In Commercial Contracts, We Do Not Want to Be Our Brother's Keeper

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Most terms and conditions of commercial contracts are important, but, if you pay attention to no other provisions, carefully review the indemnification clause. An indemnification clause is a provision by which one party agrees to protect the interests of another party, including paying all damages and usually expenses, e.g., attorney fees, incurred because of the acts or omissions of a party. Often, contracts will contain reciprocal indemnification rights and duties. Watch out, however, when the language used for one party is not the same as that used for the other party. It is not unusual for one party to be burdened with broad indemnification duties while the other party has a far lesser burden.

Be extremely careful when you see the word "sole" or "solely" in an indemnification paragraph. A typical use of this word would be, "X Party shall be liable for all costs, expenses … incurred by Y Party, except to the extent any of the same are caused by the sole negligence of Y Party." Seem fair enough? It's not. First, this language does not deal with breaches of contract. Party X will need to make sure the contract gives protection to Party X for breaches of contract by Party Y.

More significant, however, is the fact that, in Wisconsin, negligence liability is based on a comparison of the fault of the contributing parties. If Party X and Party Y participate in a project that causes a third party damage, absent any contractual allocation of fault between them, they should be responsible to that third party in proportion to their fault. But, what does the term "sole negligence" mean in the language quoted above? That Party Y will pay only for that part of the fault attributable to it, or that Party Y will only pay if the fault is entirely its own, that is, even if Party Y is 99% responsible for the damage to the third party, it need not indemnify Party X, even though Party X is only 1% responsible?

It gets worse. Liability insurance covers losses that are the fault of the insured party and, generally speaking, the types of such loss insurance pays arise because of the negligence of the insured. As a general rule, liability insurance will not cover damages caused by a breach of contract. Standard commercial general liability policies also specifically exclude coverage for damages an insured has agreed to pay in a contract. It is certainly possible then that an insurer would have no obligation to pay more than 1% of the damages in the scenario above,

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because Party X must pay damages for which Party Y is liable only because it agreed to pay them in its contract with Party Y. Party X's insurer will only pay for the damages Party X actually caused, as it is neither the insurer of Party Y nor a financial surety for Party X. This outcome is far more than simply insult to injury: the real injury would come from the denial of insurance to cover the amount payable to Party Y.

This reallocation of responsibility for indemnity may seem unfair. Wisconsin courts, emphasizing freedom to contract and commercial justification for economic terms in contracts, have upheld the enforceability of such clauses, however. Courts are generally unsympathetic to those who do not read contracts before signing them. We are all busy, but taking the time to review contract terms, in particular those that shift liability, can be worth every minute of the time it takes to perform that review.

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