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Introduction to Interpretation of Express Contractual Indemnity Provisions in Construction Contracts under California and Nevada Law, An

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An Introduction to Interpretation of Express Contractual Indemnity Provisions In Construction Contracts Under California and Nevada Law

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I. INTRODUCTION

This law review article will provide a basic framework for preparing, evaluating and analyzing the legal parameters of express contractual indemnity provisions. Research and analysis have been conducted for the purpose of summarizing indemnity provisions in general terms, as well as to position the provisions within the context of the real legal world to assess real outcomes.

Indemnity issues ordinarily arise in the construction litigation context, wherein a plaintiff is either injured related to an on-site accident or where there are damages arising out of allegations of defective construction. Responsibility for the potential exposure is the subject of this discussion, considering that many different parties perform work on any given project and are, invariably, all named in a lawsuit.

The owner, developer, general contractor and subcontractors are normally joined into the litigation either as defendants or as third-party defendants. As with most commercial building projects, the parties are related by way of a number of written contracts. Many of the contracts contain express indemnity provisions and insurance provisions. Specific analysis of the express contractual indemnity language is required in each case. Finding legal precedent in the appropriate jurisdictions interpreting the specific express contractual indemnity language, is often helpful.

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II. DEFINING EXPRESS CONTRACTUAL INDEMNITY

Parties to contracts are free to contract for terms of express contractual indemnity under California law and Nevada law. In so contracting, parties may seek to solidify their intentions with respect to indemnification and to avoid application of principles of implied indemnity in the event of a loss arising out of their relationship.

The principle of indemnity has been defined repeatedly in California case authorities. For example, in *Rossmoor Sanitation, Inc. v. Pylon, Inc.*, the California Supreme Court defined indemnity as, "an obligation resting on one party to make good a loss or damage another party has incurred."[1]

The parties to construction contracts are certainly free to negotiate and enter into express contractual indemnity provisions limited only by specific statutes which have codified California public policy and, to a more limited extent, Nevada public policy.[2] A limitation unique in the construction contract context is one which prevents a party seeking indemnity (the indemnitee) to contractually obligate the party providing indemnity (the indemnitor) to liability for the "sole negligence" of the indemnitee. Simply stated, this prevents the indemnitee from seeking to obtain and/or enforce an indemnity clause which requires the indemnitor to provide indemnity for losses that are the result of the sole negligence of the indemnitee.

The Nevada Revised Statutes (NRS) 17.225 provides that "where two or more persons become jointly or severally liable in tort for the same injury to person or property or for the same wrongful death, there is a right of contribution among them even though judgment has not been recovered against all or any of them."[3] The same statute also states that no tortfeasor is compelled to contribute beyond his or her own equitable share of the entire liability.[4] However, NRS 17.265 states that "[e]xcept as otherwise provided in NRS 17.245, the provisions of NRS 17.225 to 17.305, inclusive, do not impair any right of indemnity under existing law. Where one tortfeasor is entitled to indemnity from another, the right of the indemnity obligee is for indemnity and not contribution."[5] Hence, Nevada law allows for indemnity, but is elusive as to the meaning of the phrase "impair any right under existing law."

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1. Rossmoor Sanitation, Inc. v. Pylon Inc., 532 P.2d 97, 100, 13 Cal. 3d 622, 628, 199 Cal. Rptr. 119, 452 (1975).

2. *See generally*, Nev. Rev. Stat. 17.225-17.305 (2000), inclusive, which codifies Nevada law regarding rights to contribution and indemnity.

3. *Id.* 17.225(1) (1999).

4. *Id.* 17.225(2).

5. *Id.* 17.265 (2000).

III. INTERPRETING EXPRESS INDEMNITY PROVISIONS

Generally, express indemnity provisions are subject to the same rules governing contract interpretation. Hence, courts will first look to the "plain language" of a contractual indemnity provision in seeking to ascertain the parties' intent. Obviously, review of the express contractual indemnity language is subject to the statutory limitations discussed above and any other public policy concerns raised by the language in question.

For example, in Nevada, additional applicable statutory sections of concern include NRS 40.640[6] and NRS 41.141.[7] The existing case law in California,

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6. *Id.* 40. 640 (1999) states:

In a claim to recover damages resulting from a constructional defect, a contractor is liable for his acts or omissions or the acts or omissions of his agents, employees or subcontractors and is not liable for any damages caused by:

1. The acts or omissions of a person other than the contractor or his agent, employee or subcontractor;
2. The failure of a person other than the contractor or his agent, employee or subcontractor to take reasonable action to reduce the damages or maintain the residence;
3. Normal wear, tear or deterioration;
4. Normal shrinkage, swelling, expansion or settlement; or
5. Any constructional defect disclosed to an owner before his purchase of the residence, if the disclosure was provided in language that is understandable and was written in underlined and boldfaced type with capital letters.

7. *Id.* 41.141 (1999) states:

1. In any action to recover damages for death or injury to persons or for injury to property in which comparative negligence is asserted as a defense, the comparative negligence of the plaintiff or his decedent does not bar a recovery if that negligence was not greater than the negligence or gross negligence of the parties to the action against whom recovery is sought.
2. In those cases, the judge shall instruct the jury that:
   (a) The plaintiff may not recover if his comparative negligence or that of his decedent is greater than the negligence of the defendant or the combined negligence of multiple defendants.
   (b) If the jury determines the plaintiff is entitled to recover, it shall return:
      (1) By general verdict the total amount of damages the plaintiff would be entitled to recover without regard to his comparative negligence; and
      (2) A special verdict indicating the percentage of negligence attributable to each party remaining in the action.
3. If a defendant in such an action settles with the plaintiff before the entry of judgment, the comparative negligence of that defendant and the amount of the settlement must not thereafter be admitted into evidence nor considered by the jury. The judge shall deduct the amount of the settlement from the net sum otherwise recoverable by the plaintiff pursuant to the general and special verdicts.
4. Where recovery is allowed against more than one defendant in such an action, except as otherwise provided in subsection 5, each defendant is severally liable to the plaintiff only for that portion of the judgment which represents the percentage of negligence attributable to him.
5. This section does not affect the joint and several liability, if any, of the defendants in an action based upon:

(a) Strict liability;
(b) An intentional tort;
(c) The emission, disposal or spillage of a toxic or hazardous substance;

Nevada and the Ninth Circuit generally seem to extricate express contractual indemnity provisions from statutory sections such as the above, but an argument can always be made to the effect that these statutory provisions effectuate the public policy of the state and, thus, any contractual provision contrary to that stated statutory language is contrary to public policy. The Nevada Supreme Court, when dealing with express indemnity issues arising in an insurance context, stated that although statute may prevent the enforcement of express indemnity provisions, as a matter of public policy, we conclude "as a matter of public policy, we conclude the indemnity contracts in these cases should be enforced because they allocate risk."[8] The Nevada Supreme Court's position, however, should be analyzed against an earlier decision that stated "[l]iberty of contract is not a universal right and may be abridged when required for the public good."[9]

One of the primary areas of interpretative concern surrounds which risks the parties have agreed are covered by the indemnity provisions. In this context, the intention of the parties is controlling. Again, in *Rossmoor*, the California Supreme Court stated: "Where, as here, the parties have expressly contracted with respect to the duty to indemnify, the extent of that duty must be determined from the contract and not reliance on the independent doctrine of equitable indemnity."[10] Further, the Court stated:

> [W]e hold that . . . the question whether an indemnity agreement covers a given case turns primarily on contractual interpretation, and it is the intent of the parties as expressed in the agreement that should control. When the parties knowingly bargain for the protection at issue, the protection should be afforded.[11]

The California Supreme Court indicated, therefore, that interpretation of express contractual indemnity provisions will be employed on a case-by-case basis, governed by the unique circumstances of the damage or injury sought to be indemnified in the language of the contract is at issue.[12]

Another important interpretative area also concerns an analysis of whether or not the parties' contract contains an obligation for the indemnitor (the party

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(d) The concerted acts of the defendants; or

(e) An injury to any person or property resulting from a product which is manufactured, distributed, sold or used in this state.

6. As used in this section:

(a) "Concerted acts of the defendants" does not include negligent acts committed by providers of health care while working together to provide treatment to a patient.

(b) "Provider of health care" has the meaning ascribed to it in NRS 629.031.

8. American Fed. Savings Bank v. County of Washoe, 802 P.2d 1270, 1275, 106 Nev. 869, 876 (1990).

9. Lawson v. Halifax-Tonopah Mining Co., 35 P.2d 606, 611, 36 Nev. 591, 592 (1913).

10. Rossmoor, 532 P.2d at 100, 13 Cal. 3d at 628, 119 Cal. Rptr. at 452.

11. *Id.* at 104, 13 Cal. 3d at 633, 119 Cal. Rptr. at 456.

12. *Id.* at 104, 13 Cal. 3d at 633, 119 Cal. Rptr. at 456.

supplying indemnity) to indemnify the indemnitee (the party receiving indemnity) for the indemnitee's negligence. Arising from this question, one frequently cited California appellate decision is *MacDonald & Karuse, Inc. v. San Jose Steel Co.*[13] This case is responsible for categorizing express contractual indemnity agreements into three types. Prior to a discussion of the three types of indemnity agreements outlined in the *MacDonald* case, it should be noted that, pursuant to subsequent California case authority, categorization of indemnity agreements into the three categories should *not* be strictly applied since courts have ruled that the intent of the parties entering into express contractual indemnity agreements controls. The State of Nevada also follows this format.

Notwithstanding the above reservation, the *MacDonald* case is famous for its designation of express contractual indemnity agreements into Type I, Type II and Type III. The three categories of express indemnity agreements are explored below.

A. Type I

From the perspective of the indemnitor, a Type I express contractual indemnity agreement is the least favorable. Under a Type I agreement, the indemnitor will indemnify the indemnitee for the indemnitee's own negligence, whether the indemnitee is solely negligent or jointly negligent with the indemnitor. Subject to the limitations required by the California Civil Code and the Nevada Revised Statutes with respect to the "sole negligence" of the indemnitee in a construction contract context, this type of indemnity agreement clearly calls for the broadest indemnity coverage for the indemnitee. In a Type I indemnity agreement, the indemnitor could be obligated to indemnify the indemnitee even where the indemnitor did not engage in any measure of negligence. Moreover, the courts do not concern themselves with the character of the negligence engaged in by the indemnitee for which the indemnitee ultimately seeks indemnification. In addition, the active versus passive distinction applicable to Type II agreements, explained *infra*, is not a concern.

B. Type II

The Type II indemnity agreement is more favorable to the indemnitor. These agreements are also commonly referred to by the courts as "general indemnity" agreements. Under a Type II agreement, the indemnitor must indemnify the indemnitee for liability arising from the indemnitor's negligence and from the indemnitee's concurrent passive negligence. A Type II indemnity agreement does not require the indemnitor to indemnify the indemnitee for the indemnitee's active negligence.

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13. 105 Cal. Rptr. 725, 29 Cal. App. 3d 413 (1972).

Type II indemnity agreements frequently involve extensive analysis and argument concerning the nature of the negligence ultimately alleged against the indemnitee and, generally, significant litigation results concerning whether or not the express indemnity provisions agreed to by the parties require indemnification of the negligence of the indemnitee.

The distinction between active and passive negligence can, in general terms, be broken down as follows:

> An indemnitee who participates in some manner in the conduct or failure to act that is determined the cause of injury and which is beyond the mere failure to perform imposed by law is actively negligent and therefore not entitled to indemnity under a Type II indemnity agreement. By contrast, an indemnitee who is saddled with a measure of liability for the failure to perform the duty of care imposed by law, for which there is no participation with another in any affirmative active negligence that is determined the proximate cause of injury to a third person, may be determined to be passively negligent and subject to indemnification under a Type II agreement.

The distinction between active and passive negligence is a complex one, involving numerous court opinions. It could easily comprise a separate and distinct law review article.[14]

C. *Type III*

A Type III indemnity clause should be distinguished from a Type II or "general indemnity" clause in that the parties to the agreement have expressly announced their intention that the indemnitor will not indemnify the indemnitee for any negligence which is attributable to the acts or omissions of the indemnitee, regardless of whether said acts or omissions constitute active or passive negligence. As discussed in detail in case law, in order for the courts to construe an indemnity clause as that of Type III, the language should explicitly express the parties' intention that the indemnitor will not indemnify the indemnitee for any negligence of the indemnitee. There are exceptions to this rule, such as where the contract clause is ambiguous or unclear.

Language similar to, "but only to the extent caused in whole or in part by negligent acts or omissions of [the indemnitor]," indicates that a Type III indemnity provision exists. Obviously, legal research to locate other cases which contain language similar or identical to the language contained in the indemnity provision at issue is often helpful as well.

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14. Examples of the distinction between active and passive negligence in Nevada are *Black & Decker v. Essex Group*, 775 P.2d 698, 105 Nev. 344 (1989) (setting case precedent), and *Medallion Development, Inc. v. Converse Consultants*, 9330 P.2d 115, 113 Nev. 27 (1997).

IV. CLASSIFICATION OF INDEMNITY PROVISIONS: PRACTICAL MATTERS

The development of computer-assisted legal research over the past twenty years has greatly enhanced the ability of attorneys to locate specific case precedent with identical or near similar language. The attorney is thereby enabled to provide comprehensive recommendations to the client or insurance carrier charged with the responsibility for making decisions related to a contractual indemnity provision during the course of litigation.

Obviously, a more proactive approach, which would assist the litigation attorney, is a comprehensive transactional analysis of the contract agreement by the transactional attorney prior to the execution of that agreement by the parties involved. Unfortunately, the reality is that the subcontractor often signs an indemnity provision in a construction contract with little or no thought, or without legal representation, so that the trial attorney is later faced with interpretation of these provisions during litigation.

Again, locating specific case precedent which mirrors the language of the contract being interpreted is important. An initial reading of the contract language may cause the legal mind analyzing the provision to first conclude that the provision is a Type I indemnity provision. However, as one becomes more familiar with these types of provisions it becomes clear that provisions which initially appear to be Type I, are often not. An example of such a contractual indemnity provision is:

> *To the fullest extent permitted by law, the subcontractor shall indemnify and hold harmless the Owner, Contractor, Architect, Architect's consultants, and agents and employees or any of them from and against claims, damages, losses and expenses, including, but not limited to, attorneys' fees arising out of or resulting from performance of the subcontractor's work under this subcontract, provided that such claim, damage, loss or expense is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property including the work itself and including loss of use resulting therefrom, but only to the extent caused in whole or in part by negligent acts and/or omissions of the subcontractor, subcontractor's sub-subcontractors, anyone directly or indirectly employed by them or by 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 identified hereunder. Such obligation shall not be construed to negate, abridge, or otherwise reduce other rights or obligations of indemnity which would otherwise exist to a party or person described in this paragraph.*[15]

15. This language is seen in many contracts between general contractors and subcontractors; and practitioners are faced with the challenge of interpreting its language.

Initial review of this sample contract provision could result in the incorrect conclusion that the subcontractor has agreed to indemnify the general contractor and others for any negligent act if the negligent act is caused in part by the subcontractor, or, in the context of our analysis, the contract contains a Type I indemnity agreement. However, a careful review of the case law and familiarity with these types of indemnity provisions results in a contrary conclusion.

The indemnity is limited to indemnity for acts proximately caused only by the negligent acts or omissions of the subcontractor. In other words, this contract provision should be interpreted as a Type III indemnity agreement. Under this agreement, the subcontractor has expressly indicated the intention not to provide indemnity to the general contractor or the developer or others for any negligence of other entities or persons. In effect, the subcontractor has limited indemnity to its own acts, the acts of its employees, its subcontractors or anyone it controls or for whom the subcontractor is responsible.

The courts, in interpreting these contract provisions, have stated their intention to strictly construe indemnity provisions against the party responsible for the drafting of the agreement. This is particularly true where the party seeking indemnity is attempting to obtain indemnification for its own negligent acts, based upon an express Type I indemnity clause.

In the now-famous Nevada case *Calloway v. City of Reno*,[16] the supreme court stated:

> Indemnity clauses are strictly construed, particularly when the indemnitee claims that it should be indemnified against its own negligence. Ambiguous indemnity contracts are construed against the indemnitee, particularly when the indemnitee was the drafter of the agreement. In fact, when an indemnitee seeks indemnity for its own negligent acts based on an express indemnity clause, the indemnity clause must clearly and unequivocally express the indemnitor's assumption of liability for the negligent acts of the indemnitee.[17]

The question that then arises is: How will a court, saddled with the task of interpreting the intentions of the parties, interpret the language used in the context? An example of this interpretation is contained in the case precedent of *Continental Heller Corp. v. Amtech Mechanical Services, Inc.*[18] The court concluded that an agreement which provided for the subcontractor to indemnify a general contractor for a loss "which arises out of or is in any way connected" with the subcontractor's "acts or omissions" did not require a showing that the subcontractor was at fault in causing the general contractor's loss or that its

16. 939 P.2d 1020, 113 Nev. 564 (1997).
17. *Id.* at 1028, 113 Nev. at 577.
18. 61 Cal. Rptr. 2d 668, 53 Cal. App. 4th 500 (1997).

performance was a "substantial" or "predominating" cause of the loss.[19] The court also indicated that the mutual intention of the parties will control and, unless given some special meaning by the parties, the words of a contract are to be understood in their "ordinary and popular sense."[20]

The attorney, client, claims unit manager or claims specialist analyzing an express indemnity provision obviously hopes to find a case which contains the express contractual language at issue, wherein the language stated has been used in other contracts by other contracting parties and interpreted by courts in a favorable way for them.

An example in the United States District Court for the Western District of New York is *Fiske v. Church of St. Mary of the Angels,*[21] which resulted in an opinion by the trial court confirming the validity of the language of indemnification employed in the contract, referenced above, as an expression of the parties' intention that the indemnitor not be responsible to indemnify the indemnitee for the indemnitee's negligence.

Jerome Fiske was an employee of Fiske II, a Pennsylvania corporation involved in repairing and replacing the roof of the St. Mary's Church in Olean, New York. Prior to the accident, St. Mary's contracted with the general contractor, Whitford, for rehabilitation of St. Mary's Church. Whitford and St. Mary's Church entered into a contract containing indemnification provisions between St. Mary's Church and Whitford. Under the contract with St. Mary's, Whitford was given the responsibility for hiring subcontractors to complete the necessary repair. As such, in October of 1988, Fiske II was hired as a subcontractor by Whitford. The contract between Fiske II and Whitford contains the following indemnification language:

> To the fullest extent permitted by law, the Subcontractor shall indemnify and hold harmless the Owner, Contractor, 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 attorneys' fees, arising out of or resulting from performance of the Subcontractor's Work under this Subcontract, provided that such claim, damage, loss or expense is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the Work itself) including loss of use resulting therefrom, but only to the extent caused in whole or in part by negligent acts or omissions of the Subcontractor, the Subcontractor's Sub-subcontractors, anyone directly or indirectly employed by them or by 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. Such obligation shall

19. *Id.* at 668, 53 Cal. App. 4th at 500.
20. *Id.* at 670, 53 Cal. App. 4th at 504.
21. 802 F. Supp. 872 (W.D.N.Y. 1992).

> not be construed to negate, abridge, or otherwise reduce other rights or obligations of indemnity which would otherwise exist as to a party or person described in this Paragraph.[22]

The *Fiske* court analyzed the above indemnification language in the context of a motion for summary judgment, filed by the general contractor, Whitford, against Fiske II, pursuant to the indemnification language. Whitford's argument was essentially that the injured plaintiff, Jerome Fiske, was at the time of the accident under the direct supervision and control of Fiske II and that Fiske II had primary and ultimate responsibility for his safety. Therefore, Whitford argued that Fiske II was responsible for any negligence resulting in the accident and the ultimate injury sustained by the plaintiff and, thus, Fiske should fully indemnify Whitford pursuant to the terms of the express indemnity clause. Also at issue, was the contention of Fiske II, in opposition to the motion for summary judgment, that one or more material issues of fact remained concerning whether or not Whitford was negligent in any regard and, therefore, could not benefit from the provisions of the express contractual indemnity agreement with Fiske II.

The trial court ruled:

> After reviewing the evidence presented in the record, including affidavits and deposition testimony, the court concludes that material issues of fact remain as to whether the accident resulted from any negligence on the part of Whitford. If negligence on the part of Whitford can be established, Whitford will be at least partially responsible for any damages awarded to plaintiff as the contractual indemnification clause specifically states that indemnification would only be given to Whitford for damages resulting from the negligence of Fiske II or its subcontractors.[23]

In so holding, although unique to the procedural circumstances presented to the court at that time, the *Fiske* court specifically determined that the express contractual indemnity language at issue prevented Whitford (the indemnitee) from seeking indemnity by Fiske II (the indemnitor) for Whitford's negligence, if any negligence were to be found. Although the court refused to grant summary judgment on the basis that one or more material factual issues remained to be determined with respect to any negligence on the part of Whitford, it is clear from the ruling of the court that the contractual indemnity provisions did not require Whitford to indemnify Fiske II for Whitford's negligence, regardless of whether the negligence was deemed active or passive.

In California, this would be deemed a Type III indemnity provision under the old California system, which is no longer expressly utilized and, pursuant to

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22. *Fiske*, 802 F. Supp. at 883-84 (emphasis omitted).
23. *Id.*

subsequent case authority, courts should not strictly apply categorization. In Nevada, it would be deemed an indemnity provision which provides the same ultimate outcome without use of the classification system expressed in previous cases.

The precedent of *Regional Steel*[24] considered indemnity language similar to that discussed above. After a lengthy introduction of interpretation of express indemnity provisions, the Court stated that because the parties expressly contracted to limit their liability, joint tortfeasor liability was precluded and the Court granted summary judgment to Regional Steel Corporation.[25]

V. CONCLUSION

Certainly there is much variance in both statutory and case law precedent concerning the force and effect of contractual express indemnity clauses. A provision may be voided based upon statutory authority precluding such a provision. However, if there is no statute precluding such a provision, then the intent of the parties in contracting becomes a subject of debate. If given justifiable reason, the courts will enforce these problematic provisions. Certainly, a trial practitioner is loath to inform his or her client that it will be indemnifying a developer and/or general contractor for defects or injuries it had no part in creating. Thus, the need to clearly and articulately draft the provisions in the first instance, before litigation commences, is paramount. The effective transactional attorney should be ever mindful of the need to protect the client's interests and draft provisions that are equitable to all and which will later survive judicial scrutiny. The litigation attorney should be aware of the various and competing issues surrounding interpretation of these clauses.

24. Regional Steel Corp. v. Superior Court, 32 Cal. Rptr. 2d 417, 25 Cal. App. 4th 525 (Cal. App. 4th Dist. 1994).

25. *Id.* at 419, 25 Cal. App. 4th at 529.