

Contra Costa Lawyer

Volume 19, Number 3 • March 2006

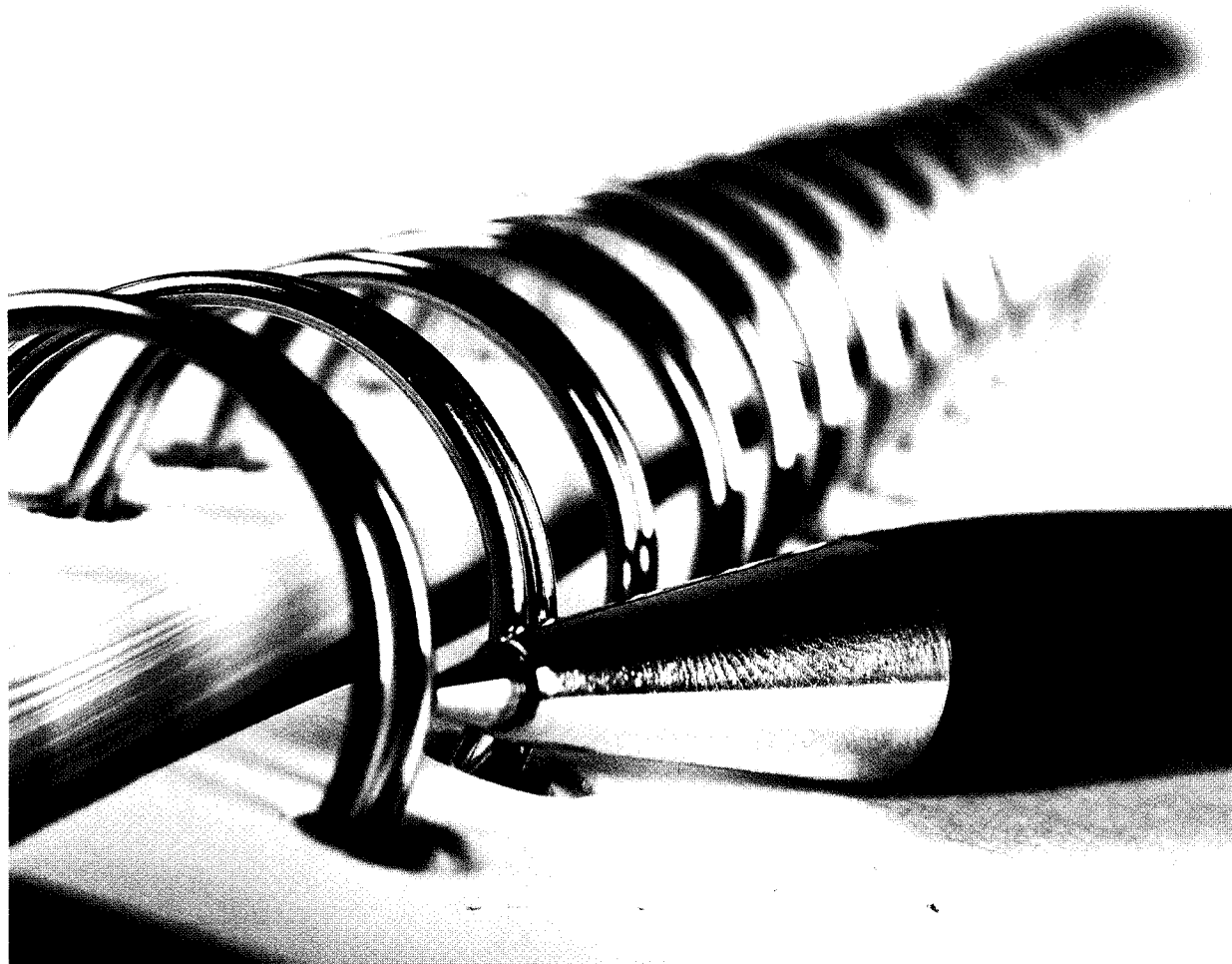
The official publication of the  Contra Costa County

BAR ASSOCIATION

Inside

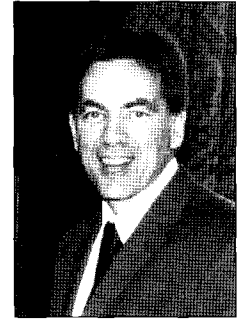
Practice Development

*Taking the Plunge: Opening a Law Practice • Major Changes Coming to East Contra Costa County
Finding the Perfect Paralegal • Marketing Your Practice • Interpreting Indemnity Agreements . . .
plus pictures from the Annual Installation Lunch and more*



Interpreting Indemnity Agreements

by Gary A. Watt



So you are sitting in mediation when the mediator walks in wearing a stern look, head shaking slowly from side to side. You know the one... like a parent perusing your report card when you were young. The mediator sits down, leans forward, looking at your client and says, "Opposing counsel has you over a barrel with this indemnity provision." *Translation:* You are toast if this case goes to trial.

Are you toast? You flip through your mediation binder containing the contract and you begin to read it for the umpteenth time. "Indemnitor shall indemnify indemnitee for blah, blah, blah, including yada, yada, yada . . ." Admit it — your eyes gloss over like they did in contracts class in law school.¹ Echoes of "The party of the first part upon demand by the party of the second part . . ." ring in your head. You recall hearing your name out of a fog and suddenly realizing you have been called upon to share your insights with the rest of the class. You mumbled something about the "four corners" of the document and a murmur resonated in your ears. The

professor — shaking her head slowly from side to side — stalked other game.

Back to the mediation. Does it have to be so bad? You knew all about the indemnity clause prior to the mediation. Presumably you've had this file for months, analyzed the indemnity provision and written to the carrier and client regarding its implications, right? But now your analysis has been challenged and worse, your client is sitting right next to you waiting for your brilliant rebuttal. "Was I wrong?" you wonder silently as you try to focus on the language of the clause. What to do...

How about using a checklist for evaluating indemnity agreements? Ascertaining whether an agreement really has your client "over a barrel" can give substantial peace of mind. It sounds like law school again, right? Outlines and checklists. The glaze starts creeping back over your eyes. But hang on, first a little vocabulary, then the checklist:

Indemnification. Recovery of money paid to satisfy a judgment or settlement of a suit.²

Indemnitor. Party to make good a loss incurred by another party (in the construction defect context, indemnitor is usually a subcontractor whose work was immaculate).

Indemnitee. Party to be relieved of a loss (in the construction defect context, usually a developer/general contractor who hires the best designers and whose field supervision is always immaculate).

Check List

Step 1. Does the clause address indemnitee's (party to be relieved of the loss) negligence?

If yes: Brace yourself if you represent indemnitor (party to make good the loss) and go to Step 2. So far, so good, if you represent indemnitee (party to be relieved of the loss), go to Step 2.

If no: The clause is only a "general" and not a "specific" indemnity provision and indemnitor can breathe easier but counsel for both parties should continue the analysis by jumping to Step 4 to determine the remaining implications for their respective clients.³

Residential Appraisal Services

Steve Lederer, SRA

*Divorce, Litigation Support,
Consulting, Estate, Trusts,
Expert Witness, etc.*

(925) 838-0706

ledrr@earthlink.net

Real Estate Lawyer

24 Years Experience/Licensed Real Estate Broker

*Commercial/Residential
Title Matters • Probate/Trusts
Dispute Resolution (International)*



**Law Offices of
Magany Abbass**

3445 Golden Gate Way
Lafayette CA 94549

925.283-9088

—WANTED— Will/Estate Contests

Over the years we have handled successfully many such matters to the point that it has become a specialty. You handle the estate, we do the contest. Cases usually handled on a contingent fee basis, but can be hourly. Referral fee where appropriate.

Pedder, Stover, Hesseltine & Walker
Attorneys At Law

(925) 283-6816

⁴ 3445 Golden Gate Way, P.O. Box 479
Lafayette, CA 94549-0479

AV Martindale-Hubbell

Step 2. *Is the language regarding the implications of indemnitee's negligence unequivocal?* In other words, does the clause clearly require indemnification *even if* indemnitee is negligent?

If **yes**: Prepare for the worst if you represent indemnitor (looks like your client is over a barrel) and go to Step 3. Things are looking favorable if you represent indemnitee (looks like your client will be relieved), but go to Step 3.

If **no**: It is not a "specific" or "Type I" indemnity clause and counsel for indemnitor can relax a little more but counsel for both parties should go to Step 4 to determine the remaining implications for their respective clients.

Step 3. *Does the wording, reasonably interpreted as written, seek indemnification for indemnitee's sole negligence or willful misconduct?*

If **yes**: Rejoice if you represent indemnitor. Contractual provisions requiring indemnification of indemnitee's sole negligence and/or willful misconduct are unenforceable as against public policy.¹ [See Civil Code §§1668 & 2782(a).] Moreover, when parties contract for indemnity, they cannot fall back on equitable indemnity if the express clause is void. [See, *Markley v. Beagle* (1967) 66 Cal.2d 951, 962.]

If **no**: Rejoice if you represent indemnitee, the provision is a "specific" or "Type I" indemnity agreement. As a result, if indemnitor is determined by a jury to be liable, no matter how small the percentage, indemnitee will be entitled to recover from indemnitor *all* damages incurred for the entire judgment or settlement paid, not just indemnitor's *share* of the loss incurred.²

If you can work your way through the checklist to this point confidently, you can spit in the mediator's eye (not actually recommended) next time you are confronted in mediation with an erroneous appraisal of an indemnity provision. You will know well before the mediation which party, if any, is "over a barrel" due to a "specific" or "Type I" indemnity provision.

But as noted above, what if the provision is only a "general" indemnity provision? Counsel should familiarize themselves with cases addressing such interpretation. Thus, "Step 4" is not so much a "step" but a "journey."

Step 4: If the clause fails to unequivocally require indemnification for indemnitee's negligence, then the clause is only a "general" provision.

If an indemnity clause fails to unequivocally discuss the impact of an indemnitee's own negligence, the clause is a "general indemnity" agreement. [See *Rossmoor Sanitation, Inc. v. Pylon, Inc.* (1975) 13 Cal.3d 622, 624]. The question whether an indemnity agreement covers a given case turns primarily on contract interpretation and it is, "the intent of the parties as expressed in the agreement that should control." [13 Cal.3d at 632.] This requires an inquiry into the circumstances of the

damage or injury and the language of the contract. [*Id.* at 633.]

In *Rossmoor*, the Supreme Court spoke only of "general indemnity" agreements and not specifically of Type I, II or III classifications. For examples and discussion of the Type I–III classification system, see *MacDonald & Kruse Inc. v. San Jose Steel* (1972) 29 Cal.App.3d 413, 420. General indemnity clauses can be Type II or Type III and indemnitor's obligation to indemnify can be circumscribed, or none at all. [See e.g., *McCrory Construction Co. v. Metal Deck Specialists, Inc.* (2005) 133 Cal.App.4th 1528, 1540-1541 (general indemnity provision unenforceable due to general rule that "active" negligence of indemnitee bars indemnification and no "contrary" intent found in the contractual language at issue).]

Generally, Type II agreements will require indemnity only if the indemnitee ►

Mediation

Preferred



Wayne V.R. Smith

Mediations & Arbitrations

Business • Construction

Real Estate • Probate

P.O. Box 3219
Martinez 94553

(925) 228-5232
fax (925) 228-1531

Walnut Creek
(925) 934-1699

wvsmith@pacbell.net
www.mediate.com/wvsmith

was non-negligent or passively but not actively negligent. Passive negligence means *nonfeasance*, e.g., failing to discover a dangerous condition. [Markley, 66 Cal. 2d at 962.] Active negligence means *affirmative* conduct or knowing acquiescence in the negligence of another. [See, *Morgan v. Stubblefield* (1972) 6 Cal.3d 606, 625.] Exposure under a Type II agreement is that portion of a total judgment attributable to indemnitor's liability and indemnitee's *passive negligence*. For examples of the operative phrases in contracts interpreted to be Type II provisions, see *MacDonald & Kruse*, 29 Cal.App.3d at 420.

Type III agreements will require indemnification only if indemnitee was neither actively nor passively negligent. Such agreements are typically interpreted to limit indemnitor's obligation to only that portion of a loss caused by indemnitor, but not by others. [MacDonald & Kruse, 29 Cal.App.3d at 420.] Type III agreements result in no obligation to indemnify if the indemnitee is negligent at all (active or passive), even if indemnitor was negligent. [See, *McCrory*, 133 Cal.App.4th at 1537.]

A final cautionary note is in order. In *Rossmoor*, the Supreme Court, while following the distinction between active and passive negligence long "accepted by the bench, the bar, and the insurance industry," emphasized that "it is the intent of the parties as expressed in the agreement that should control." [13 Cal.3d at 633.] Such interpretation

requires examination of the contract language in light of the circumstances of the damages or injuries at issue. [Id.] And as the Court of Appeal in *Crawford* indicated, courts are increasingly distancing themselves from *MacDonald & Kruse's* somewhat mechanical application of Type I – III classifications. [Crawford, 06 C.D.O.S. at 998, FN 21.]

In other words, specific contractual intent should override dogmatic adherence to the "active – passive" dichotomy. For an example of a case finding intent to indemnify despite a "general" indemnity provision and a finding of *active* negligence on the part of indemnitee, see *Morton Thiokol v. Metal Building Alteration Co.* (1987) 193 Cal.App.3d 1025.

This article and the checklist provided can put you on a more solid footing in analyzing and reporting on indemnity provisions, including exposure at trial.⁶ That way, after the mediator has her say, you can shake your head from side to side, and have yours too. ♦

— Gary A. Watt, of counsel at the McNamara law firm, handles real estate and construction litigation and appellate matters. He can be reached at gary.watt@mcnamaralaw.com.

⁶As the Court of Appeal for the Fourth Appellate District very recently put it, "The comedy troupe Monty Python once made insurance . . . the butt of a comedy skit. But we doubt that even comedians of their caliber would try to make 'indemnity' the topic of comedy. It is a topic so deadly dull that it makes insurance look interesting." [See, *Crawford v. Weather Shield Mfg., Inc.*

(2006) 06 C.D.O.S. 992, FN 4 (window manufacturer liable for developer's defense costs attributable to window claims, even though window manufacturer found non-negligent by jury, because indemnity provision included independent promise to "defend" suits "arising out of" window manufacturer's "work").]

²As the Court of Appeal in *Crawford* observed, many decisions "lump" the duty to *defend* together with the duty to *indemnify*. (Crawford, 06 C.D.O.S. at FN 9.) However, as the *Crawford* decision itself demonstrates, an indemnitor can "win" on indemnification claims and not have to pay a judgment or settlement incurred by developer, yet still "lose" on "defense" and be held liable for developer's defense costs and fees. (Id. at 993.) In this article, as in *Crawford*, the author limits the term "indemnity" to paying for a judgment or settlement incurred by indemnitee as "distinct from costs of defense." (Id.)

³Specific indemnity agreements are frequently referred to as "Type I." General indemnity agreements are frequently referred to as "Type II" or "Type III." However, the California Supreme Court has analyzed indemnity clause interpretation without reference to such classifications. (See discussion, under Step 4, *infra*.)

⁴The resolution of express contractual indemnity issues in favor of indemnitor by no means compels similar resolution of additional insured coverage under an *insurance policy*. For a case discussing that *separate* issue, see *American Casualty Co. of Reading, PA v. General Star Indemnity Co.* (2005) 125 Cal.App.4th 1510. The scope of this article is limited to contractual indemnity.

⁵It may be small consolation to your client, but indemnitor nevertheless retains its right to seek equitable contribution from other parties that are joint-tortfeasors.

⁶As *Crawford* holds, while an indemnitor found non-negligent will, ordinarily, not be liable for indemnification, it can be liable for *defense* costs and attorney fees. More sobering perhaps, as long as the indemnitee is not solely negligent, a non-negligent indemnitor *can still be liable* for indemnification if the contractual language is specific enough! [See *Continental Heller Corp. v. Antech Mechanical Services, Inc.* (1997) 53 Cal.App.4th 500, 503 (indemnity agreement required indemnification despite absence of fault of subcontractor-indemnitor)].



ARLENE SEGAL

Law Offices of Arlene Segal

Litigation - Mediation
Trust and Estate Disputes
Financial Abuse

200 Pringle Avenue, Suite 350 • Walnut Creek, CA 94596
telephone (925) 937-4224 • fax (925) 937-4273

Youngman, Ericsson & Low, LLP

1981 North Broadway, Suite 300
Walnut Creek, CA 94596

(925) 930-6000

Tax Lawyers