

Indemnification: Banish the Word!

And Rebuild Your Indemnity Clause from Scratch

By Jeffrey S. Ammon

Clients often ask me what *indemnification* means. I tell them the truth: it is legalese for *payment*, a word they understand.

What would your indemnification clause look like if you rewrote it without using the word *indemnification* or its related terms: *indemnify*, *indemnity*, *indemnitor*, and *indemnitee*? And what would your clause look like if you also abandoned the tortured, legalistic mumbo-jumbo found in most indemnity clauses? Plainer words are available.

Typical indemnity clauses are loaded with ambiguity. For example, is there a difference between *indemnify* and *hold harmless* in the typical indemnity phrase *indemnify and hold harmless*? There should be: Michigan cases uniformly state that we should avoid contract interpretations that render one or more words “mere surplusage.”¹ Adding *hold harmless* to *indemnify* has caused some courts to struggle over what those additional words might mean.² So you should not be surprised that commentators uniformly advise drafters to use just the single word *indemnify*.³ I suggest going one step further by eliminating the word *indemnify* entirely.

Besides ambiguity, typical indemnity clauses suffer from unwieldy sentences and other drafting flaws. For example, look at

the first sentence of the standard indemnity clause in section 3.18 of the American Institute of Architects Form A201-2007:

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.

This 136-word sentence runs on far too long to be easily understood. It contains some apparent doublets (and even a quad): *indemnify and hold harmless*; *from and against*; *acts or omissions*; *arising out of or resulting from*; *claim, damage, loss or expense*. It employs a proviso, which has no place in well-drafted contracts.⁴ And in *injury to or destruction of tangible property*,

what does *destruction* add to *injury*? Does anybody even refer to *injury* to property?

A better term: *pay for*

Let’s replace the verb *indemnify* with two one-syllable words that everyone understands—*pay for*—and then describe what that term covers. If we strip away all the legalese and tortured syntax from the AIA’s sentence, we can begin reconstructing a basic indemnification clause. And we’ll replace the party names, but not with the typical—yet confusingly similar—terms *indemnitor* and *indemnitee* so often seen in these provisions. To illustrate, let’s use the generic *payer* and *recipient* instead:

The payer must pay the recipient for a loss caused by the payer’s negligence.

I banned the use of *indemnity*, so I’ll call this a *loss-payment* clause instead.

Next, let’s address several elements that even the briefest loss-payment clause should cover:

- (1) What triggers a covered loss?
- (2) What expenses are covered?
- (3) Who selects—and pays for—legal counsel to defend against claims for losses?
- (4) Must the recipient notify the payer that someone has made a claim?

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What triggers a covered loss?

In our one-sentence AIA clause, the payer's negligence triggers coverage. But the payer's negligence is not always the trigger, of course. You might create triggers from different perspectives:

- Extent of the payer's fault (*to the extent caused by the payer's negligence or willful misconduct*).
- The payer's actions regardless of fault (*arising out of the payer's work or services*).
- The recipient's standard of conduct (*if the recipient acted in good faith and in a manner that the recipient reasonably believed was in the corporation's best interests*).
- Effect of the recipient's fault (*except to the extent caused by the recipient's negligence*).
- Location (*occurring within the leased premises*).
- Time (*arising after closing and based on events that occurred before closing*).
- Subject matter of the claim itself (*involving the environmental condition of the purchased property*).
- Contract breach (*based on the inaccuracy of the payer's representations*).

You must carefully choose the words connecting the trigger to the losses. Is there any difference in scope between a loss *arising from* negligence and one *resulting from* that negligence? At least one Michigan case says there is.⁵ If you use a string of alternative connectors, do you mean something different by each phrase? Or does one swallow up the other? Consider using just one connector plus a definition, as in the sample shown in the appendix.

What expenses are covered?

What about such things as medical expenses, lawyer fees, staff time, lost profits, and decline in property value? Consider using a string of illustrative examples, as I do in the sample's definition of *loss*.

But be careful when you list a string of examples. A court or adversary might seek to apply the rule of *ejusdem generis*, which Preston Tolbert renames the *class presumption*: in a list of items ending with a general term, we presume that the last term will be interpreted narrowly to be within the same class created by the previously enumerated items.⁶ Thus, we might interpret the word *building* in the phrase *house, cottage, or other building* to include only residential dwellings, not commercial buildings.

Who selects and pays defense counsel?

Some indemnity clauses attempt to cover defense issues by using the word *defend* in the triplet *defend, indemnify, and*

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bold harmless. Don't rely on that single word to carry the weight of all the legal-defense issues. This is especially important in Michigan, given its contradictory case-law comparing the duty to defend with the duty to indemnify.⁷ Let's unbundle the defense issues:

- Who controls the legal defense if litigation occurs—the recipient or the payer? Since the payer bears the economic risk, my sample gives the payer an option to control the defense.
- If the payer elects to control the defense, may the recipient retain its own counsel anyway, to advise it on whether payer's counsel is doing a good job? My sample gives the recipient this right, but at the recipient's expense.

- May the payer settle the claim without the recipient's permission? What if the settlement includes an admission of the recipient's wrongdoing or suspends a license belonging to the recipient? The sample clause gives the recipient a veto over those kinds of settlements.⁸

Is notice of a claim required?

If not, the recipient could defend the claim and then bill the payer for the loss only after the judgment or settlement is final and appeal deadlines have passed. If notice is required, what consequences befall a recipient who gives a late notice? My sample requires prompt notice but protects the recipient from forfeiting its rights if notice is late.

The sample

The appendix shows a sample loss-payment clause. This is only a sample, though. You'll adjust your own drafting depending on the nature of the contract, the audience (commercial versus consumer, for instance), and whether you represent the payer or the recipient. In short, there's probably no such thing as a "standard" loss-payment clause.

Unbundling a tortured mess of legalese takes time. But there may be no better way to understand a contract clause than by doing just that. So consider replacing your old indemnity clauses with your new loss-payment clauses in your most frequently used contract forms. You might find that *indemnification* will go the way of *witnesseth, know all men by whom these presents, in witness of which*, and other legalese that adds nothing to well-drafted contracts. And your clients will happily indemnify—er, pay for—your work. ■

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ENDNOTES

1. See, e.g., *Klapp v United Ins Group Agency, Inc*, 468 Mich 459, 468; 663 NW2d 447 (2003) (“[C]ourts must . . . give effect to every word, phrase, and clause in a contract and avoid an interpretation that would render any part of the contract surplusage or nugatory.”); but see *TMW Enterprises, Inc v Fed Ins Co*, 619 F3d 574 (CA 6, 2010) (interpretation not necessarily wrong just because it renders certain words or phrases redundant, citing as examples *loss or damage*; *caused by or resulting from*; and *faulty, inadequate or defective*).
2. See *Garner’s Dictionary of Legal Usage* (3d ed, Oxford U Press 2011), pp 443–445; see also *Poole v Cintas Corp*, unpublished opinion of the Court of Appeals, issued July 27, 2010 (Docket No. 291716) (available at the Court of Appeals website by docket number) (indemnity clause inapplicable because the clause covered any claim instead of all claims).
3. See, e.g., Adams, *A Manual of Style for Contract Drafting* (3d ed) (ABA, 2013), §§ 13.323–13.337; Kimble, *Lifting the Fog of Legalese: Essays on Plain Language* (Carolina Academic Press 2006), pp 37–47 (describing the myriad problems in a typical indemnification clause and what a revised version would look like). The Kimble essay refers to an article in the *Michigan Bar Journal*: Daly, *Taming the contract clause from hell: A case study*, 78 Mich B J 1155 (October 1999). That article contains an excellent example of how to rewrite a typical indemnification clause without abandoning the words *indemnify* and *indemnification*.
4. See Kimble, n 3 *supra* at 72; Garner, n 2 *supra* at 727; Adams, n 3 *supra* at 13.541–13.548; Kimble, *Down with provided that*, 83 Mich B J 40 (July 2004).
5. See *Robinson v Detroit*, 462 Mich 439, 453–457; 613 NW2d 307 (2000) (resulting from interpreted to mean proximate causation as that phrase is used in the statutory motor-vehicle exception to governmental immunity, MCLA 691.1405).
6. See Torbert, *Globalizing legal drafting: What the Chinese can teach us about ejusdem generis and all that*, 11 Scribes J Legal Writing 41–50 (2007); Englert, *The other side of ejusdem generis*, 11 Scribes J Legal Writing 51–55 (2007).
7. Compare *Grand Trunk Western R, Inc v Auto Warehousing Co*, 262 Mich App 345; 686 NW2d 756 (2004) (duty to defend is not separate and distinct from the duty to indemnify) with *Ajax Paving Industries, Inc v Vanopdenbosch Constr Co*, 289 Mich App 639; 797 NW2d 704 (2010) (the two concepts are not interdependent; they relate to distinctly different matters).
8. For an excellent article and sample language addressing notice and defense rights, see Daly, *Taming the contract clause from hell*, n 3 *supra*; Daly, *The return of the “contract clause from hell,”* 79 Mich B J 202 (February 2000). And for a general guide to drafting indemnification terms, see Adams, n 3 *supra* at 13.302–13.337. For example, drafters should consider whether the indemnification is an exclusive remedy and whether it should be limited to third-party claims.

Appendix

Sample Loss-Payment Clause

[Note to drafter: You should insert party names when using this clause. In this sample, I use the placeholders *Hamilton* and *Burr*.

Note to readers: Suggestions for improving this clause are most welcome.]

10. Loss Payment (also known as Indemnification)

A. **In General.** Hamilton must pay Burr for any loss of Burr’s that is caused by Hamilton’s negligence or intentional misconduct. But Hamilton need not pay to the extent that the loss was caused by Burr’s negligence or intentional misconduct.

B. **Definitions.**

Loss means an amount or amounts that Burr is legally responsible for or pays in any form. Amounts include, for example, a judgment, a settlement, a fine, damages, injunctive relief, staff compensation, a decrease in property value, and expenses for defending against a claim for a loss (including fees for legal counsel, expert witnesses, and other advisers). A loss can be tangible or intangible; can arise from bodily injury, property damage, or other causes; can be based on tort, breach of contract, or any other theory of recovery; and includes incidental, direct, and consequential damages.

A loss is *caused by* an event if the loss would not have occurred without the event, even if the event is not a proximate cause of the loss.

C. **Burr’s Duty to Notify.** Burr must notify Hamilton before the 10th business day after Burr knows or should reasonably have known of a claim for a loss that Hamilton might be obligated to pay. Burr’s failure to give timely notice does not terminate Hamilton’s obligation, except to the extent that the failure prejudices Hamilton’s ability to defend the claim or mitigate losses.

D. **Giving Notice.**

[Drafter: If the contract does not already have a notice section, insert one here. Describe permitted methods (written? electronic? what address?) and when notice is effective (e.g., next business day if sent FedEx).]

E. **Legal Defense of a Claim.**

(1) **Burr’s Control.** Burr has control over defending a claim for a loss (including settling it), unless:

- (a) Hamilton elects to control the defense as described below, or
- (b) Burr directs Hamilton to control the defense.

(2) **Hamilton’s Election to Control.** Upon receiving notice of a claim for a loss, Hamilton may take control of the defense by notifying Burr. If Hamilton takes control, each of the following applies:

- (a) Hamilton may choose and retain legal counsel.
- (b) Burr may retain his own legal counsel at his expense.
- (c) Hamilton must not settle any litigation without Burr’s written consent if the settlement imposes a penalty or limitation on Burr, admits Burr’s fault, or does not fully release Burr from liability.

(3) **Good Faith.** Burr and Hamilton must cooperate with each other in good faith on a claim.

F. **No Exclusivity.** Burr’s rights under this section 10 do not affect other rights that Burr might have.