

Maximizing Contractual Indemnity Rights: Problems with Common Law

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At its core, the concept of tort law is simple: you pay for the damages you negligently cause. In reality, tort law can sometimes require a party to pay far more than just its share of causal damages. Tort law can even require a party to pay when it was not actually negligent, but rather is related to the actually-negligent actor.

The vagaries of tort law suggest that the allocation of the "risk of loss" is a vital detail in any contract. Without effective contractual provisions, parties to a contract may find that common law tort principles yield harsh or unexpected results. Properly written contractual provisions can define which party bears the risk of which losses. Both the party receiving the financial protection (the Indemnitee) and the party providing the protection (the Indemnitor) have an interest in obtaining insurance to cover the risk that is being borne.

Whether the contract pertains to complex real estate development, the provision of a hospital's emergency services, or even the seemingly routine performance of lawn care services, well-written contracts avoid future disputes by delegating the financial burden of foreseeable, albeit unwelcome, consequences. When written properly, contractual indemnity and insurance provisions allow the Indemnitee to offload to the Indemnitor the financial risk of loss associated with tort exposure.

Unfortunately, many contractual indemnity provisions miss the mark. Historically, courts and lawmakers were reluctant to allow parties – even a party with minimal fault – to offload the consequences of their tortious acts or omissions. Many states have statutes that limit or preclude such risk shifting. In other jurisdictions, judicial decisions paint a far clearer picture of the kind of indemnity clauses that will be rejected, rather than to define what clauses will be enforced.

When facing a significant tort exposure – sometimes, a self-insured exposure – many companies find that their contractual indemnity provisions are unenforceable. Defense tenders are declined where the contractual indemnity language lacks the required legal specificity. Drafting effective, enforceable indemnity provisions requires expertise not only in contract law, but also in litigation and insurance.

Part One of this series explains why resorting to common law is often unrewarding. Part Two details the components of an effective contractual indemnity provision. Part Three explores the insurance coverage issues.

Part One: Problems with Common Law

vicarious liability

Tort law encourages plaintiffs to cast a wide net, asserting claims or filing lawsuits against parties with relative degrees of responsibility ranging from zero to 100%. Common law principles of "vicarious liability" require an otherwise innocent Principal to pay for harm caused by an Employee or Agent. "Joint and several liability" can force tortfeasors to pay more than their allocated share of causal harm. Even in states that have revised traditional principles of joint and several liability, such as Pennsylvania, in a wide range of

scenarios sympathetic to plaintiffs, it can be very hard to persuade jurors that a peripheral defendant is entirely innocent.

Contribution

Tortfeasors who are required to pay damages in excess of their adjudicated percentage can seek reimbursement from another tortfeasor pursuant to the applicable state's enactment of the Uniform Contribution Among Joint Tortfeasors Act. Conceptually, "contribution" requires each defendant-tortfeasor to pay its allocated percentage share of the causal damages.

Unfortunately, contribution has notable restrictions. First, the amount of recoverable reimbursement does not include the costs and expenses associated with defending the underlying claims. Second, contribution is a post-trial remedy, and the mere threat of potentially having to pay contribution to another defendant is sometimes an insufficient motivation to bring all defendants into pre-trial settlement discussions. Third, contribution is only available against a joint-tortfeasor. Non-parties are not tortfeasors, and thus Defendants and Additional Defendants cannot obtain contribution from non-parties. Contribution is only available from parties that have been sued by the underlying plaintiff or which had been properly joined into the case within the applicable time limitations. There are limits on when Additional Defendants can be brought into the case, and such litigants may have no exposure to the underlying plaintiff if the applicable statute of limitations has expired. In short, the right of contribution from another tortfeasor is far inferior to the right to be indemnified by another entity or its insurer.

Common law indemnity

Common law indemnity goes further than contribution. Common law indemnity allows an entirely faultless party whose exposure is purely vicarious to shift the risk of an adjudicated loss to another party, regardless of whether that Indemnitor was involved in the litigation. As with contribution, the conceptual remedy is flawed. Most notably, if the proposed-Indemnitee has any degree of fault – even as little as 1% – it is entirely barred from obtaining common law indemnity from any other entity. Also, the right of common law indemnity accrues only at the time the Indemnitee actually pays the underlying judgment or settlement; thus, the threat of having to potentially provide common law indemnity rarely motivates a recalcitrant defendant to the pre-trial settlement table. Further, common law indemnity does entitle an Indemnitee to reimbursement of the defense costs and expenses.

The effect of these three common law principles – vicariously liability, joint and several liability, and common law indemnity – causes some parties to pay in excess of their actual degree of causal fault. The next installment of this series will elaborate how the parties to a contract can limit their exposure to their relative degree of fault as well as discuss how the parties can go further by shifting the risk of losses caused by one of the contracting parties to the other contracting party.

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