

Limiting PEO Liability: The Contractual Shield

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Early one Monday morning, our old friend, Paul E. Oglethorpe (still known as PEO to his friends), the president of Acme PEO¹ (Acme), begins reviewing information on a potential new client his top sales rep met with the week before. The potential client, DefenseWorks, Inc., is a local manufacturing company primarily providing materials to the military.

Defense Works is profitable, has a good track record, and is well respected in the defense industry. They have grown quickly and have an immediate need for assistance with human resources, payroll, workers' compensation administration, and other services Acme can provide. Oglethorpe closes his file and thinks, "This is just the type of client we are looking for." He opens his cabinet, grabs a manila folder labeled Client Service Agreement (CSA) and proceeds to mail a standard CSA to DefenseWorks — which is promptly executed and returned.

Months pass and by all accounts Oglethorpe was correct in his estimation of the potential of his new client. DefenseWorks continues to grow, complies with all the terms and conditions of the CSA, and pays on time, even early on occasion! DefenseWorks has also been pleased with the services provided by Acme and has referred other companies to Acme.

Just when all seemed well with Oglethorpe's world, a massive explosion occurs at a nearby restaurant with catastrophic injuries and significant property damage. Oglethorpe, a pillar of the community, sched-

uled a meeting the next morning to determine how Acme could assist those affected by the tragedy. However, just before the meeting was scheduled to begin, Oglethorpe got a call from DefenseWorks. He learns that Acme co-employee drivers for DefenseWorks had been scheduled the previous day to deliver some "material" to a government contractor and had stopped at a restaurant for a bite to eat on their way. It took a moment for Oglethorpe to grasp what had occurred, but it all became crystal clear when his client explained the truck had been carrying C-4 and other explosive materials. Later that week, the lawsuits began to appear on Acme's doorstep.

While the preceding account is (clearly) purely fictional, a PEO will often become a target of plaintiffs or regulators based on the relationship created between the PEO and co-employees performing service for the client company. Whether the potential liability is rooted in tort (negligence), employment law, or regulatory compliance (OSHA), the PEO may be at risk due to the actions of the client company, or more specifically, its co-employees performing service for the client company. How can a PEO limit its exposure from liability generated by the client company? The answer is almost always found in a carefully drafted CSA that has been tailored for the particular client company.

Absolute Indemnification

The broadest type of indemnification provision is absolute indemnification. This type of indemnification requires the client company

to defend and indemnify the PEO from any and all claims that arise from or are in any way related to the client service agreement. Under these terms, the client company is responsible for providing, or paying, for the PEO's defense for any claim arising from the client company's actions. Further, the client company is contractually required to reimburse the PEO for any amount of damages or fines the PEO is ordered to pay. Under such a provision, the duty to defend and indemnify applies without regard to the negligence or fault of the PEO or the client company. Although many PEOs included this type of provision in contracts in the past, most clients will be reluctant to enter into a CSA containing such a broad duty.²

Indemnification from Client Acts/Tort Liability

Typically, a PEO's greatest concern is the liability it may incur for the negligent or intentional acts of a client company. Some PEOs attempt to limit this potential for liability with a basic and broad indemnification provision for client acts. Acme had such a provision in its CSA, and it read:

"Client agrees to indemnify, defend, and hold harmless PEO, its officers,

- ¹ Acme PEO and any other names are purely fictional entities and individuals. Any unintentional similarity to existing entities or individuals is purely coincidental.
- ² Some states, through case law or statute, prohibit absolute indemnification. It is important to consider the governing law when drafting and entering into a CSA to ensure the various provisions, including the indemnification language, comply with the laws of the state that will adjudicate any dispute relating to the agreement.

directors, employees, agents, and representatives from and against any and all claims, expenses (including, but not limited to court costs and attorney fees), liabilities, and administrative penalties, whether known or unknown, which PEO may incur or become liable for or which may be asserted or claimed against PEO as a result of the negligent or intentional acts of the Client or the Assigned Employees.”

Acme expected litigation to result from the catastrophic explosion. However, Acme was surprised when DefenseWorks refused to provide a defense. DefenseWorks argued the loss was not a result of negligent or intentional acts and that the indemnification provision only took effect when the act was, in fact, negligent or intentional. Acme was left in a situation where it was stuck paying for its own cost of defense while litigating the breadth and effect of the indemnification provision with DefenseWorks. If the tort liability exposure is sizeable, as in the case of Acme and DefenseWorks, even if no damages are ultimately awarded against the PEO, tens of thousands — if not hundreds of thousands — of dollars could be spent defending claims the PEO thought were covered by the basic indemnification provision of the CSA.

The PEO may be able to more effectively limit its liability by drafting specific indemnification provisions related to each liability potential it identifies. These more specific provisions might start with a provision to address liability for claims related to the client’s business:

“Client is solely responsible for the conduct of its business, as well as the fabrication of product or preparation and provision of service in which Client is engaged. The PEO has no responsibility whatsoever for Client’s business, product, and/or service, and Client agrees to defend, indemnify, and hold the PEO harmless for any and all claims, liabilities, or consequences arising out of Client’s business, product, or service.”

This type of provision might have helped Acme limit its exposure to tort liability and establish a clear contractual duty on DefenseWorks to defend Acme. In addition

to the indemnification for liability related to the client’s business, the PEO should also consider including an indemnification provision for all claims asserted by assigned employees against the PEO.

PEO Liability Concerns Outside Tort Liability

PEO liability is not limited to claims related to the negligent or intentional acts of the client company or assigned employees.

As the PEO tailors the CSA to fit each particular client company, it should pay careful attention to include indemnification provisions in each instance where a duty is placed on the client company. The CSA can set forth the duty and then provide that the client company will defend/indemnify the PEO from the particular liability exposure created by the client’s failure to comply. Some examples of duties where the CSA could include indemnification provisions include, but are not limited to, the duty to provide accurate payroll information, to comply with COBRA (or provide the PEO with all information necessary to comply), comply with applicable provisions of the ADA, comply with the Family Medical Leave Act, comply with OSHA regulations, comply with all professional licensing requirements, and provide timely notice when an assigned employee fails to report to work.

Other Methods of Protection from Liability

The indemnification clause is not the only method a PEO can use to reduce its liability. In fact, two of the simplest methods are often not given due emphasis in literature or practice: insurance and client review.

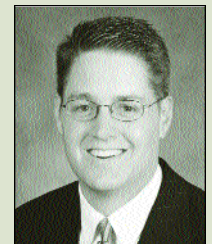
Insurance

The CSA can require the client maintain insurance of a type and with a policy limit directly related to the client’s operation and the foreseeable liability exposures. The PEO can require it be listed as an additional named insured or pursuant to an alternate endorsement. This can be difficult to pro-

cure in some cases, but the risk associated with a particular client should directly impact the emphasis placed upon enforcement of this requirement.

Client Review

Finally, one of the best ways for a PEO to limit its liability exposure is to engage in a thorough review of the potential client, its finances, and particularly its safety practices and operations, prior to entering into a business relationship. A review of the client’s operations will assist the PEO in identifying the areas of potential liability that need to be addressed in the CSA with client-specific indemnification provisions. It is important to recognize that an agreement by a client to defend and indemnify is of no value if the client company does not have sufficient wherewithal, directly or through applicable insurance, to perform its contractual obligations. ■



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