract action between the contracting parties under an indemnification clause that provided as follows:

*Indemnity.* Bainbridge hereby indemnifies, and agrees to defend and hold harmless White Flint... from any and all claims, demands, debts, actions, causes of action, suits, obligations, losses, costs, expenses, fees, and liabilities (including reasonable attorney’s fees, disbursements, and litigation costs) arising from or in connection with Bainbridge’s breach of any terms of this Agreement or injuries to persons or property resulting from the Work, or the activities of Bainbridge or its employees, agents, contractors, or affiliates conducted on or about the White Flint Property, including without limitation, for any rent loss directly attributable to any damage to the White Flint Property caused by the construction of the Project.

164 A.3d 978, 979, 981 (Md. 2017).

The Maryland Court of Appeals rejected Bainbridge’s assertion that the indemnification clause covered only third-party claims against which Bainbridge was to “defend” and “hold harmless.” *Id.* at 987. In reaching that holding, the court noted:

There are four exceptions to the American Rule where a prevailing party may be awarded attorneys’ fees: (1) the parties to a contract have an agreement to that effect, (2) there is a statute that allows the imposition of such fees, (3) the wrongful conduct of a defendant forces a plaintiff into litigation with a third party, or (4) a plaintiff is forced to defend against a malicious prosecution.

*Id.* at 985 (quoting *Nova Research*, 952 A.2d at 281). The court found that the indemnification clause contained in the parties’ contract fit squarely within exception “1,” above, to the American rule. *Id.* at 986–87.

The court rejected Bainbridge’s further assertion that to cover first-party claims, the clause needed to contain the exact language “in the enforcement of the agreement” that was present in the *Atlantic Research* clause. *Id.* at 988. In rejecting the premise that the clause needed any specific or “magic” language, the court said: “The language in *Atlantic*, however, is analogous to the case at issue, as an action for ‘enforcement of the contract’ is effectively the same as an ‘action for breach of contract.’” *Id.* (citation omitted). The court also noted that “[e]ach item in a string of terms, separated by the disjunctive ‘or,’ is given independent meaning.” *Id.* at 491. Also important is that *Bainbridge* was decided outside of the insurance and surety contexts, dispelling the sometimes mistaken belief that recovery of attorneys’ fees in first-party indemnity claims is limited to the insurance and surety industries.

In *James G. Davis Construction Corp. v. HRGM Corp.*, 147 A.3d 332 (D.C. 2016), the District of Columbia Court of Appeals also awarded attorneys’ fees incurred by a plaintiff in its first-party claims under an indemnification provision. The *Davis* court also rejected the contractor’s argument that that indemnity clause needed to have any special or “magic” language to allow recovery of attorneys’ fees in a first-party claim for breach of contract—as long as the parties’ intention was clear from the words that they chose to use. *Id.* at 341–42.

The indemnification provision that the court addressed in *Davis Construction* provided that the defendant “shall indemnify and save harmless [the plaintiff]... from and against any and all claims, demands, losses, damages, liabilities,... costs and expenses (*including but not limited to reasonable attorneys’ fees*) arising directly or indirectly... out of any breach of the forgoing provisions.” *Id.* at 336 (emphasis in original). The court found that the “express reference to attorney’s fees” was an “unmistakable fee-shifting provision” and that the “any-and-all language... delineate[d] the provision’s scope in similarly expansive terms.” *Id.* at 341. The court determined that its decision did not offend

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*Nova Research* because *Nova Research* did not address the relevant issue, which was “under what circumstances a contract that does expressly make reference to attorney’s fees authorizes the recovery of such fees in first-party actions.” *Id.* at 342. The court in *Davis Construction* went on to conclude: “In light of this key difference, the absence of the word ‘enforcement’ in Article XXI is not dispositive, and *Nova Research* does not bar the award of fees in the circumstances of this case.” *Id.*

Highlighting the need to ensure that such a fee-shifting provision is clear is the New York Court of Appeals’ determination of the issue of the recovery of attorneys’ fees in a first-party indemnity action in *Hooper Associates, Ltd. v. AGS Computers, Inc.* 548 N.E.2d 903 (N.Y. 1989). There, as in the other authority cited above, the court found it possible to shift responsibility for attorneys’ fees in first-party indemnity actions for breach of contract. *Id.* at 492. Nevertheless, the court declined to assess fees in that case because the clause in question did not contain “unmistakably clear” language requiring indemnification for attorneys’ fees. *Id.* at 492–93. As in other jurisdictions, the courts of New York will not infer a party’s intention to shift fees unless the clause is explicit in its intent. As a consequence, each word of an indemnity clause needs to be scrutinized carefully to determine whether it embodies a clear intention to indemnify for attorneys’ fees in first-party actions.

### Effect of Indemnity Provisions on Insurance Coverage

As much as clients dislike the surprise of paying the attorneys’ fees and litigation costs of counsel of their adversary, another important consideration for design professionals (and others who may look to insurance to cover their acts and omissions) is that reimbursement of an adversary’s attorneys’ fees may not be insurable under the standard errors and omissions (E & O) policy. Although traditional E & O policies cover a design professional’s liability for violation of the professional standard of care, and for the defense of claims arising out of such alleged violations, design profes-

sionals may experience coverage problems when they contract to pay another party’s attorneys’ fees for breach of contract. In fact, most professional liability policies exclude coverage for liability assumed by contract unless there would have been liability even without the contractual obligation. As a precaution, contractual indemnity provisions must be examined closely while assessing insurance coverage for a project. No design professional wants to find him- or herself in the uncomfortable position of not having coverage for liability unwittingly assumed by contract. Moreover, no owner wants the unwelcome surprise that the costs that the owner was expecting to have covered as the indemnitee are excluded by the indemnitor’s insurance. Such a situation often leads only to one direction, and that is a road to ruin for the design professional.

### Practice Pointers for Crafting Indemnity Clauses

As counsel, we pride ourselves on our ability to identify and properly assign risk, and to plan for the eventuality that sometimes the risk becomes reality. Among the most overlooked risks of construction projects is the liability being assigned and assumed through indemnity provisions. When negotiating those provisions it is important to keep the following in mind because it is too late to do so when a problem arises:

- Indemnity clauses deal with potential future problems, errors, and omissions that parties seldom care to anticipate during the glow of putting together the framework for a new project.
- Indemnity provisions often are the product of “cut and paste” efforts to string together disparate concepts in an attempt to make them as comprehensive as possible—sometimes resulting in hopeless confusion.
- Indemnity provisions can cover both third- and first-party claims; only carefully selecting the words that you choose to include will establish what is covered by your indemnity clauses.
- Regardless of how carefully you may have considered the pros and cons of including a prevailing party clause in your contract to govern the award of

attorneys’ fees in the event of a dispute, the indemnity clause that you have negotiated may unwittingly permit recovery of attorneys’ fees for first- and third-party claims, even if the clause makes no mention whatsoever of attorneys’ fees.

- The indemnity language that you choose to include in your contract should be consistent with the insurance coverage obtained for the work that your client will undertake. This is especially important for design professionals.

While no client likes paying the attorneys’ fees and litigation expenses of an opponent, when the obligation to do so is unexpected, the prospect is even less palatable. To prevent unintended consequences, it is important that counsel, in concert with your insurance professional, pay particularly close attention to the language of the indemnity provisions of your contracts. 