



Indemnity Primer

by Dan Jacobson¹

Indemnity is one of those core legal concepts that virtually every lawyer encounters somewhere down the line. Although judicial approaches to indemnity have shifted over the years, one rule holds firm: If there is an indemnity agreement, the actual words of that agreement will control. Indeed, as Justice William W. Bedsworth of the Fourth Appellate District reminds us: "If the first rule of medicine is 'Do no harm,' the first rule of contracting should be 'Read the documents.' " (*Villacreses v. Molinari*, 132 Cal. App. 4th 1223, 1225 (2005).)

Indemnity Basics

California statutes define indemnity as "a contract by which one engages to save another from a legal consequence of the conduct of one of the parties, or of some other person." (Cal. Civ. Code § 2772.) The state Supreme Court has noted that indemnity "may be defined as the obligation resting on one party to make good a loss or damage another party has incurred." (*Rossmoor Sanitation, Inc. v. Pylon, Inc.*, 13 Cal. 3d 622, 628 (1975).) Although the parties have great flexibility in crafting their indemnity deal, the law prohibits a contract to indemnify for acts known to be illegal at the time they are committed. (Cal. Civ. Code § 2773.)

Sometimes indemnity is grounded in a contract; but it can also be grounded in equity. (*Prince v. Pacific Gas & Elec. Co.*, 45 Cal. 4th 1151, 1158 (2009).)

As for terminology, the *indemnitor* is the party obligated to pay the *indemnatee*. (See *Maryland Casualty Co. v. Bailey & Sons, Inc.*, 35 Cal. App. 4th 856, 864 (1995).) Contract-based indemnity is referred to in the case law as either "express indemnity" (*Prince*, 45 Cal. 4th at 1158) or "contractual indemnity" (*Rossmoor*, 13 Cal. 3d at 634).

Mythical Rule

In 1972 an intermediate California appellate court classified indemnity agreements as Type I, Type II, and Type III. (See *MacDonald & Kruse, Inc. v. San Jose Steel, Inc.*, 29 Cal. App. 3d 413, 419- 421 (1972).) Just three years later, however, the state Supreme Court dealt with various types of indemnity agreements in the *Rossmoor* case and never even mentioned the *MacDonald & Kruse* classifications. And three short years after *that*, another intermediate appellate tribunal ruled that "the *MacDonald & Kruse* classification is no longer tenable in light of *Rossmoor*." (*Rodriguez v. McDonald Douglas Corp.*, 87 Cal. App. 3d 626, 674 (1978).)

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In 2005 the legal community was admonished that the *MacDonald & Kruse* nomenclature had been leading parties astray and would no longer be followed. (See *McCrary Construction Co. v. Metal Deck Specialists*, 133 Cal. App. 4th 1528, 1538- 1539 (2005).) In fact, a careful reading of the *MacDonald & Kruse* opinion reveals that the justices who authored it meant only for their classifications to aid indemnity agreement discussions, not create legal rules; even at that, the opinion splitting indemnity clauses into three distinct categories issued from a divided court. (See *MacDonald & Kruse*, 29 Cal. App. 3d at 418-421.)

Despite the courts' decades-long rejection of the Type I, II, and III language, lawyers today continue to use those terms - and many continue to think such labeling leads directly to legal conclusions. For example, the *MacDonald & Kruse* opinion classified a Type III indemnification clause as one that provides indemnity only for the indemnitor's negligence. If an attorney mistakenly applies this classification as law, he or she might look for language requiring indemnity for only the indemnitor's negligence and then smugly conclude that the indemnity agreement is a Type III; the lawyer may then mistakenly assume that because the agreement is a Type III, it requires indemnity only for the indemnitor's negligence.

Such mechanical, circular logic *may* lead the lawyer to a correct legal conclusion, but that conclusion will surely lack any nuance contained in the specific language of the indemnity agreement itself - and there may well be language in the governing clause that raises considerations beyond the Type III categorization. In short, one can't know what the indemnity agreement really says - much less what it truly means - without reading it very carefully. As various courts have opined, "it is the intent of the parties as expressed in the agreement that should control." (*Zalkind v. Ceradyne, Inc.*, 194 Cal. App. 4th 1010, 1024-1025 (2011), quoting *Rossmoor*, 13 Cal. 3d at 633.)

Contract Interpretation

Although there are many statutory guides for interpreting contracts in general (for example, Cal. Civ. Code §§ 1635- 1663), some specific rules cover indemnity agreements. (See for example Cal. Civ. Code §§ 2778- 2782.96.) Two of the most important provisions are found in section 2778, and they deal with the obligation of defense. One part of the section states that indemnity against claims, demands, or liabilities "embraces the costs of defense" that are "incurred in good faith, and in the exercise of a reasonable discretion." (Cal. Civil Code § 2778(3).) Moreover, upon request by the indemnitee, the indemnitor is bound to provide a defense as to the matters embraced by the indemnity; however, the indemnitee "has the right to conduct such defenses, if he chooses to do so." (Cal. Civil Code § 2778(4).)

Case law has recognized that outside of the insurance context, it is the indemnitee who "may often have the superior bargaining power, and who may use this power unfairly to shift to another a disproportionate share of the financial consequences of its own legal fault." Thus in a noninsurance situation, the contractual language on indemnity "must be particularly clear and explicit, and will be construed strictly against the indemnitee." (*Crawford v. Weather Shield Mfg., Inc.*, 44 Cal. 4th 541, 552 (2008).)

Nonetheless, an appropriately worded indemnification agreement can have a sweeping effect against the indemnitor. In *Crawford* the state Supreme Court relied heavily on sections 2778(3) and 2778(4) to determine that the indemnitor had a duty to defend the indemnitee; and that the duty arose from the very beginning of the case brought by the injured third party and existed even though the indemnitee ultimately was found not liable on the substantive charge of injuring that third party.

Current Terminology

The courts have encouraged using the term *general indemnity clause* when referring to an indemnity agreement that "does not address itself to the issue of an indemnitee's negligence."

(See *McCrary*, 133 Cal. App. 4th at 1537, quoting *Rossmoor*, 13 Cal. 3d at 628.)

In many indemnity disputes, the bone of contention is the negligence - whether active or passive - of the indemnitee. In fact, the *Rossmoor* case dealt with that very dichotomy. As the court observed, "[p]assive negligence is found in mere nonfeasance. ... Active negligence ... is found if an indemnitee has personally participated in an affirmative act of negligence, was connected with negligent acts or omissions by knowledge or acquiescence, or has failed to perform a precise duty which the indemnitee had agreed to perform." (*Rossmoor*, 13 Cal. 3d at 629.) The distinction is important because a general indemnity clause (one that does not address an indemnitee's negligence) does not cover an indemnitee who has been actively negligent. (*Rossmoor*, 13 Cal. 3d at 629.)

However, the active-passive dichotomy is not wholly dispositive. As noted above, the indemnity question is one of contract interpretation. If it can be determined that the parties clearly intended by their agreement to protect the indemnitee against claims stemming from the indemnitee's own negligence, the courts will enforce such an agreement. (*Rossmoor*, 13 Cal. 3d at 633.) To reiterate, "[t]he extent of the duty to indemnify ... is determined from the contract." (*Myers Building Industries, Ltd. v. Interface Technology, Inc.*, 13 Cal. App. 4th 949, 969 (1993).)

Writing Required?

The foregoing discussion raises an important question: Must an indemnification agreement be in writing?

California's statute of frauds says that a "special promise to answer for the debt, default, or miscarriage of another" is invalid unless set forth in writing. (Cal. Civ. Code § 1624(a)(2).) But the specific subsection concludes with a loophole of sorts: "except in the cases provided for in [Civil Code] Section 2794." Section 2794, in turn, refers to contracts involving "an original promise of the promisor," which are then specifically defined (these often involve surety and guaranty contracts). (See Cal. Civ. Code § 2794(1)-(6).)

A prudent approach is to assume that an *agreement* to provide indemnity probably should be in written form; there should be at least enough documentation to argue that the contract complies with requirements of the statute of frauds. But as explained below, under certain circumstances one can wind up bound to indemnify another without a signed contract.

Equitable Indemnity

As noted, indemnity may be either express or implied. Indemnity that is implied is called (naturally) *implied indemnity*. Sometimes it is also referred to as *equitable indemnity*. (See *Prince*, 45 Cal. 4th at 1158 and 1164.)

Implied indemnity is an equitable doctrine that apportions responsibility among tortfeasors responsible for the same indivisible injury on a comparative fault basis. The equitable indemnity doctrine "originated in the common sense proposition that when two individuals are responsible for a loss, but one of the two is more culpable than the other, it is only fair that the more culpable party should bear a greater share of the loss." (*Fremont Reorganizing Corp. v. Faigin*, 198 Cal. App. 4th 1153, 1176 (2011).)

Case law dictates that in equitable indemnity cases, "there must be some basis for tort liability against the proposed indemnitor." (*BFGC Architects Planners, Inc. v. Forum/Mackey Construction, Inc.*, 119 Cal. App. 4th 848, 852 (2004).) Equitable indemnity is also restitutionary in nature. The basis for the doctrine is restitution, and the concept is "that one person is unjustly enriched at the expense of another when the other discharges liability that it should be his responsibility to pay." (*Western Steamship Lines, Inc. v. San Pedro Peninsula Hosp.*, 8 Cal. 4th 100, 108 (1994).)

Joint and several liability in the context of equitable indemnity is fairly expansive. It is not limited to the old common term *joint tortfeasor*, and it can apply to acts that are concurrent or successive, joint or several, as long as they create "a detriment caused by several actors." (BFGC, 119 Cal. App. 4th at 852.)

Implied Contractual Indemnity

The foregoing discussion presupposes a two-dimensional indemnity world: On one side is express contractual indemnity; on the other, implied or equitable indemnity. Historically, there was a third dimension called *implied contractual indemnity*. The California Supreme Court succinctly set out the paradigm when it cast this odd doctrinal offshoot as "indemnity implied from a contract not specifically mentioning indemnity." (*Prince*, 45 Cal. 4th at 1157.)

However, implied contractual indemnity is no longer a separate category under the law. Though not extinguished, implied contractual indemnity is now viewed simply as "a form of equitable indemnity." (*Bay Development, Ltd. v. Superior Court*, 50 Cal. 3d 1012, 1029- 1030 & fn. 10 (1990); *E.L. White, Inc. v. City of Huntington Beach*, 21 Cal. 3d 497, 506-507 (1998).)

The state Supreme Court has explained that implied contractual indemnity is available when contracting parties are each responsible for injuring a third party (who is a stranger to their contract). The theory is that such a contract implies it will be performed properly, and that damages incurred by a contracting party that resulted from improper performance by the other contracting party are compensable in indemnity. In such cases, the "contractual" part of implied contractual indemnity has nothing to do with any indemnity clause that is (or is not) contained in the subject contract. The "contractual" component simply signifies that the duty owed to the

injured third party results from a contract between the indemnitor and the indemnitee. (See *Prince*, 45 Cal. 4th at 1159.)

Settlement Dynamics

Indemnity claims are often asserted by and between tort defendants. By doing so, an indemnity claimant hopes to force other parties - some of whom may be more culpable - to foot the bill entirely, or at least repay some portion of the damages the indemnity claimant had to pay to the plaintiff.

But what happens if a defendant makes a settlement with the plaintiff and tries to exit the case? As every personal injury and defense lawyer knows, this happens seven days a week. The answer is fairly simple. Pursuant to a specific statute, a good faith settlement cuts off all claims for equitable indemnity based on comparative negligence. (See Code Civ. Proc., § 877.6(c).)

Counsel must understand that although this rule is broad, powerful, and often-invoked, it has its limits. For example, a good faith settlement eliminates only claims for *implied* indemnity; there is no effect on a claim based on express contractual indemnity. (See *C.L. Peck Contractors v. Superior Court*, 159 Cal. App. 4th 828 (1984).)

Indeed, equitable indemnity and express contractual indemnity are like oil and water; they don't mix. Paramount among the rules governing the enforcement of indemnity agreements is that "where 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 by reliance on the independent doctrine of equitable indemnity." (*Mel Clayton Ford v. Ford Motor Co.*, 104 Cal. App. 4th 46, 54 (2002).)

Furthermore, even a clear indemnity contract will only supersede equitable indemnity if the agreement has covered the subject of the theoretical equitable indemnity. When the parties knowingly bargain for specific protection, the protection should be afforded. This requires an inquiry into the circumstances of the damage or injury as well as the language of the contract. "[O]f necessity, each case will turn on its own facts." (*Zalkind v. Ceradyne, Inc.*, 194 Cal. App. 4th 1010, 1024-1025 (2011), quoting *Rossmoor*, 13 Cal. 3d at 633.)

Whether lawyers are dealing with express or implied indemnity, they should be guided by two basic maxims: Read the contract, and read the code. Doing so will help unravel what can otherwise be a tangle of terms, shrouded in shopworn case law, that will surely trip up a novice.