

Contractual Indemnities - Contractors Think Before You Ink!

Construction Update

Contractors are frequently being required to provide indemnities to owners. Before agreeing to them, there are some critical issues to think about. In particular:

- Is the indemnity manageable?
- Does it affect your insurance?
- Are you covered by insurance for the risk?
- If not, are you prepared to run the risk of the indemnity being called upon?
- Can you negotiate a cap on liability?
- Can you limit the indemnity to only extend to loss or damage arising from your negligence?
- Can you exclude consequential loss?

Think before you sign and see if there are strategies you can implement to manage the risks.

It is not uncommon for construction contracts to include an indemnity provision covering breach of contract. But what does it actually mean for contractors?

What is an Indemnity?

An indemnity is an agreement to be liable for the events stipulated -

- often the owner's liability to others caused by the contractor, but
- sometimes extending much broader and sometimes not limited in amount.

It can result in substantial risk shifting, for example where it makes the contractor liable where it wouldn't otherwise be liable.

Who does this affect?

- Contractors
- Insurers
- Owners

Article Highlights

- Contractors must beware before agreeing to indemnify.



So what?

Because indemnity clauses manage the risk borne by a party, it is important for owners and contractors alike to read and understand the terms of the contract before they sign or be at risk of potentially carrying the full burden of liability irrespective of the conduct of the other party.

Indemnities frequently extend beyond the risks and amounts covered by insurance and, in some cases, could affect the cover itself!

Tips for Contractors

Contractors should carefully consider indemnity provisions in contracts. Ask yourself the question – *what is the scope of any liability which an indemnity may expose YOU to?*

Think about doing the following:

1. Negotiate a cap on liability;
2. Require the indemnity to only extend to loss or damage arising from your negligence;
3. Check with your brokers to see whether the indemnity could affect your insurance policies;
4. See what risks are covered by your insurances and whether you are willing to agree the indemnity where it makes you take on risks that are beyond your insurance cover;
5. Exclude consequential loss.

Contracting out of proportionate liability

It is not uncommon for owners to require contractors to contract out of the proportionate liability provisions set out in s4A and Part 1F of the *Civil Liability Act 2002* (WA) ("the Act").

Proportionate liability means just that – it makes each defendant liable only to the extent of his or her contribution to the damage caused. The Western Australian Act *expressly permits* contracting out of proportionate liability.

An indemnity could have the effect of negating the protection of the Act where you have agreed to be liable for someone else's negligence.

Beware Insurance Consequences

Be mindful of insurance consequences as many policies specifically exclude liability incurred under a contractual indemnity (including accepting liability by contracting out of proportionate liability).

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This means that you may not be covered by insurance for the categories of risk you assume by the contract **and** the categories of loss and damage or exposure that you agree to be liable for.

Make sure where possible that your insurance policy provides an indemnity to the extent that you as the contractor are liable to indemnify the owner under the contractual indemnity.

Conclusion

Always ask:

- Is the indemnity manageable?
- Does it affect your insurance?
- Are you covered by insurance for the risk?
- If not, are you prepared to run the risk of the indemnity being called upon?

Contractors be aware of the consequences of using and accepting indemnity.

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