

Paper Title: Navigating Uninsured Indemnity Agreements

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Session Title: Navigating Uninsured Indemnity Agreements

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Meghan Douris provides her clients – the nation and region’s leading general contractors and subcontractors – legal counsel on the diverse issues impacting their construction projects, including: differing site conditions, geotechnical engineering concerns, delay and impact claims, heavy civil construction contract claims, general business matters, construction contract issues, and risk management strategies. Clients value her ability to assess complex construction contracts and determine an appropriate and creative litigation strategy to achieve a resolution.

A seasoned litigator, Tom is a problem solver who works with his clients to expeditiously and efficiently mitigate risk and navigate their most challenging issues throughout all project phases, from the initial contract formation through project completion, including claims and if necessary litigation. Tom explores all options for dispute resolution, but when litigation is the best solution to a problem, he can be counted on to be an aggressive advocate for the needs of his clients.

Emily Yoshiwara works with clients in the construction and real estate industries to solve their most complex legal challenges. With a practice that spans across the firm’s construction, commercial litigation, business and real estate, and government contracts groups, she has assisted clients with a variety of issues, including contract review, in-depth legal research, and drafting and responding to discovery.

I. Overview of Contractual Indemnity and its Function

Construction is full of risks. However, on a construction project these risks are frequently allocated through the parties' contract. Contractual indemnity provisions are frequently included in construction contracts to compel one party—the indemnitor—to defend and/or reimburse the other—the indemnitee—against claims or losses. Indemnity clauses have the power to significantly shift the risk between parties. When entering into a construction contract contractors and subcontracts alike should be wary of indemnity clauses and the potential costly additional liabilities they may create.

A. Anatomy of an Indemnity Clause

Every indemnity provision has two key parts that define the scope of the indemnity obligation. The variation or exclusion of even a few words can entirely alter the scope of the indemnity and significantly narrow (or widen) the obligation of the indemnitor.

First, each indemnity clause will identify the party that is entitled to indemnification—the indemnitee or indemnitees. This often just means the party signing the contract. However, some indemnity provisions will provide for indemnification to parties not part of the contract at issue. For instance, a contractor may be required to indemnify and hold harmless not just the owner with whom it is signing the contract, but also the architect or engineer—with whom it is not in contractual privity. Each additional indemnitee adds to the risk shouldered by the indemnitor.

Next, an indemnity provision will define the type of losses from which the indemnitor agrees to hold the indemnitee harmless. The breadth and specificity of this portion can drastically change the eventual liability of the indemnitor. Usually an indemnity clause will contain broad language detailing the type of losses that will be indemnified—i.e. all claims, damages, expenses, etc. It might also lay out the categories of losses it covers, for example, all losses stemming from personal injury or property damage. Depending on the specificity of the type and category of losses, these details can drastically alter obligations for an indemnitor.

II. Types of Indemnity Clauses and Anti-Indemnity Statutes

Although indemnity provisions vary greatly from contract to contract, the fault of each party will often determine whether an indemnity obligation is owed. Indemnity provisions typically fall within two categories: 1) provisions that only protect against losses where the indemnitor is wholly or partially at fault—even if the indemnitee is also partially at fault; and 2) “fault free” or general provisions that create indemnity regardless of fault. In order to limit the obligations of indemnitors, many states have passed anti-indemnity statutes, which prohibit certain types of indemnity clauses as a violation of public policy. More than 40 states have some

type of anti-indemnity clause which limits the types of indemnity provisions that can be enforced.

A. Indemnitor's Fault

One common type of indemnity clause is one in which the indemnitor agrees to indemnify the indemnitee against loss that is caused wholly or partially by the indemnitor. Such clauses require at least some fault on the part of the indemnitor. For example, in *Bradford v. Kupper Associates*, 662 A.2d 1004 (N.J. 1995) the court examined this type of indemnity provision when a contractor's injured employees brought a claim against the project's owner and engineer. The owner and engineer added the contractor as a third party because of the contract's indemnification clause which read, in relevant part:

The CONTRACTOR will indemnify and hold harmless the OWNER and the ENGINEER and their agents and employees from and against all claims, damages, losses and expenses including attorney's fees arising out of or resulting from the performance of the WORK, provided that any such claims, damage, loss or expense is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property including the loss of use resulting therefrom; *and is caused in whole or in part by any negligent or willful act or omission of the CONTRACTOR, and SUBCONTRACTOR*, anyone directly or indirectly employed by any of them or anyone for whose acts any of them may be liable.

Id. at 1018 (emphasis added). The court held that as long as there was some negligence on the part of the contractor—or any of its subcontractors or their agents—full indemnification of the indemnitee was guaranteed. The court stated that a promise to indemnify for sole negligence is unenforceable (because of New Jersey's anti-indemnity statute), “whereas a promise to indemnify for 99% negligence may be enforced.” *Id.* at 1019. Because the contractor had been at least partially responsible for its employees' injuries, it was required to indemnify the project's owner and engineer. *Id.* at 1019.

However, some states have passed statutes prohibiting an indemnitee from being held responsible beyond the extent of its own negligence. In these states, even if the parties agree to a contractual indemnity provision like the one in *Bradford*, the indemnitor is only responsible for its own negligence. *See, e.g.*, Del. Code Ann. 6 § 2704; Minn. Stat. § 337.02; N.C. Gen. Stat. § 22B-1; Or. Rev. Stat. § 30.140. These states have determined that such clauses are against public policy and cannot be enforced.

B. Indemnitee's Sole Fault

Some indemnity provisions will provide for indemnification regardless of whether the loss was caused by the indemnitee's sole negligence. These provisions

are often disfavored favored by courts as they allow a negligent indemnitee to face no consequences for its own loss.

A significant number of states have enacted anti-indemnity statutes that prohibit contractual provisions that require an indemnitor to indemnify an indemnitee for its *sole* negligence. *See, e.g.* Ga. Code Ann. § 13-8-2; Md. Code., Crts. & Jud. Proc. § 5-401; Mich. Comp. Laws § 691.991. These states would permit an indemnity provision like the one in *Bradford*, but prohibit any indemnity provision that covers losses resulting from the indemnitee's *sole* negligence.

C. Fault Free Provisions

Finally, some contracts include a general or fault free indemnity provision which operates regardless of the indemnitor's fault. Often this type of provision will create indemnity for any injuries or damages arising out of the performance of the indemnitor's work on the contract. In *Perkins v. Rubicon, Inc.*, 563 So.2d 258 (La. 1990) an industrial plant and its maintenance contractor included this type of clause in their contract. The clause stated that the contractor agreed to:

indemnify and hold [the owner] harmless from all claims, suits, actions, losses and damages for personal injury, including death and property damage, even though caused by the negligence of [the owner], arising out of [the contractor's] performance of the work contemplated by this agreement.

The Louisiana Supreme Court looked at this clause when one of the contractor's employees was injured because of the actions of the owner. The contractor argued it should not be liable for these damages under the indemnity clause because it was not negligent. However, the court held that the agreement did not require fault on behalf of the contractor, but instead required causation similar to cause-in-fact. *Id.* at 259. The court stated that rather than looking at the contractor's fault, it would instead ask "Would the particular injury have occurred but for the performance of work under the contract?" *Id.* Thus, the court required the contractor to indemnify the owner because the language of the contract clearly indicated that the contractor's fault was not required for indemnity. *See also Rossmoor Sanitation, Inc. v. Pylon, Inc.*, 532 P.2d 97 (Cal. 1975) (referring to fault free provisions without a requirement for indemnitee negligence as a "general" indemnity clause).¹

III. Evolution of Indemnity Clauses

Traditionally, indemnity clauses mirrored insurable risk. This meant that they would typically provide indemnification for personal injury and property damage claims from third parties. However, with increasing frequency contractors are being asked to sign agreements in which they undertake to indemnify project owners against *any* site-related liabilities. These broad indemnity provisions have

¹ California has since legislated around these issues for construction contracts. (Cal. Civ. Code 2772-2784).

created greater indemnification obligations, including liability for contractual claims and damage to the work itself.

A. Indemnity Clauses Mirroring Insurable Risk

Indemnity provisions have historically covered losses relating to property damage or bodily injury. The following indemnity clause comes from the AIA's General Conditions:

To the fullest extent permitted by law, the Contractor shall indemnify and hold harmless the Owner, Architect, Architect's consultants, and agents and employees of any of them from and against claims damages losses, and expenses, including but not limited to attorney's fees, arising out of or resulting from performance of the work, provided that such claim, damage, loss, or expense is attributable to bodily injury, sickness, disease or death, or injury to or destruction of tangible property (other than the Work itself), but only to the extent caused by the negligent acts or omissions of the Contractor, a Subcontractor, or anyone directly or indirectly employed by them, or anyone for whose acts they may be liable, regardless of whether or not such claim, damage, loss, or expense is caused in part by a party indemnified hereunder.

Indemnity provisions such as this create indemnity obligations for losses attributable to bodily injury or damage to property other than the work itself. Provisions similar to this typically trigger an indemnity obligation for injuries to workers or other third parties or damage to property as a result of the work on the project. This is the type of indemnity provision that is most frequently and commonly included in construction projects.

B. Broader Indemnity Clauses: Defective Work and Contract Claims

However, parties have continued to broaden the language used in indemnity agreements to increase the scope of liability. Courts will determine whether an indemnity obligation is covered by looking to the parties' intent. This is usually done by looking to the explicit language of the contract. *See, e.g., Simons v. Tri-State Construction Co.*, 655 P.2d 703 (Wash. 1982). The clearer the contractual language is, the more likely an indemnity provision is to be enforced, even if the obligations it imposes are broader or inconsistent with typical indemnity obligations. Thus, when the contractual language and intent of the parties is clear, courts have found that an indemnitor can be liable for damages other than those arising from personal injury or property damage.

For instance, some indemnity provisions have been interpreted to shift liability for construction defect claims. For example, in *Centex Golden Construction Co. v. Dale Tile Co.*, 93 Cal.Rptr.2d 259 (2000). Dale Tile Co.

(“Dale”) a tile subcontractor, signed an agreement to indemnify the general contractor Centex Golden Construction Co. (“Centex”). The relevant indemnity provision read:

General Indemnity—All work covered by this Agreement done at the site of construction or in preparing or delivering materials or equipment, or any or all of them, to the site shall be at the risk of SUBCONTRACTOR exclusively. SUBCONTRACTOR shall, with respect to all work which is covered by or incidental to this contract, indemnify and hold CONTRACTOR harmless from and against all of the following:

1. Any claim, liability, loss, damage, cost, expenses, including reasonable attorneys' fees, awards, fines or judgments arising by reason of the death or bodily injury to persons, injury to property, design defects (if design originated by SUBCONTRACTOR), or other loss, damage or expense, including any if the same resulting from CONTRACTOR's alleged or actual negligent act or omission, regardless of whether such act or omission is active or passive.... However, SUBCONTRACTOR shall not be obligated under this Agreement to indemnify CONTRACTOR with respect to the sole negligence or willful misconduct of CONTRACTOR, his agents or servants or subcontractors who are directly responsible to CONTRACTOR, excluding SUBCONTRACTOR herein.

After the project was completed, the owner brought a claim against the Centex for defective title work, which Centex settled. Centex then filed an indemnity action against Dale seeking the money it had paid in settlement. The jury found that neither Dale or Centex had been negligent. Dale argued it was not required to indemnify Centex without a showing of negligence. However, the court found that the language of the contract was sufficiently clear to provide indemnity regardless of fault. The court held that Centex was only required to show that the claim for which it sought indemnification was connected to Dale’s work and that it was not caused by Centex’s sole negligence or willful misconduct. Even though the claim arose from the work itself, the broad language of the indemnity provision allowed the court to find indemnity.

Some courts have even interpreted an indemnity provision to cover claims stemming from contract claims between the indemnitor and indemnitee. In *Energy XXI, GOM, LLC v. New Tech Engineering L.P.*, 787 F. Supp.2d 590 (S.D. Tex. 2011), the owner of an off-shore well brought several claims against its service contractor, including a claim for breach of contract, because of damage to the well. The service contractor (New Tech) filed a counterclaim that the well owner (Energy) had an obligation to indemnify it under the parties’ contract. The indemnification clause read:

Energy XXI shall be responsible, and Contractor [New Tech] shall never be liable, for property damage of ... Energy XXI ... and Energy XXI agrees to defend, indemnity [sic.] and hold harmless, Contractor, against any and all such claims, demands, losses or suits, (including, but not limited to, claims, demands or suits for property damage ...) which may be brought against Contractor by Energy XXI, any employee of Energy XXI or the legal representative or successor of any such employee, in anywise arising out of or incident to work being performed on or about Energy XXI's property or jobsite, irrespective of whether such claims, demands or suits are based on the relationship of master and servant, third party, or otherwise, and even though occasioned, brought about, caused by, arising out of or resulting from Energy XXI's work, or its acts, activities, or presence on any location, structure or vessel, or travel to and from such location, structure, or vessel, the unseaworthiness or unairworthiness or [sic.] vessels and craft, or the negligence or strict liability, in whole or in part, of Contractor, or by or from any other means, relationship or cause, without limitation whatsoever.

Although the language of the clause specifically provided for indemnification of claims brought by the contractor against the owner, Energy argued the clause did not cover breach of contract claims. However, New Tech asserted that indemnity for breach of contract was contemplated by the parties' agreement. The court agreed with New Tech and held that the expansive language of the clause was broad enough to encompass breach of contract claims so long as the damage stemmed from property damage. The court thus found that Energy was contractually obligated to indemnify New Tech for the breach of contract claims. *Energy XXI* demonstrates that courts are willing to stray from the traditional limits of indemnity provisions if the language of the provision permits.

IV. Conclusion

It is clear that the scope of the obligation under a contractual indemnity provision is broadening. The language used to address the indemnitor's fault (if any is used at all) can significantly increase the indemnitor's liability. In addition, courts seem willing to uphold indemnity provisions that stray outside the typical scope of insurable risk, as long as the language and intent of the parties is clear and does not violate the local anti-indemnity statute. Because of the considerable obligations that can come with a broad indemnity clause, all parties to a construction contract should be wary of these clauses.