CONSTRUCTION LAW

Recurring Issues With Contract Indemnities

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Indemnity provisions of the contracts executed between a project owner and its contractors, architects and other professionals are critical elements in transferring risk of third-party claims such as property damage and personal injury. An indemnity provision will therefore require one of the parties (typically the contractor, architect or professional) to defend, indemnify, and hold harmless the other (typically the owner) with regard to specific claims (or potential claims).

Although most practitioners have some experience drafting and negotiating indemnity provisions, there are common misconceptions with regard to construction contract indemnities. For instance, many attorneys are surprised to learn that absent clear language to the contrary, an indemnitee is unable to recover the costs incurred to enforce the indemnification provision. Also, not all practitioners are aware that the indemnitee cannot be indemnified for its ordinary (as opposed to gross) negligence. Both of these issues have arisen recently

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in our practice and are worth discussing in some greater detail.

Enforcement Not Covered

Imagine a situation in which the owner of a construction project is sued by a third party for personal injury or property damage, and the contractor fails to respond to the owner's demand to defend and indemnify the claim. Although the owner could ultimately bring an action against the contractor to enforce the indemnity, the costs of such an action could easily approach or exceed the cost of the underlying claim, and unless the indemnity specifically states that the fees associated with the enforcement of the indemnity will be covered by the indemnifying party, the fees will be borne entirely by the owner, potentially negating the benefit of any award.

The guiding Court of Appeals authority on this matter is *Hooper Associates v. AGS Computers,* 74 N.Y.2d 487 (1989). In *Hooper*, the parties entered into a written contract under which the defendant undertook to design, install and supply a computer for the plaintiff. Three years after the contract was executed, the plaintiff brought an action for

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breach of contract and other first-party claims, as well as a claim for attorney fees. With regard to attorney fees, the plaintiff relied upon an indemnity provision in the contract that provided for the defendant to indemnify the plaintiff for certain claims but which did not "exclusively or unequivocally" refer to first-party claims or support an inference that the defendant intended to indemnify the plaintiff for first-party claims (*Hooper*, supra at 492).

Ultimately, the Court of Appeals found that the indemnity provision relied upon by the plaintiff did not extend to the breach of contract or other first-party claims. As a result, the attorney fees were not recoverable.

In *Hooper*, the court relied on two general propositions. The first is that words in a contract are read to achieve the apparent purpose of the parties. Therefore, absent language specifically requiring the indemnifying party to pay for the costs of enforcing the indemnity, the court will not read this obligation into the contract. The second is that since attorney fees are costs of litigation, a prevailing party may not collect such fees unless the agreement specifically states that these fees are recoverable or there is a statute or rule allowing for such

recovery. The Hooper court noted that the indemnity serves the purpose of covering third-party claims and the defense of third-party claims, but not covering attorney fees and court costs in a first-party claim (Id at 492). Therefore, absent a prevailing party clause or a clause specifically providing that the costs incurred enforcing the indemnity are to be reimbursed, the costs of such enforcement will be borne by the owner.

Negligence

Section 5-322.1 of the New York General Obligations Law provides that an indemnification provision of a construction contract is void and unenforceable when it seeks 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 promisee…" The language of the statute, coupled with the case law that subsequently interpreted it, means that a contractor cannot be required to indemnify the owner (or the contractor's subcontractors) to the extent the owner (or subcontractor) is negligent.

Although this concept is settled law in New York, it is not uncommon for owners to seek indemnity

from its contractors for all claims, regardless of fault, or for all claims except those that arise out of the owner's gross negligence. Either concept would run afoul of the General Obligations Law since they contemplate a scenario in which the contractor is required to indemnify the owner for claims of negligence. A properly crafted indemnity clause in a construction contract would therefore carve out claims to the extent of the owner's negligence.

Conclusion

Since indemnification clauses are standard in construction contracts, it is common for attorneys to use "stock" language and overlook some legal points that govern the provision's effectiveness. When preparing or negotiating the contract, it is important for owner's counsel to review the language to ensure that the provision is valid and enforceable. The above points should be considered in crafting the protections afforded by this essential provision.