

Potential Perils and Pitfalls of Construction Indemnification

By David Grant



Freedom of contract is broad. Parties have many options when divvying up rights and duties pursuant to a written contract. Remedies can be limited; damages can be liquidated. One option is an indemnity provision. Everyone knows what that entails, right?

Indemnity is a contractual obligation of one party to compensate the loss occurred to the other party (the “Indemnitee”) due to the act of the indemnifying party (the “Indemnitor”) or any third party. The parties can agree to indemnify each other for third-party claims arising out of the transaction. But that is far from the end of the matter. The issue is more nuanced and fraught with potential peril. (A court may also impose an indemnity obligation based on equitable principles, but that is outside the scope of this article which identifies potential consequences and pitfalls of contractual indemnification.)

I. Be Aware of Direct Indemnity

When most people think of indemnity, they think of it in the traditional sense: one party indemnifying the other party on a third-party claim. *See, e.g., Dream Theater, Inc. v. Dream Theater*, 124 Cal. App. 4th 547, 555, 21 Cal. Rptr. 3d 322 (2004). A typical example is an insurance contract, whereby one party (the insurer or the indemnitor) agrees to compensate the other (the insured or the indemnitee) for any damages or losses, in return for premiums paid by the insured to the insurer.

But indemnity can mean so much more and occur in virtually any commercial contract. Civil Code section 2772 defines 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.” Where indicated by the express terms of the contract, indemnity can mean direct indemnity (i.e., claims between the two parties), turning any action between the parties into a potential claim for indemnity. *See, e.g., Zalkind v. Ceradyne, Inc.*, 194 Cal. App. 4th 1010, 1025, 124 Cal. Rptr. 3d 105 (2011). Where it is not explicitly stated whether “indemnity” means

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learning” (don’t get me started on that one), “self-isolating,” “covidiot,” and “zoombombing.” We have not had so many new words come out of a crisis since WWII gave us “fubar” and “snafu” (look them up, I’m not printing their meanings here).

Unfortunately, the “Rona” took its toll on ABTL as well. One by one ABTL chapters around the state began cancelling programs. Perhaps worst of all, we cancelled our Annual Seminar that was to take place in Hawaii.

But hey, we are business trial lawyers; we adapt. We found ways to assist our bench, and to make virtual programs available that would assist our members in navigating the new legal landscape. Those have included webinars by presiding judges in Orange County (thank you Judge Nakamura), Los Angeles County, San Diego County and the Central District. In the case of Orange County, Judge Nakamura participated on several occasions.

These webinars filled the bar in on the challenges the Courts were facing, but also answered our questions about when and how filings would be processed, motions would be heard, and trials would be handled. The strong working relationship between the bench and bar has always been a hallmark of ABTL, and that has absolutely been true during this crisis.

What’s next you ask?

Help us help those who are less fortunate. Every year ABTL-OC raises much needed funds to support Public Law Center and its representation of indigent members of our community in need of legal assistance. Our June PLC fundraiser was COVID-cancelled. But that cannot stop ABTL-OC. I have issued our annual “President’s Challenge” to the ABTL-OC Board asking them to support PLC and I ask the same of our members.

I recognize the financial strain the pandemic has had on many of us, but for some less fortunate than us, this pandemic has been catastrophic. You can help. Email abtloc@abtl.org with your pledge for PLC. Please give as generously as possible so that we may continue our chapter’s long and proud tradition of working alongside PLC. When we support PLC, we support access to justice for the poor. Any amount will do. PLC needs us now more than ever. Let’s show PLC that ABTL-OC is here to help.

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turn to the same trial team, consider what a more diverse team of advocates might bring to the table.

Does everyone have an obligation to be an ally? That's an individual choice. The question is what kind of a justice system, what kind of a society, do you want to be part of? If it's different from what we have today, what simple everyday choices can you make, as a trial lawyer, in-house counsel or judge, to advance that change?

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“third-party” and/or “direct” indemnity, a court will apply traditional canons of interpretation in an attempt to discern the parties’ intended meaning. Cal. Civ. Code § 2778 (setting forth certain rules “unless a contrary intention appears[.]”) A broadly worded indemnity provision that does not expressly limit itself to third-party claims can be interpreted to apply to all claims, including claims between the parties. *Hot Rods, LLC v. Northrop Grumman Systems Corp.* 242 Cal. App. 4th 1166, 1181, 196 Cal. Rptr. 3d 53 (2015) (“[The] parties expressly adopted a broad definition of ‘claim’ and ‘person’ that encompasses ‘any alleged liabilities,’ and covers both first and third party claims.”); *see also Zalkind v. Ceradyne, Inc.*, 194 Cal. App. 4th 1010, 1027, 124 Cal. Rptr. 3d 105, 116 (2011) (“This language does not limit indemnification to third party claims and extends indemnification to ‘any and all’ damages incurred by the [parties]”—concluding that “‘Indemnify’ Includes Direct Claims Between the Parties”).

II. Indemnity May Go So Far as Exculpation

In rather extreme circumstances, an indemnity clause can even act as an exculpatory clause. For instance, Party A (the Indemnitor) might be obligated to indemnify Party B (the Indemnitee) as to Party B’s own harms inflicted upon Party A. Party A sues Party B for breach of contract or in tort. But Party A also owes a broad indemnification obligation to Party B. Accordingly, any recovery against Party B in favor of Party A would trigger Party A’s indemnification obligation and functionally absolve Party B of any liability. This result is counterintuitive. But courts will enforce agreements that way, provided the parties clearly “go out of their way and say ‘we really, really mean it,’” *City of Bell v. Superior Court*, 220 Cal. App. 4th 236, 250, 163 Cal. Rptr. 3d 90 (2013) (“Cases which have interpreted an indemnification agreement to act as an exculpatory clause between the parties to the agreement have involved agreements which contain language clearly providing that the indemnification clause applied to such claims.”) Moreover, “[a]n indemnity agreement may provide for indemnification against an indemnitee’s own negligence, but such an agreement must be clear and explicit and is strictly construed against the indemnitee.” *Roos v. Kimmel*, 55 Cal. App. 4th 573, 583, 64 Cal. Rptr. 2d 177 (1997). Exculpation

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does have a limit beyond the plain language of the agreement. In construction contracts, the Legislature intervened and has made exculpatory indemnity agreements in construction contracts unenforceable to the extent they seek indemnity for the indemnitee's active negligence. CAL. CIV. CODE §§ 2782, 2782.05, & 2782.9.

III. A Party Cannot Be Indemnified for Its Own Misrepresentations

This broad right of contract has its limits in California. California Civil Code section 1668 states: "All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law." Thus, even the broadest indemnity obligation cannot extend to cover an indemnitee's own intentional and/or negligent misrepresentations to an indemnitor. See, e.g., *McClain v. Octagon Plaza, LLC*, 159 Cal. App. 4th 784, 794, 71 Cal. Rptr. 3d 885 (2008) (Section 1668 "encompasses intentional and negligent misrepresentation."); see also *Blankenheim v. E. F. Hutton & Co.*, 217 Cal. App. 3d 1463, 1473, 266 Cal. Rptr. 593 (1990) (same).

IV. Indemnity as an Exclusive Remedy

Finally, attorneys need to be careful that, in creating certain indemnification rights, other remedies are not waived. Parties may be inclined to contract for certain procedures for indemnification claims—e.g., a notice provision, alternative dispute resolution, or a cap on liability. Unless the intent is otherwise, it should be specified that the indemnification provision is a new, contractually-created remedy, and not the exclusive remedy in the event of a dispute between the parties. See, e.g., *Nelson v. Spence*, 182 Cal. App. 2d 493, 497, 6 Cal. Rptr. 312 (1960) ("Where a contract expressly provides a remedy for a breach thereof, the language used in the contract must clearly indicate an intent to make the remedy exclusive."); *McDonald v. Stockton Met. Transit Dist.*, 36 Cal. App. 3d 436, 442, 111 Cal. Rptr. 637 (1973) ("When a contract describes a remedy for breach without an express or implied limitation making that remedy exclusive, the injured party may seek any other remedy provided by law.").

V. Conclusion

Indemnity provisions can be an effective way to manage risk, but attorneys and their clients, must be aware of the potential consequences discussed above and carefully scrutinize any indemnification agreement to ensure that the plain language clearly defines the scope of the indemnity as understood by the attorney and client. Parties seeking contractual indemnification should also give thought to the ability of the proposed indemnitor to perform the obligations (e.g. creditworthiness and available insurance).

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