To Protect or Not to Protect: Indemnification Provisions in Complex Construction Projects

by Gary Strong

Express indemnity clauses are a common component in virtually all construction contracts, yet they are routinely included in such contracts without a full understanding of the risk transfer objectives of the parties or whether the indemnity clause fulfills those objectives. Indemnity clauses are risk transfer provisions where one party seeks to shift the risks of claims on a construction project down the line to the entity closer to the actual work. Typically such clauses transfer risk from the owner to the general contractor, and subsequently to the subcontractors.

Types of Indemnity Provisions

An agreement by an indemnitor to indemnify another (the indemnitee) against the results of the indemnitor's negligence is fairly straightforward. The ability to shift risk that is a result of the indemnitee's own negligence, however, requires specific and explicit language in the indemnification clause. Indemnity clauses are typically classified into the following three types:

Type I – This type 'expressly and unequivocally' states that the indemnitor will indemnify the indemnitee, even if the indemnitee is solely or concurrently negligent with the indemnitor. Thus, under this type of clause, even if the indemnitee is 100 percent at fault, the indemnitor must fully indemnify the indemnitee.

Type II – This type provides that the indemnitor will indemnify the indemnitee for the indemnitor's negligence and the indemnitee's concurrent passive negligence. Therefore, the indemnitor must indemnify the indemnitee for the percentage of active and passive negligence of the indemnitor plus any concurrent passive negligence by the indemnitee. But, the indemnitor does not cover the percentage of active negligence by the indemnitee.

Type III – This type is the most limited indemnity, and provides that the indemnitor will only indemnify the indemnitee for that portion of liability caused by the indemnitor's negligence. Thus, negligence of the indemnitee could bar or reduce the indemnification benefits provided by the indemnitor.

Relevant New Jersey Case Law

The Type I indemnification clause is the one that is the most debated within New Jersey state and federal courts. New Jersey courts have repeatedly stated that indemnification against a party's own negligence will only be enforced where there is unequivocal language in the contract requiring that result. The cases of *Azurak v. Corporate Property Investors, Mantilla v. N.C. Mall Associates,* and *Ramos v. Browning Ferris Industries of South Jersey, Inc.*[1] set the basic framework for the unequivocal language rule.

In *Ramos* and *Mantilla,* the Appellate Division and Supreme Court established the baseline rule that a contract will not be construed to provide protection to the indemnitee against losses resulting from its own negligence unless such an intention is expressed in "unequivocal terms."[2] Stated another way, a court will not uphold an indemnification for a party's own negligence unless the contract contains an unequivocal expression of an intention to indemnify.

The cases following *Azurak, Mantilla,* and *Ramos* illustrate that the language of the indemnification clause needs to be both specific and unambiguous to clearly convey the intent to indemnify against the party's own negligence.

In *Englert v. Home Depot,*[3] the parties entered into a contract containing an indemnification provision and conflicting indemnification language in the rider of the contract. The Appellate Division held that ambiguities within the indemnification provision, and inconsistencies between the contract and a rider to the contract, did not "demonstrate the required clear and unequivocal intention for Raimondo to be indemnified for its own share of negligence."[4]

In addition to specifically referencing the negligence or fault of the indemnitee, the facts of the underlying claim must conform with the unambiguous terms of the agreement. In *Taylor v. The Port Authority of NY and NJ,*[5] the court held that the indemnification agreement was specific and explicit enough to be upheld, but was so specific that it did not apply to the underlying suit. The indemnification clause encompassed only negligence acts

in the port authority facility, while the accident happened outside the facility.

The court examined the specific language of the indemnification agreement to determine its scope and breadth. Emphasizing that absent an express obligation requiring the indemnitor to indemnify against the port authority's own negligence outside the premises, the indemnification obligation was not applicable.[6]

The lesson of this case is that not only does the indemnification provision need to be clear and unequivocal regarding the intention to include the indemnitee's own negligence, but it must anticipate which risks are to be allocated and state the intent to have the indemnitor indemnify the indemnitee, even for the indemnitee's own negligence. If the indemnification provision is not clear regarding the indemnitee's own negligence it will likely not be held enforceable.

While a court will not expand an indemnification provision, and will strictly construe the terms stated, it will uphold a very broad indemnification agreement as long as it is unambiguous and clearly expresses the intent of the parties. In *Hertz Corp. v. Zurich American Ins. Co.*,[7] a federal court applying New Jersey law upheld an "extraordinarily broad" indemnification agreement because it found the language was clear and unambiguous.[8]

The case involved a Hertz equipment agreement that included a broad but detailed indemnification agreement.[9] Hertz sought declaratory judgment that the indemnity provision was enforceable and applicable to the underlying action instituted when a construction worker was killed, possibly due to Hertz's negligence.[10] The court found that the indemnification clause unambiguously obligated the rental customer to defend and indemnify Hertz for all claims brought by anyone having anything to do with rental equipment, even if the liability resulted from Hertz's ordinary negligence.

Instead of facing an expensive defense of the claim and a possible judgment, the indemnification agreement allowed Hertz to shift its liability risk to the indemnitor/lessee, demonstrating that a specific and unambiguous indemnification clause is a very powerful risk avoidance tool.[11]

Economic Loss Doctrine and its Affect on Contractual Indemnity

At first glance, it would appear that the economic loss doctrine has little connection with the contractual indemnity clause negotiated between two parties. The New Jersey Supreme Court has held the economic loss doctrine bars tort-based claims when they are duplicative of breach of warranty or breach of contract claims; that is, when no personal injury or damage to property other than the subject matter of the warranty or contract is alleged.[12] A trial court judge[13] recently held that because the plaintiff's negligence claims (the plaintiff in this case did not assert any claims against any of the developer's subcontractors) against the defendant developer were dismissed based upon tenets of the economic loss doctrine, the defendant developer's claims for contractual indemnity based upon the subcontractor's negligence were extinguished.

Conclusion

The best laid intentions for indemnity clauses are not always enforced by New Jersey federal and state courts. Nevertheless, parties involved in complex construction projects will continue to craft indemnification provisions that transfer liability and exposure from the indemnitor to the indemnitee.

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Endnotes

1. *Azurak v. Corporate Property Investors,* 347 N.J. Super. 516 (App. Div. 2002); *Mantilla v. NC Mall Associates,* 167 N.J. 262 (2001); *Ramos v. Browning Ferris Industries of South Jersey, Inc.,* 103 N.J. (1986).
2. *Mantilla v. NC Mall Associates,* 167 N.J. 262 (2001); *Ramos v. Browning Ferris Industries of South Jersey, Inc.,* 103 N.J. (1986).
3. 389 N.J. Super. 44 (App. Div. 2006).
4. *Id.*

5. 2008 WL 2572685 (July 1, 2008, App. Div.).
6. *Id.*
7. 496 F. Supp.2d 668 (E.D. Va. 2007).
8. *Id.* at 669-670.
9. *Id.*
10. *Id.*
11. *Id.* at 672.
12. *Spring Motors Distribution, Inc. v. Ford Motors, Co.,* 98 N.J. 555 (1985); *Saltiel v. GSI Consultants, Inc.,* 170 N.J. 297 (2002).
13. *The Plaza Grande at Old Bridge Condominium Association, Inc. v. D.R. Horton, Inc. New Jersey, et al.* Docket No. MID-L-5710-09.