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CONSTRUCTION LAW

# The Importance Of Contractual Indemnification

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Construction involves risk. The opportunity for injury or property damage resulting from construction operations is great and the list of potential plaintiffs—construction workers, visitors to the site, passersby, owners of neighboring properties—is long. More often than not, an owner has little or no control over construction operations occurring at its property and is not in a position to manage construction site safety or to prevent accidents. The result is that owners often find themselves defendants in actions stemming from accidents that they had no hand in causing and could not reasonably have prevented. Although the owner likely has liability insurance that is designed to defend and to indemnify itself against such claims, it will likely have to pay a deductible or self-insured retention, and may find itself paying higher insurance premiums in the future, and its potential liability may exceed the limits of the applicable policy. The owner may also incur liability for things that its insurance will not cover, such as municipal fines or third-party claims for pure economic loss unrelated to bodily injury or property damage. How does the owner protect itself?

Enter the indemnification clause. Indemnification clauses are nearly ubiquitous in construction contracts, yet they are too often misunderstood, and sometimes misused. Indemnification clauses, if not drafted correctly, may result in unintended consequences, may not provide the protection for which they were designed, and in some instances, may be entirely void. Because of these inherent pitfalls, this article is intended to provide practical guidance to those who draft and review indemnification provisions for use in construction contracts.

## Why Indemnify?

What is it about a construction contract that makes an indemnification clause so important? Construction operations are, of course, inherently dangerous and an owner naturally wants to transfer risk to the contractors and subcontractors who are in a better position to control that risk. While the indemnification clause can accomplish that risk transfer, it also serves two other critical functions.

First, it provides rights of indemnification and/or contribution that the owner would not have at common law. For example, if a construction worker is injured on the job and sues the owner, the provisions of the Worker's Compensation Law may prohibit the owner from seeking contribution against the construction worker's employer. The indemnification clause can overcome that prohibition.

Second, the indemnification clause may be required in order to make the contractor's liability insurance available to the owner in the event that the owner incurs tort liability as a result of the actions of the contractor or its subcontractors. The construction contract will typically require the contractor to maintain general liability insurance and will often specify minimum levels of insurance that the contractor must carry. Owners often rely on the contractor's liability insurance to protect not only the contractor, but also the owner in the event that the owner incurs liability as a result of the contractor's operations. The contract may also require that the owner be named as an "additional insured" on the contractor's liability policy. But even with these provisions in the contract, the owner may not have

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the benefit of the contractor's insurance if the contract does not also contain an indemnification clause.

### Exception to the Exclusion

Every commercial general liability (CGL) policy will contain a contractual liability exclusion that excludes from coverage:

> "Bodily injury" or "property damage" for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement.[1]

In a nutshell, the CGL policy will not cover liability that the named insured assumes voluntarily. There are exceptions to the contractual liability exclusion, however, (1) for liability that the insured would have had in the absence of a contract or agreement or (2) where the liability is assumed in a contract that is an "insured contract." It is the "insured contract" exception that makes the indemnification clause important. The definition of an "insured contract" typically includes:

> That part of any other *contract or agreement pertaining to your business*…under which you *assume the tort liability of another party* to pay for "*bodily injury" or "property damage*" to a third person or organization.[2]

The indemnification clause contained in the contract between the owner and the contractor, whereby the contractor assumes the tort liability of the owner for bodily injury or property damage to others, creates the "insured contract" that is necessary to overcome the contractual liability exclusion in the CGL policy. Without a valid indemnification clause, coverage under the contractor's insurance may not be available to the owner.[3]

### 'Additional Insured'

The status of an "additional insured" (AI) is often misunderstood. It is not the same as a "named insured." It is not an "additional named insured." It does not provide first-party coverage (coverage for loss suffered directly by the additional insured), and it does not provide coverage for liability resulting from the additional insured's own acts of negligence.

The named insured is the person to whom the policy was issued. The named insured has all of the protections afforded by the policy, as well as all of the obligations to pay premiums, provide timely notice of claims to the carrier, etc. The additional insured, on the other hand, has the benefit of the GCL policy, but only to the extent that the additional insured incurs liability as a result of the act of the named insured (or anyone for whose acts the named insured is liable).

> Construction operations are, of course, inherently dangerous and an owner naturally wants to transfer risk to the contractors and subcontractors who are in a better position to control that risk.

AI coverage and the indemnification clause operate independently of one another. The indemnification clause is covered under the "insured contract" exception contained in the CGL policy, while the AI coverage is added by endorsement to the policy. The existence of the indemnification clause, however, is sometimes necessary to trigger AI coverage.

There are perhaps as many as 30 AI endorsements in use in the insurance industry. Some forms of endorsements are standard forms drafted by ISO, while others are manuscript and carrier specific. Some forms of AI endorsement will provide AI coverage only to the extent that the named insured has assumed the obligation to provide the AI coverage by written agreement, which means that there must be a written agreement between the named insured and the additional insured and the agreement must contain a requirement to provide AI coverage. Furthermore, some endorsements may provide AI coverage only to the extent that the named insured has agreed in writing to indemnify the AI, which means that there not only has to be a written agreement between the named insured and the AI, but the agreement must also contain an indemnification clause in favor of the AI.[4]

### The Obligation to Defend

In addition to the obligation to indemnify, there should also be an obligation to defend. In a CGL policy, the obligation to defend is broader than the obligation to indemnify. The carrier must defend its insured even if it is ultimately determined that the insured was not liable to the aggrieved party. Similarly, an owner will want its contractor to step in and defend claims against the owner for which the owner is entitled to indemnification. Without the express obligation to defend set forth in the applicable agreement, the owner will be forced to incur the costs of its own defense which may or may not be recoverable from the contractor. Indeed, even if the indemnification clause qualifies as an "insured contract" under the contractor's CGL policy, defense may not be available to the owner unless "[t]he obligation to defend, or the cost of the defense of, [the] indemnitee, has also been assumed by the insured in the same 'insured contract.'"[5]

### 'To the Fullest Extent…'

New York General Obligations Law General Obligations Law (GOL) §5-322.1 provides, in part:

> A covenant, promise, agreement or understanding in, or in connection with or collateral to a contract or

> agreement relative to the construction, alteration, repair or maintenance of a building, structure, appurtenances and appliances…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 promise… is against public policy and is void and unenforceable.

In *Itri Brick & Concrete v. Aetna Casualty & Surety*,[6] an employee of a subcontractor was injured on the job. The employee was prevented from suing his employer because of the Worker's Compensation Law,[7] so the employee sued the general contractor. The general contractor, in turn, sought contractual indemnification from the subcontractor/employer based upon the indemnification clause contained in the parties' agreement. The Court of Appeals refused to enforce the indemnification clause, and, as a result, the subcontractor's liability insurance was not available to the general contractor.

The court held that an indemnification provision that is so broad as to require full indemnification even if the indemnitee is partially at fault is totally void and unenforceable. The court refused to enforce the indemnification provisions even to the extent that the indemnitor was culpable.

On facts similar to *Itri Brick*, the court in *Judlau Contracting v. Brooks*,[8] determined that the general contractor was entitled to partial indemnification from its subcontractor for that portion of the claim not attributable to the general contractor's negligence. Although the subject indemnification provision did not specifically exclude indemnification for the negligent acts of the indemnitee, the court held that "the phrase 'to the fullest extent permitted by law' limits rather than expands a promisor's indemnification obligation," and saves an otherwise overly broad indemnification provision from being declared void and unenforceable in its entirety.[9]

## The Owner's Dilemma

Sections 240 and 241 of the New York Labor Law impose upon owners a strict, non-delegable duty to provide a safe work place for construction operations performed on the owner's property, regardless of the owner's ability to control or direct the construction operations.[10] If a construction worker can demonstrate a violation of the statute and that the violation was the proximate cause of the worker's injury, the worker is entitled to recover compensation from the owner and from the general contractor, regardless of actual fault and irrespective of any comparative negligence on the part of the worker.[11] If that same construction worker is an employee of the contractor, the Worker's Compensation Law limits the amount the worker is entitled to recover from his or her employer.[12] The worker can, however, pursue the owner for additional recovery and the owner has no defense based upon the fact that the owner was not in control of the job site or the conditions that caused the injury.[13] The owner will, of course, want to pursue a claim for indemnification or contribution against the contractor; however, the owner might be surprised to find that unless the employee has suffered a "grave injury"[14] the Worker's Compensation Law also protects the employer against third-party claims for contribution stemming from injuries to the contractor's employees. There is an exception to that protection, however, when the owner's claim for indemnification is:

> based upon a provision in a written contract entered into prior to the accident or occurrence by which the employer had expressly agreed to contribution to or indemnification of the claimant or person asserting the cause of action for the type of loss suffered.

Accordingly, indemnification clauses should contain language that makes it clear that the obligation to indemnify (1) includes liability imposed upon the indemnitee solely by statute or operation of law (e.g. Labor Law §§240 and 241) and (2) includes liability resulting from claims of bodily injury or property damage by anyone employed by the contractor or its subcontractors.

## Conclusion

Although indemnification provisions are standard in most construction contracts, careful consideration should be given to the precise language used (and not used) so as to ensure that the clause provides the fullest protection intended and to prevent it from being deemed altogether void.

1. This language is taken from the Insurance Services Office Inc. (ISO) CGL form CG 00 01 12 07. The CG 00 01 12 07 is the ISO's most current CGL policy form as of this writing, however, a revised form of GCL policy with significant changes is expected to be issued by ISO in April 2013.
2. ISO Form GC 00 01 12 07 (emphasis added). The "insured contract" exception can be changed by endorsement, which means that there is no assurance that the exception applies unless you have reviewed the entire policy including all endorsements.
3. *Itri Brick & Concrete v. Aetna Casualty & Surety*, 89 NY2d 786, 791 (1997).
4. Since AI endorsements are not uniform, the only way to determine whether and to what extent AI coverage is being provided is to obtain a copy of the endorsement and to confirm that the contract language complies with the requirements of the AI endorsement.
5. ISO Form CG 00 01 12 07.
6. 89 NY2d 786 (1997).
7. New York Worker's Compensation Law §11.
8. 11 N.Y.3d 204 (2008).
9. 11 N.Y.3d at 210.
10. New York Labor Law §§240 and 241.
11. *Zimmer v. Chemung County Performing Arts*, 65 NY2d 513, 521 (1985).
12. New York Workers' Compensation Law §11.
13. *Zimmer*, 65 NYS2d at 521.
14. A "grave injury" is defined in the statute to include death, permanent loss of use or amputation of a limb, permanent disability as a result of a brain injury and certain other disfiguring and/or disabling injuries.