

“Indemnity” and “Hold Harmless”

Contract Provisions

By Dale Alberstone, Esq.

Quite often real estate related contracts contain legalese that one party will indemnify and hold the other party harmless against certain claims or judgments. For example, a buyer of an apartment building situated near a gas station, oil field or other operation involved with chemicals or hazardous wastes, will include a provision in his purchase agreement similar to the following:

“Seller agrees to indemnify and hold buyer harmless from all claims, causes of action, damages and judgments arising out of the presence or discharge of any hazardous substances [which is more particularly defined in the agreement] which existed on or under the subject property prior to the date and time of recordation of the deed from seller to buyer.”

Contracts between owners and property management companies also routinely contain indemnity and hold harmless provisions, such as:

“Owner agrees to indemnify and hold ABC Property Management Company harmless of and from any and all claims, causes of action, damages and judgments arising out of any act or omission of ABC, including ABC’s negligence.”

The use of the words “indemnify” and “hold harmless” are frequently inserted in contracts, but little thought is given to their definitions, much less the differences between the terminologies.

But one new case did give much thought to those provisions. In Queen Villas Homeowner’s Association v. TCB Property Management, decided by the California Court of Appeal on February 28, 2007, the court carefully examined and contrasted the meaning of “indemnity” and “hold harmless” clauses.

Queen Villas arose out of a dispute between a condominium homeowner’s association and the property management company. *The contract between them provided that the association would indemnify and hold harmless the management company against all claims, costs, suit and damages arising out of the management company’s performance of its contract or in connection with the company’s operation of the association.*

After one of the members of the board of directors of the homeowner’s association allegedly embezzled \$134,000 of the association’s money, the association sued the property management company (but not, evidently, the prior board member) for breach of the company’s contractual duties relative to its management of the association’s checking account, from which the board member allegedly embezzled the money.

The management company then filed the equivalent of a motion to dismiss on the basis that the “indemnity” and “hold harmless” clauses exculpated (that is, insulated) it from liability.

Before reading further, I ask the reader to evaluate in your own mind whether you think the indemnification and hold harmless clause (as underscored above) in the Queen Villas' case protects the management company from liability to the homeowner's association even if the association's claims for breach of contract are proved to be valid.

Indemnity

In analyzing the issues, the Court of Appeal first examined the concept of "indemnification." The court explained that agreements of indemnity ordinarily relate to claims asserted by third parties, that is, persons or entities who are not parties to the contract. In its usual context, an indemnification provision means that if a party to a contract is held liable to a third person in a monetary amount, the other party to the contract is required to reimburse (i.e. indemnify) the party who is liable. As an example, the court hypothesized:

"We have no doubt, for example, if a third-party visitor to the Queen Villas' complex tripped over a shovel left out by a gardener hired by the management company and then sued the management company for negligent hiring, the management company would invoke the indemnity – and in that case properly so – for protection against the suit."

The court next explained that the general policy of law is to look with disfavor on attempts to avoid liability for one's own acts or to secure exemption from one's own actions or one's own negligence.

The court further employed what logicians refer to as a "reductio ad absurdum" argument. It posited:

"Under the property management's interpretation, it could just outright plain fail to do any work at all for the association, such as hiring a gardening company or arranging for insurance or typical things that property managers do, and the [indemnity] clause would protect it even from a breach of contract action by the association for having paid for services never performed."

The court then concluded that the subject indemnity provision had no application to the pending litigation because a third party had not first sued the management company, which then sought reimbursement (i.e. indemnity) from the homeowner's association. Absent the management company's liability to a third person, there was no debt against the company for which the association could indemnify. Thus, the management company's indemnity defense failed.

Hold Harmless

The court next examined the meaning of a "hold harmless" clause. It explained that "hold harmless" means "the right not to be *bothered* by the other party itself seeking indemnification." As with indemnity, the court explained that a hold harmless provision requires the presence of

three persons, two of whom are parties to the contract and the remaining one not a party.

Thus, if an owner in the condominium complex sued the homeowner's association for liability based on something its agent (i.e. the management company) did wrong, the association could not then sue the management company (i.e. "bother" the company) because of the company's error. As between the association and the management company, the management company would be deemed "harmless" and the association therefore could not blame and hold the management company liable for the harm the company caused the owner.

Because no third person had sued the association, the management company's defense to the association's litigation under a "hold harmless" theory failed for the same reason the indemnity defense failed.

Intentional Acts

To the extent that an indemnity or hold harmless provision may purport to protect a party from his own intentional wrongdoing or gross negligence, particularly if the conduct arises in an area where public interest is involved (such as ensuring that tenants have habitable units or that an apartment complex employs reasonable security measures based on known prior criminal activity in the building), such clauses may be unenforceable. In general, contracts which have for their object, directly or indirectly, to exempt any one responsible from his own fraud or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law. (Civil Code Section 1668). The field of law involving exculpatory clauses becomes rather complex when dealing with intentional wrongs or conduct amounting to gross negligence. That is particularly true where an important public policy or interest is involved.

In determining whether there is a public concern to be protected, the court looks to six factors:

- Whether the transaction concerns a business that is generally suitable for public regulation;
- Whether the service performed is of great importance to the public;
- Whether the party performing the service holds himself out as willing to perform it for any member of the public;
- The party seeking to avoid liability had decisive bargaining strength over the member of the public;
- The party seeking to avoid liability confronts the public with a standardized contract of exculpation; and
- The individual gives up control subjecting him to the risk of carelessness by the other party.

Thus, the inclusion of indemnity and hold harmless provisions may, under the circumstances involving matters of important public policy, be unenforceable even if a third person is involved.

Conclusion

What is important to know is that “indemnity” and “hold harmless” provisions in a contract require the presence of at least three persons, namely: the two parties to the contract and a third individual who sues one of the parties for damages. The party sued must not then bother the protected party. Instead, the sued party must hold the other party harmless and if that other party is also sued and becomes liable, the first party must then indemnify (i.e. reimburse) the protected party for its monetary liability.

If the protected party intentionally caused the harm or acted with gross negligence, the indemnity and hold harmless protections may be void.

Finally, if only two parties are involved, the hold harmless and indemnity provisions have no applications and are not a defense to the defending party to the contract.

Dale Alberstone is a prominent real estate attorney who has practiced real property and business law in Century City for the past 31 years. He has been appointed to periodically serve as a judge pro tem of the Los Angeles Superior Court and is a former arbitrator for the American Arbitration Association. He also testifies as an expert witness for and against other attorneys who have been accused of legal malpractice. Mr. Alberstone has been awarded an AV rating from Mardindale-Hubbell. An AV rating, registered through Reed Elsevier, reflects an attorney who has reached the heights of professional excellence and is recognized for the highest levels of skill and integrity. The foregoing discussion is intended as a general overview of the law and may not apply to the reader's particular case. Readers are cautioned to consult an advisor of their own selection with respect to any particular situation. Address correspondence to Dale S. Alberstone, Esq., ALBERSTONE & ALBERSTONE, 1801 Avenue of the Stars, Suite 600, Los Angeles, California 90067. Phone: (310) 277-7300.