

CONTROL, FAULT, AND KNOCK-FOR-KNOCK: A GUIDE TO SELECTING INDEMNITIES IN ENERGY CONSTRUCTION AND SERVICES AGREEMENTS

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Synopsis: Selecting an indemnity in construction and services agreements continues to present challenges for both energy project owners and their contractors. Legacy classification of indemnity clauses into categories such as “broad form,” “intermediate form,” and “limited form” no longer serves a useful purpose as many anti-indemnity statutes prohibit broad form and intermediate form indemnities. We propose a new framework for selecting energy construction and services indemnities that is based primarily on the degree of control exerted over the project site. A “control-based indemnity,” which places the burden of proof on the contractor to demonstrate that the owner did not cause the loss, should be used when the contractor controls the worksite. A “fault-based indemnity,” which places the burden of proof on the owner to demonstrate that the contractor caused the loss, should be used when the contractor does not control the work site. A “knock-for-knock indemnity,” which makes each of the contracting parties responsible for their own losses regardless of the cause, should be used when there are many contractors conducting operations at a single worksite, where determination of responsibility for a loss can be difficult and expensive. By analyzing the relative level of control exercised over the worksite by the contractor, parties can select indemnities that more suitably allocate risk. This framework also generally reflects the indemnity usage our law firm has recently observed while negotiating energy construction and services agreements, including those for pipeline, solar, wind, LNG, carbon capture, refinery, nuclear, and other facilities.¹

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1. While we discuss and apply this indemnity framework in the context of energy construction and services agreements, these principles may find useful application in other industries and circumstances which are outside the scope of this article.

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I. INTRODUCTION

Indemnities are hard. Even in the cerebral halls of The University of Chicago Law School, the very mention of the word “indemnity” causes students’ eyes to glaze over. The words in an indemnity clause may be written in English, but they are loaded with hidden meanings and implications. One student struggling to understand an indemnity clause described it as a “house of mirrors.” On top of the contractual language, practitioners must contend with varying statutory regimes, which potentially reduce enforceability of indemnities.²

Energy project owners and their contractors use indemnity clauses to modify the fault-based liability regime that would otherwise control under applicable law. Owners and contractors should be able to reduce moral hazard—which arises when one party’s incentive to take precautions is diminished due to another person bearing the consequences of a loss³—by placing liability for certain risks in the hands of the party best able to avoid that risk.⁴ When an owner shifts more risk to a contractor than would otherwise exist under applicable law,⁵ the parties should expect a corresponding increase in the price for the contractor’s work. Owners are therefore incentivized to select an indemnity regime that maximizes the gains achieved through elimination of moral hazard while minimizing the costs arising from excessive allocation of risk to the contractor.⁶ If a contractor is well-positioned to prevent a loss from occurring, the price for it bearing such a risk should be less than if the contractor is asked to bear losses that it cannot prevent.

2. While this article peripherally discusses issues that arise from the interaction of contractual indemnity language with applicable law, the interaction between indemnity language and local law is not its focus. Each practitioner must take care to ensure that indemnity language is consistent with applicable law.

3. David Rowell & Luke B. Connelly, *A History of the Term “Moral Hazard”*, 79 J. OF RISK AND INS. 1051 (2012). The term “moral hazard” originated in insurance literature and has been adopted by economists to generally describe loss-increasing behavior that arises under insurance or in other contexts where Party A bears the costs of Party B’s actions, and Party B therefore lacks adequate incentive to minimize losses. *Id.* at 1051.

4. *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951, 957 (7th Cir. 1982) (“[T]he costs of the untoward consequences of a course of dealings should be borne by that party who was able to avert the consequence at least cost and failed to do so.”) (describing the animating principle of *Hadley v. Baxendale* [1854] 156 Eng. Rep. 145). Placing the costs of negative consequences in the hands of the party best able to avoid those negative consequences is a concept arising in tort law. *Id.*

5. S. Scott Gaille, *Reducing Conflict and Risk: Why Parties Benefit from Using Enumerated Adjustment Clauses in Energy Construction and Services Agreements*, 42 ENERGY L. J., 123 (2021). There are situations where a project owner is better served by accepting additional risk rather than shifting risk to the contractor. *Id.* at 138-39 (“By bearing the risk for differing site conditions, owners receive bids closer to the true cost of work. Owners can then engage the most efficient contractor rather than the contractor who may have been a poor estimator of the risk of encountering differing site conditions and thus submitted the lowest bid.”).

6. Penny L. Parker & John Slavich, *Contractual Efforts to Allocate the Risk of Environmental Liability: Is There a Way to Make Indemnities Worth More Than the Paper They Are Written On?*, 44 SMU L. REV. 1349 (1991). A contractual indemnity may also operate to *limit* the indemnitor’s liability to the indemnitee such that the indemnitor’s liability is less than its liability would otherwise be under the fault-based liability regime that would otherwise apply. *Id.* at 1351-52 (“Under certain circumstances, an indemnity may actually serve to limit, not extend, the indemnitor’s liability to the indemnitee. For example, an indemnity drafted as the exclusive

Practitioners have traditionally placed indemnity provisions into three categories:⁷ (1) “broad form” (also called “sole negligence”); (2) “intermediate form” (also called “contributory fault”); and (3) “limited form” (also called “comparative fault”).

- *Broad Form.* A broad-form indemnity requires the contractor to indemnify the owner against all losses which occur in connection with the contractor’s work, even losses caused by the owner’s sole negligence. This type of indemnity uses language that requires the contractor to indemnify the owner “regardless of the fault” of the owner.
- *Intermediate Form.* An intermediate-form indemnity requires the contractor to indemnify the owner against all losses which occur in connection with the contractor’s work, except in cases of the owner’s sole negligence. This means that if the contractor is found to be even 1% responsible for a loss, it becomes obligated to indemnify the owner for the entire loss.
- *Limited Form.* A limited-form indemnity is usually based on comparative fault,⁸ which requires the contractor to indemnify the owner for losses only to the extent that the owner can demonstrate the contractor’s responsibility for the loss. This means that if the contractor is found 1% responsible for a loss, it is only required to

remedy between the parties may be limited contractually to a ‘survival’ period that is shorter than the statute of limitations for actions that could otherwise be brought under applicable tort and contract theories.”).

7. Edward Arnold et al., *What Does the Indemnity Clause Cover and When Does the Claim Accrue*, SEYFARTH (Jan. 2, 2019), <https://www.constructionseyt.com/2019/01/indemnity-clause-cover-claim-accrue/>. Indemnification generally includes the duty to defend, and contractual obligations in the energy industry are no different. Scott Gaille, *3 Types of Indemnities (Energy Construction)*, GAILLE PLLC (July 10, 2019), <https://gaillelaw.com/2019/07/10/3-types-of-indemnity-energy-construction-gaille-energy-blog-issue-79>. While the duty to indemnify is “a duty to make good any loss, damage, or liability incurred by another,” this duty generally arises at the end of a lengthy fact-finding (and potentially litigious) process that may take months or years to resolve. *Indemnity*, Black’s Law Dictionary (10th Ed. 2014); Christopher R. Mosley et al., *Litigating the Duty to Indemnify*, SHERMANHOWARD (Mar. 9, 2022), <http://shermanhoward.com/wp-content/uploads/2022/04/Litigating-the-Duty-to-Indemnify.pdf>. By contrast, the duty to defend includes active defense or funding of the defense while the fact-finding process is ongoing and pending resolution. For further discussion, see Sean McChristian, *Indemnity vs. Duty to Defend: Know the Differences and Potential Critical Variations in State Law*, UNDER CONSTR.: A.B.A. F. ON CONSTR. L. (Aug. 16, 2019), https://www.americanbar.org/groups/construction_industry/publications/under_construction/2019/summer/indemnity-vs-duty/.

8. Arnold et al., *supra* note 7. A limited-form indemnity also can be further limited based on contributory fault. Tom Stilwell & Sameer Mohan, *Deconstructing Anti-Indemnity in Texas, Louisiana, California and New York*, BAKERHOSTETLER (May 14, 2015), <https://www.bakerlaw.com/files/uploads/News/Linked%20documents/ConstructioAnti-IndemnityPresentation.pptx>. A contributory fault approach requires the contractor to indemnify the owner for losses which occur in connection with the contractor’s work, to the extent that the owner can demonstrate that the owner was not contributorily at fault for the loss. This form of indemnity is the conceptual opposite of the intermediate form, because if the owner cannot prove that the contractor was 100% at fault for the loss, it cannot obtain the indemnity. *Understanding Indemnification Clauses*, MAYNARDNEXSEN (Dec. 6, 2021), <https://www.maynardnexsen.com/publication-understanding-indemnification-clauses>. This type of indemnity uses language that requires the contractor to indemnify the owner “only to the extent” of the negligent acts or omissions of the contractor, but also adds that the contractor’s indemnification obligation will be excused if the loss is due “in any part” to the owner’s negligence or other culpable conduct. Arnold et al., *supra* note 7.

indemnify the owner for 1% of that loss. This type of indemnity uses language that requires the contractor to indemnify the owner “only to the extent” of contractor’s fault.

Due to the passage of anti-indemnity acts in the majority of United States jurisdictions, the utility of referencing the three categories described above during contract negotiation has declined. These anti-indemnity acts now generally deem void any indemnity requiring a contractor to indemnify an owner for the owner’s own negligence.⁹ This means that the broad form and intermediate form indemnities are often no longer enforceable.¹⁰

In any event, current energy industry practice no longer aligns with the legacy categories of broad, intermediate, and limited forms. In our experience, indemnification clauses in construction and services agreements now typically fall into one of three new categories:

- *Control-Based*. A control-based indemnity allocates risk for loss to the contractor, subject to the contractor’s opportunity to prove that the loss was caused by the owner’s negligence—in which case, the contractor’s indemnification would be proportionately reduced to the extent of the owner’s negligence. Under a control-based indemnity, the burden of proof generally rests on the contractor.
- *Fault-Based*. A fault-based indemnity allocates risk for loss to the contractor to the extent that the owner can prove that the contractor was at fault for such loss. Under a fault-based indemnity, the burden of proof generally rests on the owner.
- *Knock-for-Knock (No Fault)*. A knock-for-knock indemnity allocates risk based on the identity of the party experiencing the loss, regardless of which party was at fault. Each party bears its own losses, irrespective of whether another party’s negligence may have caused them. Under a knock-for-knock indemnity, burden of proof is irrelevant since it does not matter which party was at fault.

9. TEX. INS. CODE ANN. § 151.102 (2012) (“[A] provision in a construction contract . . . is void and unenforceable as against public policy to the extent that it requires an indemnitor to indemnify, hold harmless, or defend a party . . . against a claim caused by the negligence or fault . . . of the indemnitee . . .”); CAL. CIV. CODE § 2782(a) (West 2012) (“[P]rovisions . . . contained in . . . any construction contract and that purport to indemnify the promisee against liability for damages for death or bodily injury to persons, injury to property, or any other loss, damage or expense arising from the sole negligence or willful misconduct of the promisee . . . are against public policy and are void and unenforceable . . .”); N.Y. GEN. OBLIG. LAW § 5-322.1(1) (McKinney 2023) (“A covenant . . . in . . . [a construction contract] purporting to indemnify or hold harmless the promisee against liability for damage arising out of bodily injury to persons or damage to property contributed to, caused by or resulting from the negligence of the promisee . . . is against public policy and is void and unenforceable . . .”); LA. STAT. ANN. § 9:2780.1(B) (2018) (“[A]ny provision . . . contained in . . . a . . . construction contract which purports to indemnify, defend, or hold harmless . . . the indemnitee from or against any liability for loss or damage resulting from the negligence or intentional acts or omissions of the indemnitee . . . is contrary to the public policy of this state and is null, void, and unenforceable.”).

10. TEX. INS. CODE ANN. § 151.102 (2012); see CAL. CIV. CODE § 2782(a) (West 2012); see also N.Y. GEN. OBLIG. LAW § 5-322.1(1) (McKinney 2023); see also LA. STAT. ANN. § 9:2780.1(B) (2018).

This article analyzes each of these indemnities and identifies the primary driver for selecting among them as the extent to which a contractor exercises control over the work site. We conclude by providing a simplified framework and matrix that can be used as a reference to determine which type of indemnity should be selected.

II. CONTROL-BASED INDEMNITIES: *RES IPSA LOQUITUR* AND THE PRESUMPTION OF FAULT

The distinguishing characteristic of a control-based indemnity is that the contractor bears the burden of proof to demonstrate that the owner is not entitled to receive indemnification, rather than the owner being required to prove the contractor's fault in order to receive indemnification. This paradigm is motivated by the same theoretical underpinnings of the common law principle known as *res ipsa loquitur*, which is Latin for "the thing speaks for itself."¹¹

The English case *Byrne v. Boadle* first applied the doctrine of *res ipsa loquitur* in 1863.¹² As the plaintiff, Mr. Byrne, walked down a street, he was struck by a barrel of flour which fell from the defendant Mr. Boadle's flour shop window, injuring Byrne.¹³ In his suit against Boadle for negligence, Byrne was unable to present any witnesses to establish that Mr. Boadle or any of his employees committed any negligent acts which caused the barrel of flour to fall.¹⁴ The trial court applied a traditional formulation of the causation requirement (i.e., that the plaintiff had the burden of proof to demonstrate the defendant's negligence) and granted judgment for Boadle on the basis that no evidence had been presented by Byrne on the issue of causation.¹⁵ On appeal, Byrne argued that although he was unable to present any witnesses to demonstrate Boadle's negligence, he should prevail in the negligence action anyway because Boadle and his employees were in control of the flour shop and barrels of flour generally do not fall from windows without some act of negligence causing the barrel to fall.¹⁶ Byrne argued that in situations like these, the burden of proof should be on the defendant to demonstrate that no negligent acts had occurred, rather than upon the plaintiff to prove that the defendant committed a negligent act.¹⁷

The Exchequer Court agreed with Byrne that in the circumstances alleged, the defendant should have the burden of proof to demonstrate that he was not negligent.¹⁸ Chief Baron Pollock explained:

11. *Res Ipsa Loquitur*, MERRIAM-WEBSTER, <https://www.merriam-webster.com/legal/res%20ipsa%20loquitur> (last visited Mar. 2, 2023).

12. *Byrne v. Boadle* [1863] 159 Eng. Rep. 299.

13. *Id.*

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.*

There are certain cases of which it may be said *res ipsa loquitur*, and this seems one of them. I think it would be wrong to lay down as a rule that in no case can presumption of negligence arise from the fact of an accident. Suppose in this case the barrel had rolled out of the warehouse and fallen on the plaintiff, how could he possibly ascertain from what cause it occurred? It is the duty of persons who keep barrels in a warehouse to take care that they do not roll out, and I think that such a case would, beyond all doubt, afford *prima facie* evidence of negligence. A barrel could not roll out of a warehouse without some negligence, and to say that a plaintiff who is injured by it must call witnesses from the warehouse to prove negligence seems to me preposterous. . . .¹⁹

. . . I think it apparent that the barrel was in the custody of the defendant who occupied the premises, and who is responsible for the acts of his servants who had the control of it; and in my opinion the fact of its falling is *prima facie* evidence of negligence, and the plaintiff who was injured by it is not bound to show that it could not fall without negligence, but if there are any facts inconsistent with negligence it is for the defendant to prove them.²⁰

The fundamental basis for Chief Baron Pollock's opinion was the defendant's control of the flour shop and responsibility for the acts of his servants.²¹ Pollock recognized that in analogous situations in which this legal principle might apply, the following circumstances would exist simultaneously: (i) it would be unlikely for the event to have occurred without the defendant's negligence; and (ii) the plaintiff would have a near-impossible task of obtaining truthful testimony from employees of the defendant.

The doctrine of *res ipsa loquitur* remains substantially the same today.²² *Black's Law Dictionary* describes the circumstances under which application of the *res ipsa loquitur* principle is appropriate: "(1) the occurrence resulting in injury was such as does not ordinarily happen if those in charge use due care; (2) the instrumentalities were under the management and control of the defendant; and (3) the defendant possessed superior knowledge or means of information about the cause of the occurrence."²³

19. *Id.* The first known use of the term *res ipsa loquitur* (but in the form *res loquitur ipsa*) appeared in *Pro Milone*, a speech made by Marcus Tullius Cicero in 52 BC on behalf of his friend Titus Annius Milo who was accused of murdering his political enemy Publius Clodius Pulcher. Jeffrey Kahn & John Lopatka, *Res Ipsa Loquitur: Reducing Confusion or Creating Bias?*, 108 Kentucky L.J. 239, 245 n.29 (2019); see *What is Res Ipsa Loquitur?*, DIMARCO ARAUJO MONTEVIDEO (Apr. 24, 2018), <https://www.damfirm.com/res-ipsa-loquitur/>. As part of his defense of Milo, Cicero argued that political gangs who had taken control of the streets of Rome were responsible for the resulting injuries. While Chief Baron Pollock does not expressly cite Cicero's use of this legal maxim, it is assumed that Pollock was making reference to Cicero's original use in his opinion.

20. *Byrne v. Boadle* [1863] 159 Eng. Rep. 299.

21. *Id.*

22. For example, in *Bond v. Otis Elevator Company*, 388 S.W.2d 681 (Tex. 1965), a contractor installed and maintained an elevator under an agreement requiring it to indemnify the owner for losses arising from the contractor's negligence. *Id.* The Texas Supreme Court determined that both the owner and the contractor were liable to a plaintiff injured by the elevator due to their joint control of the instrumentality causing the injuries (but ultimately allocated liability to the contractor due to the contractual indemnity). *Id.*; see *General Elevator Co. v. District of Columbia*, 481 A.2d 116 (D.C. 1984) (accepting the principle that *res ipsa* type reasoning is useful in determining allocation of liability under a contractual indemnity, even when the principle of *res ipsa loquitur* does not technically apply under the specific facts at issue).

23. *Res ipsa loquitur*, BLACK'S LAW DICTIONARY (11th ed. 2019).

These circumstances parallel those commonly found on many energy projects. First, contractors have built hundreds of solar plants, thousands of wind turbines, and millions of miles of pipelines. Due to the repetitive nature of energy work by experienced contractors, major losses do not ordinarily occur without someone's negligence. Second, on such energy projects, it is usually the contractor that exercises management and control over the project site—and is therefore best positioned to prevent a loss. The owner's presence is limited to a small number of inspectors who act as mere observers and do not exercise control over the work. Third, almost all of the personnel with knowledge of causation for the loss are likely to be employees or subcontractors of the contractor.

Under a typical limited form (fault-based) indemnity, the owner is only entitled to receive indemnification for claims or losses “to the extent” of the contractor's fault. This means that the project owner may find itself in the same position as the unfortunate Mr. Byrne, who was struck by the falling barrel.²⁴ In circumstances where the contractor controls the work site (much like how Mr. Boadle controlled his flour shop), a typical fault-based indemnity may prohibit an owner from receiving any indemnification from the contractor due to a potentially insurmountable obstacle: the burden of proof.²⁵

We recently witnessed a modern version of *Byrne v. Boadle* on a compressor station project. During the course of construction, hundreds of contractor personnel came on and off the site, while only a handful of owner personnel were present (e.g., a site inspector and an owner representative). The contractor supplied and installed thousands of small steel fasteners, each easily identifiable by their shape and color. Near the conclusion of the project, the contractor initiated the commissioning and startup procedure to test a newly-installed compressor turbine. Upon initial startup of the turbine, a discordant sound emanated from the turbine, and the contractor immediately shut down the turbine to investigate the cause of the noise. After opening up the damaged turbine, personnel recovered a small fastener of the same shape and color as those used by the contractor. The fastener had apparently fallen or been kicked into the compressor station piping by accident and then had been sucked into the turbine upon startup. When the owner invoked the contractual indemnity to receive reimbursement for damage to the turbine, the contractor argued that the owner must provide eyewitness or video evidence of contractor personnel knocking or dropping the fastener into the compressor station piping. But the owner had no such evidence.

One purpose of a control-based indemnity is to avoid such results. The owner should not be responsible for bearing risks that are within the control of the contractor—such as the care and handling of fasteners. A control-based indemnity generally includes language as shown below:²⁶

24. *Byrne v. Boadle* [1863] 159 Eng. Rep. 299.

25. *Id.*

26. We have noticed that while students and practitioners may understand and correctly describe the conceptual differences between types of indemnities, they often struggle to classify specific indemnity language into its proper category. We provide this simplified example language to assist the reader in linking the concepts discussed herein to contractual language that allows those concepts to become operative. This language is

Contractor shall Indemnify²⁷ Owner Group from any and all claims or losses directly or indirectly based on, in connection with, relating to, or arising out of the Work or any member of Contractor Group's actions or inactions under this Agreement. Notwithstanding the foregoing, Contractor's Indemnification obligation shall be reduced in accordance with principles of comparative responsibility to the extent that Contractor proves that Owner Group's negligence, gross negligence, or willful misconduct caused such claims or losses.

Because such a control-based indemnity does not require a contractor to indemnify the owner for the owner's own negligence, the provision is presumptively consistent with anti-indemnity statutes in the United States.²⁸ Even in the absence of an anti-indemnity statute, the contractor should not be asked to indemnify an owner for events that are the fault of the owner—which itself results in economic inefficiency arising from the contractor being forced to make assumptions about the degree of care that will be exercised by the owner and structure its bid accordingly.

Circumstances where a third party is at fault for some or all of a loss can complicate control-based indemnities. In our practice, we have seen four general approaches to resolving this issue:

- *Contractor Indemnifies Owner for All Third-Party Responsibility.* Under this first approach, the contractor indemnifies the owner for the proportion of fault attributable to the third party. The rationale for this approach is that the party in control (the contractor) is allocated this risk and is thereby appropriately incentivized to implement precautions to minimize third-party losses (e.g., by providing an off-duty police officer to direct traffic at the site entrance). This approach does not prohibit the contractor from seeking reimbursement from responsible third parties or insurance policies.²⁹
- *No Indemnity of Owner for Losses Caused by Third Parties.* Under this second approach, the owner does not receive indemnification for losses to the extent that the contractor can demonstrate such losses were caused by third parties. The rationale for this approach is that the contractor may have little or no power to avoid or mitigate the actions of third parties and that allocating the risk of third-party negligence to the contractor will not serve to affect incentives in a meaningful way.
- *Contractor Indemnifies Owner Unless Contractor Fault is Zero.* Under this third approach, the contractor indemnifies the owner for

simplified and abbreviated and should not be considered “model” language. For example, a control-based indemnity may also include a process by which the owner agrees to refund to contractor a percentage of advanced defense costs—to the extent the contractor demonstrates that owner negligence contributed to the loss.

27. Indemnify is defined to include both costs of defense and costs of indemnification.

28. Note that anti-indemnity case law remains poorly developed. For example, the Texas Anti-Indemnity Act became effective on January 1, 2012, but the first cases substantively interpreting the Act did not appear until 2022. *See Signature Indus. Servs. v. Int'l Paper Co.*, 638 S.W.3d 179 (TEX. 2022). We are currently unaware of any case law holding that a control-based indemnity is unenforceable under the applicable anti-indemnity statute.

29. To avoid double recovery, the contractor's indemnification obligation is reduced to the extent that the owner receives insurance proceeds from a Builder's All-Risk policy in respect of the loss. However, this does not excuse the contractor from indemnifying the owner while the insurance claim is pending.

the proportion of fault attributable to the third party unless the contractor can demonstrate that it had zero responsibility for the loss. The rationale for this third approach is similar to the second approach, except here the parties assume that the contractor will have at least some power to avoid or mitigate the actions of third parties (e.g., by placing warning signals near the site entrance). However, some third-party actions will occur regardless of the contractor's efforts to avoid third-party losses (e.g., a reckless driver traveling at twice the speed limit), and in these circumstances placing responsibility for the loss on the contractor would not decrease the probability of the loss occurring.

- *Contractor Indemnifies Owner for Half of Third-Party Responsibility.* Under this fourth approach, the owner and contractor share the risk of third-party negligence equally. This may be viewed as a “fair” approach because it makes the owner and contractor equally responsible for losses which may be outside the control of either party while still preserving the incentive for the contractor to implement safeguards and controls to prevent losses.

The distinguishing characteristic of the control-based indemnity is that the contractor bears the burden of proof regarding the comparative negligence of others, on the basis that the contractor controls the site where the work is occurring. The practical application of a control-based indemnity results in temporary indemnification of the owner until investigation into causation concludes. If the investigation shows that a member of the owner group (or, in the variations discussed above, a third party) was wholly or partially responsible for the loss, the owner must proportionally reimburse the contractor for amounts previously paid to the owner.³⁰

In our experience, the control-based indemnity is the predominant form of indemnity both at greenfield projects (i.e., those locations that do not require working in and around existing owner facilities) and at contractor-controlled work locations within an existing owner facility (i.e., where the contractor has the ability to restrict the presence of non-contractor personnel other than the owner's representative and inspectors). The principal rationale is similar to that of *res ipsa loquitur*. Owners of energy projects hire contractors with track records of successfully constructing similar facilities. These expert contractors execute the work

30. Whether a contractor is obligated to defend and indemnify an owner against certain claims may depend upon interpretation of the relevant anti-indemnity statute. For example, the Texas Supreme Court recently interpreted the Texas anti-indemnity statute to rule against an owner's attempt to obtain certain defense costs from its contractor. *Signature Indus. Servs.*, 638 S.W.3d 179. The contractor had been performing maintenance and construction work for the owner before the parties became embroiled in a payment dispute. *Id.* at 184. The contractor alleged that the owner's failure to pay caused it to miss required tax payments. *Id.* at 185. As the contractor's financial situation deteriorated, the contractor's president (who had personally guaranteed certain loans to the contractor) also sued the owner directly. *Id.* at 185-86. The owner then sought indemnification from the contractor against the president's claim under the contract's control-based indemnity. *Signature Indus. Servs.*, 638 S.W.3d 179. The Court explained that while the “true cause” of the president's personal liability may have been the contractor's failure to pay taxes, the Texas anti-indemnity statute only asks whether the “claim” for which indemnity is sought was “caused by” the fault of the indemnitee, and that this determination could be made on the basis of the pleadings without additional factual inquiry. *Id.* at 195.

using their own hand-picked personnel and subcontractors. The owner typically maintains minimal oversight of day-to-day work. Therefore, if something goes wrong, it is likely to be the contractor's fault—and the control-based indemnity protects the owner from finding itself in a position where its limited site presence makes it difficult to prove negligence.

The control-based indemnity also may serve as a screening mechanism for energy project owners to sort contractors based on their level of comfort with the proposed project. In the process of reviewing redlines to construction agreements by contractors, we have noticed a correlation between a contractor's level of experience with similar projects in the same geographic area and whether or not such contractor is willing to accept a control-based indemnity. The less experience a contractor has with a given type of energy project in the relevant geographic area, the riskier it is for a contractor to accept a control-based indemnity. Even if indemnification is rarely invoked, an owner may benefit from using the control-based indemnity to screen out those contractors with lower experience levels, and suitable contractors may benefit by using their acceptance of the control-based indemnity to differentiate themselves from less-experienced competitors.

III. FAULT-BASED INDEMNITIES: ENSURING RECOVERY OF LEGAL COSTS

The distinguishing characteristic between the control-based indemnity and the fault-based indemnity is which party bears the burden of proof. Under the control-based indemnity, the contractor bears the burden to prove that the owner (or in some cases, a third party) was responsible for all or part of the loss. Under the fault-based indemnity, it is the owner that must carry the burden of proof and demonstrate that the contractor was responsible for all or part of the loss. A fault-based indemnity is integrated into a construction or services agreement using language similar to the following:

Contractor shall Indemnify Owner Group from any and all claims or losses directly or indirectly based on, in connection with, relating to, or arising out of the Work or any member of Contractor Group's actions or inactions under this Agreement, but only to the extent caused by the negligent acts or omissions of Contractor Group, and shall defend Owner Group from any suit or action brought against Owner Group founded upon the allegation of any such claim or loss.

Like the control-based indemnity and its theoretical foundation in the common law principle of *res ipsa loquitur*, the fault-based indemnity is also rooted in common law principles. Depending on the jurisdiction, an obligation for one party to indemnify another may arise under (1) an "express contractual indemnity," (2) an "implied contractual indemnity," or (3) an "equitable implied indemnity."³¹ Express contractual indemnities are "derived from specific language of a contract where one party expressly promises to indemnify the other for a particular kind of loss," while an implied contractual indemnity "arises where a duty to indemnify may be implied from a contractual relationship between two parties."³² As two industry observers explained:

31. Sherri L. Sweers & Thomas B. Quinn, *The Law of Indemnity in Wyoming: Unravelling the Confusion*, 31 LAND & WATER L. REV., 811, 811-12 (1996).

32. *Id.* at 813-14.

The historical bases of indemnity are the related legal theories of unjust enrichment and restitution. At least as to comparative equitable indemnity, and to some degree implied contractual indemnity, courts have determined that it would be unfair for one of several parties causing damage to another to be ‘unjustly enriched’ by not having to compensate the injured party for the damage that they did cause, and allowing for restitution to the party that actually did pay. In other words, if you were partly responsible for damage that somebody else paid for, it’s only fair that you pay them back.³³

A contractual relationship between an owner and a contractor is one where an indemnity may be implied:

Typically, [an implied contractual indemnity] action stems from a breach of contract between the two parties where the indemnitor agreed to perform services. The agreement implied an obligation to do the work in a proper manner and to discharge damages resulting from an improper performance. For example, in [a Wyoming Supreme Court case], the engineering company built a heating system for the architect of an instructional facility under an oral subcontract. The heating system’s failure to meet specifications caused the architect to pay additional costs. The architect sued the engineer for indemnity for the financial settlement he had to pay.³⁴

If such claims are already available as a matter of law, then what is the purpose of a fault-based indemnity? While an owner may be able to make a common law indemnification claim against its contractor, a properly drafted indemnification clause will also allow the owner to recover certain types of losses, such as “attorney’s fees, which are not typically recoverable under a common law cause of action.”³⁵ However, even when the contract contains a fault-based indemnity provision, questions may arise regarding the scope of the contractor’s duty to defend.³⁶

Some fault-based indemnities provide for a refund of defense costs, to the extent that the contractor is not found to be at fault.³⁷ Others do not. For example, in *English v. BGP Intern., Inc.*, a project owner hired a contractor to conduct seismic exploration activities on “land owned by approximately 15,000 different parties.”³⁸ After the contractor commenced exploration activities without first obtaining the permission of certain landowners, the landowners named both owner and contractor in lawsuits alleging trespass and negligence.³⁹ The contractor refused the owner’s request for defense against the lawsuits, insisting that it did not owe a

33. Theodore D. Levin et al., *An Overview of Indemnification and the Duty to Defend*, AM. COUNCIL OF ENG’G COMPANIES 1, 2 (2014), <https://docs.acec.org/pub/DA77E02A-C742-9915-1727-73DF2CCCC23B9>.

34. Sweers & Quinn, *supra* note 31, at 815 (describing the facts in *Kemper Architects, P.C. v. McFall, Konkel & Kimball Consulting Engineers, Inc.*, 843 P.2d 1178 (Wyo. 1992)).

35. *Indemnification Clauses in Commercial Contracts*, THOMPSON REUTERS, <https://legal.thomsonreuters.com/en/insights/articles/indemnification-clauses-in-commercial-contracts> (last visited Mar. 10, 2023).

36. Levin et al., *supra* note 33. “The obligation to defend is broader than the obligation to indemnify because it applies regardless of the merits of the third-party suit. The allegations of the lawsuit trigger the obligation to defend, not the ultimate disposition of the case.” *Indemnification Clauses in Commercial Contracts*, *supra* note 35.

37. *Indemnification Clauses in Commercial Contracts*, *supra* note 35.

38. *English v. BGP Intern., Inc.*, 174 S.W.3d 366, 369 (Tex. App. 2005).

39. *Id.*

duty to defend unless the owner demonstrated that the contractor was negligent.⁴⁰ The relevant indemnity provision required the contractor to

protect, defend, indemnify and hold harmless [the owner] . . . against loss or damage arising out of any claim or suit . . . resulting from operations when [the contractor] . . . commence[s] field operations without the [consent of all landowners] or any claim or suit arising out of the negligent actions or omission of [contractor].⁴¹

In determining that the contractor owed a duty to defend, the court emphasized that “the duty to defend and duty to indemnify are distinct and separate duties,” and that “the duty to defend is determined solely by the precise language in the contract and the factual allegations in the pleadings.”⁴²

In most cases, however, the contractor’s indemnity is not applicable to the extent that anyone other than a member of “Contractor Group” (which includes contractor, contractor’s personnel, contractor’s subcontractors, and such subcontractors’ personnel) caused the claim or loss. Consider a hypothetical vehicle accident at the site gate involving a contractor vehicle, an owner vehicle, and a third-party vehicle in which each of the drivers was found to be one-third negligent. The contractor’s indemnity would usually only extend to its own driver’s negligence. The result is that the contractor’s indemnity of the owner would be for one-third of the owner’s defense costs, claims, and losses arising from such accident.

One potential inefficiency of using a fault-based indemnity (rather than a control-based or knock-for-knock indemnity) is the inherent uncertainty in determining *ex ante* whether the contractor or the owner will bear the costs of a hypothetical loss. As John Collins and Denis Dugan explained almost 60 years ago, “[t]he problem of allocating the cost of injuries and property damage incurred on premises during the time work is being performed by contractors . . . presents, at base, a question of insuring against the risks and of who buys the insurance.”⁴³ Because a fault-based indemnity leaves the owner susceptible to losses actually caused by the contractor’s actions or inactions (but causation of such losses may be impossible to demonstrate), both the owner and contractor are at risk of bearing the loss and therefore incur a duplication of costs if both choose to insure against the same loss.⁴⁴

In our practice, we typically see fault-based indemnities where the contractor does not exercise management and control over the project site. For example, the

40. *Id.* at 369, 375-76.

41. *Id.* at 369.

42. *BGP Intern., Inc.*, 174 S.W.3d at 371-72 (quoting *Farmer’s Tex. County Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81, 82 (Tex. 1997)). See *Tesoro Petroleum Corp. v. Nabors Drilling USA, Inc.*, 106 S.W.3d 118, 125 (Tex. App. 2003) (“The duty to defend may be triggered by the pleadings, but the duty to indemnify is based on the jury’s findings.”).

43. John R. Collins & Denis W. Dugan, *Indemnification Contracts – Some Suggested Problems and Possible Solutions*, 50 MARQ. L. REV. 77, 84-85 (1996).

44. *Id.* at 85 (describing a similar outcome when an indemnity clause is unnecessarily vague: “One problem with a general form of indemnification which does not make explicit whether it is to provide indemnification in cases where the owner’s negligence allegedly causes or joins in causing the damages, is that there is likely to be double insurance coverage with consequent duplication of cost.”).

owner could have two construction contractors working at the same site, each performing a different type of work. By way of further example, a contractor may be asked to work within a running facility, among the owner's operational personnel. In such cases, *res ipsa loquitur* principles are no longer applicable because it is unfair to presume a given contractor is at fault for a loss. Such loss is equally likely to have been caused by another contractor or one of the owner's employees.⁴⁵

IV. KNOCK-FOR-KNOCK INDEMNITIES: NO-FAULT

A knock-for-knock indemnity is a mutual indemnity where each party contractually assumes liability for injuries and damages to its own employees, contractors, subcontractors, and property, regardless of the fault or cause of the injury or damage.⁴⁶ Under this type of indemnity, also called an "identity-based indemnity," the parties agree to accept liability for injury or damage to their own personnel or property, even when the party suffering the loss can demonstrate that the loss occurred due to the fault of another party.

A knock-for-knock indemnity is integrated into a construction or services agreement using reciprocal language similar to the following:

Contractor shall Indemnify Owner Group from any and all claims or losses directly or indirectly based on, in connection with, relating to, or arising out of bodily injury, illness, or death of any member of Contractor Group [or property damage to any property of Contractor Group],⁴⁷ whether caused by the sole or concurrent negligence or fault of any member of Owner Group, which arise out of or relate to the Work.

Owner shall Indemnify Contractor Group from any and all claims or losses directly or indirectly based on, in connection with, relating to, or arising out of bodily injury, illness, or death of any member of Owner Group [or property damage to any property of Owner Group], whether caused by the sole or concurrent negligence or fault of any member of Contractor Group, which arise out of or relate to the Work.

45. Stanley A. Martin & Leah A. Rochwarg, CONSTRUCTION LAW HANDBOOK § 28.04(A) (2018). Negligence-based indemnities also may be appropriate for subsets of claims in certain circumstances, such as: (i) claims related to defects in owner-provided designs, (ii) claims related to defects in owner-supplied materials, and (iii) claims that occur years after completion (in which the owner's maintenance practices could have caused the loss). These examples are similarly consistent with the principle of the degree of contractor's control being the determining factor.

46. Russell E. Jumper & Timothy J. Fandrey, *General Contractor Clauses: Knock-for-Knock Indemnification*, THOMSON REUTERS PRACTICAL LAW (2021); see *In re Deepwater Horizon*, 470 S.W.3d 452, 456 n.5 (Tex. 2015).

47. Some anti-indemnity statutes allow knock-for-knock indemnities for personal injury but not for property loss. For example, the Texas Anti-Indemnity Act "does not apply to a provision in a construction contract that requires a person to indemnify, hold harmless, or defend another party to the construction contract or a third party against a claim for the bodily injury or death of an employee of the indemnitor, its agent, or its subcontractor of any tier." TEX. INS. CODE § 151.103 (2012).

The primary advantage of knock-for-knock indemnification is certainty regarding which party is responsible for which losses.⁴⁸ Under a knock-for-knock approach, litigation costs are reduced or avoided because it does not matter who caused the loss—it only matters who experienced the loss.⁴⁹ Such certainty provides additional cost savings by reducing the potential overlap in insurance policies procured by the various parties.⁵⁰ Under such an identity-based approach, the responsibility for a loss is clear and risk is predictably allocated at the time of contracting. This means that insurance coverage only needs to be obtained for a party's own property and personnel (and not also for losses that could be inflicted on others).

Knock-for-knock indemnities also may increase transparency between the parties regarding mitigation of risks.⁵¹ Under a control-based or fault-based indemnity, a party may seek to shift the responsibility for a loss to the other party, especially when the loss is substantial. This attempted loss shifting generally plays out through costly litigation or arbitration, where each party has an incentive to obscure or distort the cause(s) of a loss because establishing actual causation determines responsibility for the loss. This situation presents a prisoner's dilemma, whereby each party's self-interest is served by attempting to lay blame on the other party, but the mutual interests of all parties would be best served by identifying the true cause of the loss to ensure it does not reoccur. An identity-based, knock-for-knock regime provides a solution for this prisoner's dilemma because it removes causation as the determining factor for allocating responsibility. Because the parties know that responsibility for a loss remains fixed regardless of who caused the loss, information sharing and development of best practices are encouraged. For example, we witnessed a case where a contractor continued to attempt to remedy a collapsed tunnel (throwing good money after bad) in an effort to escape liability under an indemnification clause—when it would have been in everyone's best interest to abandon the tunnel and proceed with an alternative route. Under a knock-for-knock regime, the contractor may have avoided such expenditures.

Despite these advantages, the knock-for-knock indemnity has a significant downside—the unappealing result of an innocent party potentially bearing the costs of another's negligence.⁵² Knock-for-knock indemnities may also contribute to moral hazard by failing to create proper incentives for contractual parties to avoid the imposition of losses on others. This moral hazard may be exacerbated

48. Robert Meade & Nicholas Neuberger, *Knock-for-Knock Indemnities: Risk Allocation in Offshore Oil and Gas Contracts*, LEXISNEXIS (2019), <https://brucewell.com/news/knock-knock-indemnities-risk-allocation-offshore-oil-and-gas-contracts>.

49. *Id.*

50. *Id.*

51. *Id.*

52. Indeed, even jurisdictions that permit knock-for-knock indemnities acknowledge their imperfect nature. In an English case involving a tugboat accident, the court described the knock-for-knock indemnity between the litigants as “a crude but workable allocation of risk and responsibility” given the reality that “happenstance” would otherwise often determine who should be liable. *Smit v. Mobius* [2001] EWHC (Comm) 531 [19] (Comm) (Eng.).

when a contractor is faced with time or cost pressure. In such cases, a contractor may select means or methods that introduce additional risks to others but minimize time or cost. By contrast, under a control-based or fault-based indemnity, a contractor would be less likely to “cut corners” in order to finish a task in a shorter period of time or at a lower cost, because the potential losses (for which it would owe an indemnity) would far outweigh any gain the contractor would receive.

Due in part to these considerations, many jurisdictions have restricted or prohibited the use of knock-for-knock indemnities on public policy grounds.⁵³ For example, the Texas Construction Anti-Indemnity Act renders void and unenforceable a contractual provision to the extent that it requires one party to indemnify another against a property⁵⁴ loss claim caused by the negligence or fault of the indemnitee. By contrast, the Texas Oilfield Anti-Indemnity Act provides an exception for agreements which provide indemnification for claims caused by the indemnitee’s own negligence if the indemnity obligation is supported by liability coverage furnished by the indemnifying party.⁵⁵ As a result, whether a knock-for-knock indemnity is enforceable under Texas law will depend in part on whether the Construction Anti-Indemnity Act or the Oilfield Anti-Indemnity Act applies to the indemnity and the character of the particular losses indemnified.⁵⁶

Where knock-for-knock indemnities are permitted by applicable law, the benefits of identity-based indemnification generally only prevail when multiple parties with large numbers of personnel and equipment are all occupying the same work location—with little or no delineation between work areas and no clear control of the worksite by a single party.⁵⁷ In these circumstances, a control-based

53. See TEX. INS. CODE ANN. § 151.102; CAL. CIV. CODE § 2782(a); N.Y. GEN. OBLIG. LAW § 5-322.1(1); LA. STAT. ANN. § 9:2780.1(B).

54. TEX. INS. CODE ANN. § 151.102. Note that the Texas Anti-Indemnity Act provides an exception for bodily injury or death claims for employees of the indemnitor and permits indemnity for the sole or partial negligence or fault of the indemnitee for those claims only. *Id.* § 151.103.

55. TEX. CIV. PRAC. & REM. CODE ANN. § 127.005 (West 1999). See Russell E. Jumper & Timothy J. Fandrey, *General Contract Clauses: Knock-for-Knock Indemnification Provision (TX)*, PRACTICAL LAW (Dec. 15, 2021), [https://content.next.westlaw.com/practical-law/document/17bf17e0c36cd11e99687ad62ac048e9b/General-Contract-Clauses-Knock-for-Knock-Indemnification-Provision-TX?viewType=FullText&transitionType=Default&contextData=\(sc.Default\)](https://content.next.westlaw.com/practical-law/document/17bf17e0c36cd11e99687ad62ac048e9b/General-Contract-Clauses-Knock-for-Knock-Indemnification-Provision-TX?viewType=FullText&transitionType=Default&contextData=(sc.Default)) (“Texas . . . has carved out an exception . . . that allows parties to use an indemnity provision if the provision is supported by certain liability insurance coverage”); Thomas A. Donaho, *Texas Oilfield Indemnity Handbook* 8-10, BAKERHOSTETLER, <https://www.bakerlaw.com/webfiles/Litigation/2019/Articles/06-19-2019-Texas-Oilfield-Indemnity-Handbook.pdf> (explaining the insurance coverage exception in the Texas Oilfield Anti-Indemnity Act).

56. Amy K. Wolfshohl & Cornelius M. Sweers, *Engineering, Procurement, and Construction Contracts in Texas: Key Provisions, Issues and Pitfalls*, 17 CONSTR. L.J. 6, 23 (2021) (“[W]hen the [Texas Oilfield Anti-Indemnity Act] does not apply to a construction project, the [Texas] Construction Anti-Indemnity Act applies and would render a [Texas Oilfield Anti-Indemnity Act] knock-for-knock indemnity provision at least partially unenforceable.”).

57. Alex Johnson, *Indemnities in Offshore Construction Projects – Do Not Be Shocked by Knock for Knock* 1-2, SQUIRE PATTON BOGGS (2016), https://www.squirepattonboggs.com/~/_media/files/insights/publications/2016/09/construction-and-engineering-update-autumn-2016/construction-and-engineering-update-autumn-2016.pdf. “[K]nock for knock’ indemnities (assuming they are well crafted, precise, and clear) are likely to be upheld by English courts and however crude the arrangement might seem, the courts seem to accept that it does offer some certainty in an extremely risky work environment.” *Id.* at 3.

indemnity is unworkable because no single party controls the work site and thus the underlying principle of *res ipsa loquitur* does not apply. Likewise, a fault-based indemnity regime may be impractical due to the high cost of demonstrating causation due to the number of potential parties and instrumentalities involved.⁵⁸

Knock-for-knock indemnities have historically been observed in contracts governing work on offshore oil and gas platforms because this work environment is the most likely to be characterized by many parties operating simultaneously in a work area that is not wholly controlled by any single party.⁵⁹ In the litigation occurring in the aftermath of the 1988 Piper Alpha oil platform explosion, Lord Bingham described the motivation for the “market practice” of using knock-for-knock indemnities:

Operations to exploit the oil and natural gas resources of the North Sea have two prominent features relevant for present purposes. First, such operations are potentially hazardous . . . The second feature worthy of note is the involvement of many contractors and sub-contractors . . . [T]he Piper Alpha disaster led to claims against 24 different contractors. Of those on board the platform who were killed, 134 were employed by contractors and 31 by the operator. Of those who survived, 55 were employed by contractors and 6 by the operator.⁶⁰

However, a knock-for-knock indemnity is not automatically appropriate for all offshore work. For example, it is erroneous to argue that a knock-for-knock indemnity should apply to an offshore construction project being undertaken by a single general contractor who is in control of the platform or vessel where the work is occurring. In such cases, the many subcontractors are part of the general contractor’s “group,” and therefore a control-based indemnity by the general contractor would be appropriate. Thus, rather than merely assuming that “offshore scope of work” automatically implies a knock-for-knock indemnity, practitioners should consider whether a control-based or fault-based indemnity would result in a more appropriate allocation of risk.

Because identity-based indemnities involve mutual indemnification for losses between the contracting parties, these indemnities generally do not address third-party claims or losses. Instead, when an identity-based indemnity is implemented, third-party claims and losses are generally handled via a fault-based indemnification provision whereby each contracting party indemnifies the others for third-party claims and losses to the extent of the indemnitor’s negligence.

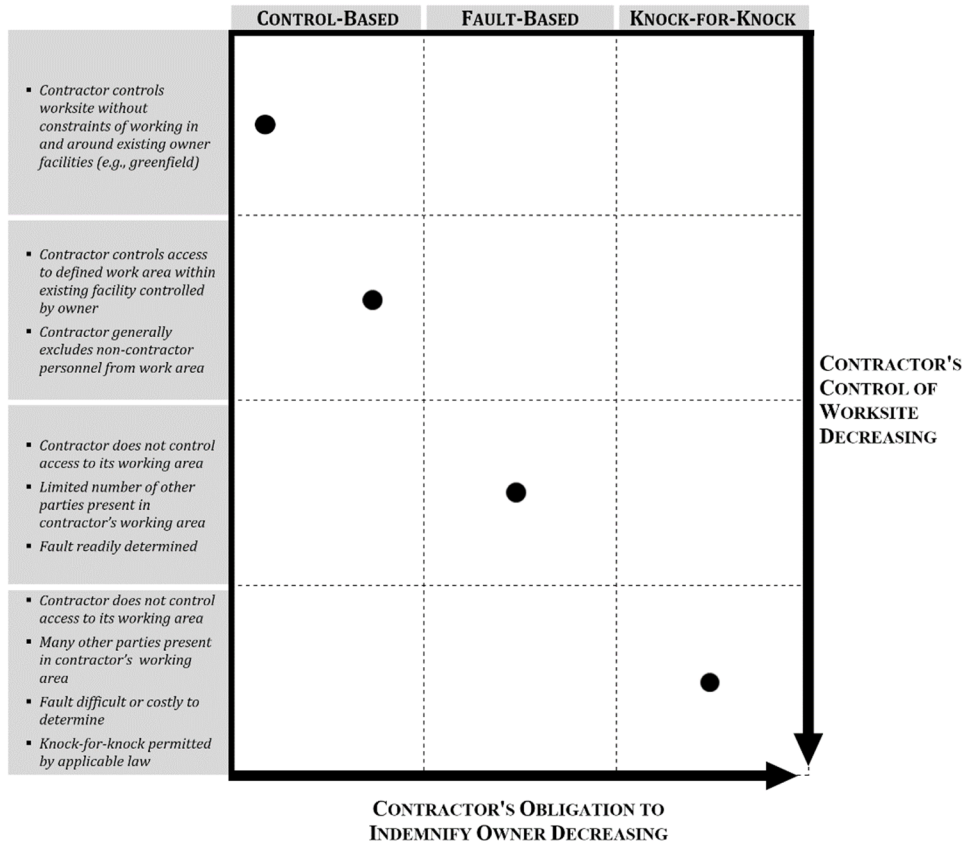
58. *Caledonia North Sea Ltd. v. British Telecomms. Plc* [2002] UKHL 4.

59. Patrycja Mielcarek, *The Knock-for-Knock Agreements in the Offshore Sector Under the United States and Norwegian Law: The Problem of Gross Negligence and Willful Misconduct* (2012) (on file with U. of Oslo Faculty of Law).

60. *Caledonia North Sea Ltd. v. British Telecomms. Plc* [2002] UKHL 4.

V. INDEMNITY SELECTION MATRIX: USING DEGREE OF CONTROL TO SELECT THE PROPER INDEMNITY

On any given energy project, the contractor’s relative level of control over the work site will exist somewhere along a continuum. Certain project circumstances allow the contractor to exercise near-complete control over the work site, with nearly all on-site personnel either employees or subcontractors of the contractor. By contrast, other projects require contractor personnel to undertake work alongside dozens of unrelated contractors with no clear delineation between work areas. Each of these circumstances—and those existing in between—calls for application of an indemnity paradigm designed to balance incentive alignment against economic inefficiency. The matrix below illustrates this continuum of control and the type of indemnity that strikes the appropriate balance between these trade-offs. Note that as the contractor’s control over the worksite decreases, its obligation to indemnify the owner similarly decreases:



VI. CONCLUSION

Selecting contractual indemnities in energy construction and services agreements has become increasingly difficult due to confusion among practitioners re-

garding when certain types of indemnities are appropriate. This difficulty is further compounded by the general inapplicability of historical indemnification categories to the types of indemnities typically being used in construction and services agreements. By moving toward consideration of indemnities as control-based, fault-based, or identity-based (knock-for-knock), owners and contractors can more efficiently allocate the risk of losses using indemnification principles based primarily on relative control over the contractor's working area. In doing so, a contractor bears the burden of proving the owner's negligence when the contractor has sole control over a location, an owner bears the burden of proving the contractor's negligence when the owner allows a contractor to work in and around owner personnel or other contractors, and everyone bears their own losses when there are many parties working alongside each other.