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Crucial Provisions Enforcing Construction-Contract Indemnity Clauses

Construction Law Practitioner Column By Daniel Lee Jacobson

Typically, a contract between a subcontractor and a general contractor will contain a clause that purports to indemnify the general contractor for damages claimed by a third party. There is often a similar clause contained in the contract between a general contractor and a developer. The enforceability of such a clause depends on a number of factors.

The statute of frauds governs the validity of an indemnification agreement. Civil Code Section 1624(a)(2). Such agreements are covered by the statute of frauds and must be in writing. Without such a writing, there can be no valid cause of action for express indemnity.

It is important to understand the difference between an action for express indemnity, which is governed by the statute of frauds, and an action for what the courts have called "implied contractual indemnity," which is not governed by the statute of frauds. See *Ranchwood Communities Ltd. P'ship Co. v. Jim Beat Co.*, 49 Cal.App.4th 1397 (1996).

The title "implied contractual indemnity" is a misnomer. An action for implied contractual indemnity, while being at least partially based on the existence of a contract, is not based on contractual indemnity. In fact, to the extent that such an action is based on the existence of a contract, it is only based on contractual language that does not specifically deal with indemnity. *Bay Dev. Ltd. v. Superior Court*, 50 Cal.3d 1012 (1990); *Ranchwood*.

Implied contractual indemnity is a form of equitable indemnity and is bound by the restrictions of an equitable cause of action. For instance, whereas an express indemnity cause of action cannot be barred as a result of a determination of a good-faith settlement under Code of Civil Procedure Section 877.6, such a finding will bar an implied contractual indemnity cause of action. *Bay Development*.

The validity of indemnity clauses in construction contracts also is governed by Civil Code Section 2782, which states that "agreements contained in ... any construction contract and which purport to indemnify the promisee against liability for damages for death or bodily injury to persons, injury to property, or any other loss, damage or expense arising from the sole negligence or willful misconduct of the promisee or the promisee's agents, servants or independent contractors ... , or for defects in design furnished by such persons, are against public policy and are void and unenforceable."

So while an indemnification agreement might look airtight on its face, if that agreement does not exempt from its ambit "the sole negligence or willful misconduct of the ... [general contractor] or the ... [general contractor's] agents, servants or independent contractors ... or for defects in design furnished by ... [the general contractor], the agreement ... [is] void and unenforceable."

Is indemnitor negligence required in order for a construction-contract indemnity clause to be enforced against that indemnitor? Three recent cases shed light on this issue.

In *Continental Heller Corp. v. Amtech Mech. Servs. Inc.*, 53 Cal.App.4th 500 (1997), the court concluded that indemnitor negligence was not necessary. In *Heppler v. J.M. Peters Co.*, 73 Cal.App.4th 1265 (1999), the court concluded that indemnitor negligence was necessary.

The same division of the 4th District Court of Appeal that decided *Heppler* harmonized *Continental Heller* and *Heppler* and decided in *Centex Golden Construction Co. v. Dale Tile Co.*, 78 Cal.App.4th 992 (2000), that under the facts of *Centex*, indemnitor negligence was not necessary.

In *Continental Heller*, a single subcontractor was involved in a contract that required the subcontractor to install a valve at a meat-packing plant. A defect in the valve caused an explosion, but no negligence was found on the part of the subcontractor. The court found that notwithstanding the lack of a finding of negligence, the subcontractor was liable to the general contractor pursuant to an indemnity

agreement.The court noted that both parties were "large, sophisticated construction enterprises which could be expected to review, understand and bargain over their indemnity agreement." Furthermore, there were a number of substantive negotiated modifications to the original contract. "This is not a case of a small-time subcontractor being saddled with ruinous liability for the mere privilege of installing a valve in a meat packing plant." Also, the subcontractor solely selected and installed the defective valve.
In *Heppler*, multiple subcontractors were involved in the construction of mass-produced housing that was ultimately sold to the plaintiffs, who alleged construction defects. The court found that absent a finding of negligence on the part of the subcontractors, the subcontractors were not liable to the general contractor pursuant to indemnification clauses in their contracts.

The court found that it was dealing with a commercial context wherein "the attendant circumstance - subcontractors performing a limited scope of work that was to be combined with the work and materials of numerous others to build mass-produced residences - do not support an expansive indemnity obligation."The court found that "[t]he indemnity language contained in the preprinted subcontracts does not evidence a mutual understanding of the parties that the subcontractor would indemnify Peters even if its work was not negligent. Indemnity provisions are to be strictly construed against the indemnitee, and had the parties intended to include an indemnity provision that would apply regardless of the subcontractor's negligence, they would have had to use specific, unequivocal contractual language to that effect."
Also, the contracts in *Heppler* were between subcontractors and a developer of mass-produced housing. Such a developer is strictly liable for construction defects, and a subcontractor is not. *La Jolla Village Homeowners' Ass'n v. Superior Court*, 212 Cal.App. 1131 (1989).

The court reasoned that "[i]n a case such as this, ... [enforcement of the indemnity provisions without a finding of negligence] would have the effect of transferring Peters's strict liability as a developer to the subcontractors, without the use of specific contractual language that unambiguously manifested this intent." The court found this result to be unacceptable.

In *Centex*, a general contractor sought to enforce an indemnity agreement against a subcontractor where the language of the indemnity agreement was found to be clear in its grant of indemnity regardless of fault. The case involved the construction of a single commercial building. The subcontractor had a great deal of control over its own work.

The court concluded that given the clear language that granted indemnity regardless of fault, the lack of indemnitee strict liability in a setting that did not involve the mass production of housing, and the degree of control that the subcontractor had over its work, subcontractor negligence was not required to enforce the express indemnity agreement.

There is a classification system regarding indemnity agreements that was born in *MacDonald & Kruse Inc. v. San Jose Steel Co.*, 29 Cal.App.3d 413 (1972). Under that system, the agreements are classified into three categories of enforceability.

A "Type I" indemnification agreement is the broadest. "Under this type of provision, the indemnitee is indemnified whether his liability has arisen as the result of his negligence alone, or whether his liability has arisen as the result of his co-negligence with the indemnitor."

A "Type II" indemnification agreement is less broad. "Under this type of indemnity provision, the indemnitee is indemnified from his own acts of passive negligence that solely or contributorily cause his liability, but is not indemnified for his own acts of active negligence that solely or contributorily cause his liability." Active negligence connotes a breach that results from action that is affirmatively taken as opposed to a breach that results from no or less action affirmatively taken (passive negligence). See *Armco Steel Corp. v. Roy H. Cox Co.*, 103 Cal.App.3d 929.

A "Type III" indemnification agreement is the most narrow. "Under this type of provision, any negligence on the part of the indemnitee, either active or passive, will bar indemnification against the indemnitor irrespective of whether the indemnitor may have also been a cause of the indemnitee's liability."Although

at least one court has disagreed with the *MacDonald* classification system (*Rodriguez v. McDonnell Douglas Corp.*, 87 Cal.App.3d 626 (1978)), the *MacDonald* nomenclature seems to be alive and well.

However, to the extent that *MacDonald* focuses on the passive versus active negligence analysis, *Heppler* rejected a "mechanical application" of that analysis. The *Heppler* court followed *Hernandez v. Badger Constr. Equip. Co.*, 28 Cal.App.4th 1791 (1994), and applied what that case described as "well-established general principles of contract interpretation in determining indemnity obligations."

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