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MEETING OF THE MINDS: AVOIDING MISUNDERSTANDINGS IN MUNICIPAL CONTRACTS

INDEMNITY ISSUES

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I. Introduction

There is no "standard" indemnity clause for public agencies or for particular contracts. Cities utilize a wide variety of clauses, ranging from very long and detailed to extremely brief. The purpose of this paper is narrow – it is not to recommend any particular type of indemnity clause, but rather, to highlight some pitfalls that should be avoided when either drafting or negotiating indemnity clauses in contracts. There are at least two excellent and recent papers on the subject of indemnity to which you may want to refer for a broader discussion.[2]

Ideally, all of our cities would use the most protective indemnity clause. Often, however, a contracting party raises objections to our preferred clause, requiring negotiation. Some cities refuse to negotiate over indemnity language, but many are reluctant to sacrifice a particular contractor or consultant over disagreement about an indemnity clause, and do negotiate. Also, State law places constraints on our ability to use the indemnity clause of our choice, particularly with regard to contracts with architects, engineers and other design professionals, and with regard to construction contracts.

Consequently, indemnity clauses differ from contract to contract. At bottom, the indemnity clause should accurately reflect the intent of the parties, as the parties to a contract may allocate risk in any manner they desire.[3] Caution should be exercised not simply to rely on boilerplate clauses, but to give serious consideration to the mutual intent of the parties and to utilize sufficiently precise language to accomplish that objective given that these clauses will be strictly construed against the indemnitee.[4]

II. Indemnification Clauses Generally

A. *Classifications of Indemnity Clauses.*

MacDonald & Kruse, Inc. v. San Jose Steel Company, Inc.[5] describes generally three types of indemnity clauses. Type I is a broad provision that expressly indemnifies the indemnitee for all harm, including the indemnitee's negligence. The use of this provision would indemnify a city for negligent acts,

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[2] For extensive discussions of indemnity, see "Architect and Engineer Design Liability and AB 573: Big Deal or Ho-Hum," Roland Nikles, presented at the Spring 2007 City Attorney Conference; "Drafting and Reviewing Insurance and Indemnity Provisions," William H. Staples, presented at the Spring 2003 City Attorney Conference.

[3] *Rossmoor Sanitation, Inc. v. Pylon, Inc.* (1975) 13 Cal. 3d 622, 633.

[4] *Heppler v. J.M. Peters Company, Inc.* (1999) 73 Cal. App. 4th 1265, 1278.

[5] 29 Cal.App.3d 413 (1972).

whether they were active or passive.[6] The use of language that provides for indemnification for any and all claims, "except those arising from the sole negligence or willful misconduct of indemnitee . . ." has been held to be a Type I indemnification provision.[7] The court's reasoning is that if the only wrongdoing excluded is *sole* negligence, then any kind of co-negligence short of that is indemnified. Hence, a Type I clause is the most protective indemnity clause and thus is preferred.

The second type of provision – Type II -- only indemnifies the indemnitee for passive, not active, negligence. These provisions typically state that the indemnitee is indemnified for liability "howsoever may be caused" or "regardless of responsibility for negligence." Courts have held that this language is sufficient to provide indemnification for passive negligence, but that the language does not "expressly and unequivocally" provide for indemnification for active negligence.[8] Apart from the obvious disadvantage of more limited protection, another disadvantage of a Type II clause is that it generates disputes over whether the city's negligence was active or passive, a common occurrence with Type II clauses. While State law precludes an indemnity for active negligence in a construction contract (Civil Code §2782(b)), an indemnity clause should otherwise generally not be limited to a city's passive negligence; in other words, outside of construction contracts, avoid Type II indemnity provisions.

The third type of provision only indemnifies the indemnitee for liability caused by the indemnitor if the indemnitee is in no respect responsible for the indemnified injury. Under a Type III provision, *any* negligence on the part of the indemnitee city will bar indemnification whether or not the contractor is also at fault, even if primarily at fault.[9] Repeat: if the city is *in any respect* at fault, it cannot seek indemnification under a Type III provision. Hence, Type III indemnity clauses should be avoided as they generally provide insufficient protection.

Here is the rub: a very minor change in language can convert a Type I to a Type III indemnity clause. Because Type III clauses are to be avoided, precision in language is critical.

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[6] Active versus passive negligence is very fact-dependent, but active generally means the party created a condition or had knowledge of a condition that causes injury. Passive negligence is where the party did not create the condition that causes injury and lacked of knowledge of it, but failed to perform a legal duty to guard against it.

[7] *C.I.Engineers & Constructors, Inc. v. Johnson & Turner Painting Co.* (1983) 140 Cal.App.3d 1011, 1018.

[8] *MacDonald & Kruse*, 29 Cal.App.3d at 419.

[9] *Id*. at 420.

MacDonald & Kruse has been heavily criticized as too mechanical and formulaic an approach to indemnity, but the decision has never been overruled.[10] Subsequent cases, however, hold that the parties' mutual intent will control over a rigid application of the classifications established in *MacDonald & Kruse*. But, even under subsequent cases, precise language matters – for example, in *Rossmoor, supra,* the Supreme Court held that if an indemnity clause fails to address the indemnitee's negligence, the clause is considered a "general" indemnity clause, and while it may protect the indemnitee from liability due to its *passive* negligence, it will not protect against the indemnitee's *active* negligence. Even *Rossmoor* observes that this is not a rigid rule and not always dispositive.[11] The lesson to be learned from these cases is that to avoid a court relying on those classifications when interpreting an indemnity clause, the clause must clearly and unequivocally express the parties' intent; otherwise, an indemnitor may argue for and a court may well resort to a mechanical application of the *MacDonald & Kruse* or *Rossmoor* rules. It is too risky to hope that a reviewing court will consider parol or other evidence of the parties' intentions where the meaning of a boilerplate indemnification is in dispute. While it is the intent of the parties that is important, that intent is illuminated by the court's interpretation of certain standard language in these types of provisions.

In *American Motorcycle Assn. v. Superior Ct.*, the California Supreme Court recognized a common law right of comparative indemnity in the context of tort law, reasoning that the evolution of comparative negligence principles demanded similar changes in suits for equitable indemnification. The Court held that "concurrent tortfeasors have a common law right to obtain partial indemnification from other concurrent tortfeasors on a comparative fault basis."[12]

Courts have made clear that contract principles govern the interpretation of any indemnification provision.[13] Given the public policy set out in cases like *American Motorcycle* in favor of allocating liability based on the degree of fault, there does not seem to be anything prohibiting a city from expressly agreeing to some kind of partial indemnification based on comparative fault when the contracting party refuses to accept a Type I clause.

B. *A Note About Indemnity By Design Professionals.*

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[10] *See Rossmoor Sanitation Inc. v. Pylon, Inc.* (1975) 13 Cal. 3d 622 (Supreme Court seems to lean towards a different analysis, but fails to overrule); *McCrary Construction Corp. v. Metal Deck* (2005) 133 Cal. App. 4th 1528, 1538-39; *Rodriguez v. McDonnell Douglass Corp.* (1978) 87 Cal. App. 3d 626, 674 ("*MacDonald & Kruse* classification is no longer tenable").
[11] 13 Cal. 3d at 628-29; *C.I. Engineers & Constructors, Inc., supra*, 140 Cal.App.3d at 1014-1015.
[12] *American. Motorcycle Assn. v. Sup. Ct*, (1978) 20 Cal.3d 578, 604.
[13] *Ralph M. Parsons Co. v. Combustion Equipment Assoc., Inc.* (1985) 172 Cal.App.3d 211, 228.

For contracts with "design professionals" (i.e. architects and engineers) under Civil Code § 2782.8, a city can only require indemnity for the professional's negligence, recklessness or willful misconduct. It is not clear, however, whether a public agency can require under Section 2782.8 indemnification for its own negligence (i.e. where the design professional is only partially at fault) by means of a Type I clause, or whether the Section is intended to limit the design professional's liability to the extent of its own negligent or wrongful conduct; nonetheless, you can expect a design professional to argue that the section implies comparative fault and to resist a Type I clause.[14] Shifting to a Type III clause, however, would mean that *any* negligence on the part of the indemnitee city would entirely vitiate the indemnity obligation of the design professional, which is not a desirable result. Accordingly, as a compromise, a clause should be used that has the effect of allocating indemnity obligations based on percentage of fault.

C. *A Shorter Note About Construction Contracts.*

As noted above, in construction contracts, a public agency can only seek indemnification for its passive negligence, and may not shift liability for defects in design.[15] But State law does not preclude a city seeking full indemnification for mixed claims, i.e. those claims where both a city (passively) and the contractor are at fault. Hence, while limited to passive negligence, the indemnity clause should require full indemnification even if the city is partially at fault.

D. *Defense and Insurance.*

Civil Code Section 2778 creates certain presumptions about indemnity clauses. For example, it provides that implied in every indemnity clause is the duty of defense of an indemnified claim.[16] While the issue of insurance coverage is not within the scope of this paper, note that defense obligations associated with contractual indemnity commitments are generally insurable, at least for negligent conduct.

E. *Summary.*

In summary, except when precluded by state law as noted above, cities should aspire to obtain indemnification for both their active and passive negligence and whenever feasible utilize a Type I clause. With this type of broad

[14] For an excellent discussion of this issue, see "Architect and Engineer Design Liability and AB 573: Big Deal or Ho-Hum, Roland Nikles, presented at the Spring 2007 City Attorney Conference. Nikles argues that the legislative history of Section 2782.8 contradicts the argument that it was intended to be a proportionate fault statute.
[15] Cal. Civil Code § 2782(b).
[16] Cal. Civil Code § 2778(3).

provision, the contractor must immediately defend a city following the occurrence of liability.[17] Alternatively, the indemnified party always has the option to defend itself, at the indemnitor's expense.[18] With a clause that only covers passive negligence or the contractor's wrongdoing, the fight is over the extent of the City's wrongdoing, which will preclude indemnity until a court decides that issue. Practically, this means that the City must defend itself first before a court rules whether it is entitled to be indemnified. A Type III clause, signified by its failure to address the consequences of the indemnitees' negligence, should be avoided because it bars recovery against the indemnitor if the indemnitee city is only minimally responsible for the injury.

III. Sample Indemnification Clauses[19]

A. *Type I*.

The below language has been interpreted as a Type I provision, indemnifying for both active and passive negligence, the critical language highlighted in bold font:

> The Contractor shall indemnify, defend, and hold harmless the City, and its officers, employees, and agents ("City indemnitees"), from and against any and all causes of action, claims, liabilities, obligations, judgments, or damages, including reasonable attorneys' fees and costs of litigation ("claims"), arising **out of the Contractor's performance of its obligations under this agreement or out of the operations conducted by Contractor, including the City's active or passive negligence, except for such loss or damage arising from the sole negligence or willful misconduct of the City.** In the event the CITY indemnitees are made a party to any action, lawsuit, or other adversarial proceeding arising from Contractor's performance of this agreement the Contractor shall provide a defense to the City indemnitees or at the CITY's option reimburse the City indemnitees their costs of defense, including reasonable attorneys' fees, incurred in defense of such claims.

As noted above, there are many different formulations of this language that will accomplish the goal. The key is (i) not to delete the phrase "except those arising from the sole negligence or willful misconduct of the City" as failure to address the consequences of the city's negligence will arguably convert this Type I clause to a Type III clause absent contrary evidence of the parties' intentions; and (ii) though not essential, try to include the phrase "active or passive," as otherwise, the

[17] Cal. Civil Code § 2778(3).
[18] Cal. Civil Code § 2778(4).
[19] These are for purpose of illustration only. They are not a substitute for the exercise of your own independent legal judgment when drafting the appropriate indemnity clause for any particular contract.

clause may be interpreted as protecting the city only from its passive negligence. Do not be surprised if the consultant wants to add the phrase "negligent or wrongful," or some variation thereof, in front of the word "performance" in the 5th line. Another, more detailed version of a Type I clause is as follows:

> CONSULTANT shall indemnify, defend with counsel approved by CITY, and hold harmless CITY, its officers, officials, employees and volunteers from and against all liability, loss, damage, expense, cost (including without limitation reasonable attorneys fees, expert fees and all other costs and fees of litigation) of every nature arising out of or in connection with CONSULTANT's performance of work hereunder or its failure to comply with any of its obligations contained in this AGREEMENT, except such loss or damage which is caused by the sole negligence or willful misconduct of the CITY. Should conflict of interest principles preclude a single lawyer from representing both CITY and CONSULTANT, or should CITY otherwise find CONSULTANT'S legal counsel unacceptable, then CONSULTANT shall reimburse the CITY its costs of defense, including without limitation reasonable attorneys fees, expert fees and all other costs and fees of litigation. The CONSULTANT shall promptly pay any final judgment rendered against the CITY (and its officers, officials, employees and volunteers) covered by this indemnity obligation. It is expressly understood and agreed that the foregoing provisions are intended to be as broad and inclusive as is permitted by the law of the State of California and will survive termination of this Agreement.

Note that the above clauses require indemnification by the indemnitor for liability arising from its "performance," regardless whether negligent or wrongful.

B. *Design Professionals.*

As noted earlier in this paper, Civil Code Section 2782.8 precludes a public agency from requiring an indemnity of the above kind in a contract with a design professional; instead, the indemnity obligation is restricted to the design professional's "negligence, recklessness or willful misconduct." Aside from that, Section 2782.8 does not expressly preclude a Type I clause in a contract with a design professional, as follows:

> CONSULTANT shall indemnify, defend with counsel approved by CITY, and hold harmless CITY, its officers, officials, employees and volunteers from and against all liability, loss, damage, expense, cost (including without limitation reasonable attorneys fees, expert fees and all other costs and fees of litigation) of every nature arising out of or in connection with CONSULTANT's negligence, recklessness or willful misconduct in the performance of work hereunder or its failure to comply with any of its obligations contained in this AGREEMENT, except such loss or damage which is caused by the sole active negligence or willful misconduct of the CITY. Should conflict of interest principles preclude a

> single lawyer from representing both CITY and CONSULTANT, or should CITY otherwise find CONSULTANT'S legal counsel unacceptable, then CONSULTANT shall reimburse the CITY its costs of defense, including without limitation reasonable attorneys fees, expert fees and all other costs and fees of litigation. The CONSULTANT shall promptly pay any final judgment rendered against the CITY (and its officers, officials, employees and volunteers) with respect to claims determined by a trier of fact to have been the result of the CONSULTANT's negligent, reckless or wrongful performance. It is expressly understood and agreed that the foregoing provisions are intended to be as broad and inclusive as is permitted by the law of the State of California and will survive termination of this Agreement.

Some consultants or contractors strenuously resist a Type I clause, because they are on the hook despite the City's passive contributory negligence. In such instances, do not merely drop the "sole negligence" phrase and inadvertently create a Type III clause. Instead, incorporate language that expresses the precise intent of the parties to allocate liability based on degree of fault. In his paper,[20] Nikles cautions that under Civil Code Section 2782, even a Type I clause in a design contract can only protect a public agency from its *passive* negligence, because it is a species of construction contracts; on page 8 he includes an alternative formulation of an indemnity clause that also expressly excludes the public agency's active negligence. Also, some city attorneys utilize a bifurcated indemnity clause because professional liability insurers typically will reimburse defense costs but not defend, whereas commercial general liability insurers will provide a defense.

C. *Comparative Indemnity.*

In light of the earlier discussion regarding comparative indemnity, the following clause is one example of language allocating liability based on degree of fault:

> CONSULTANT shall indemnify, defend with counsel approved by CITY, and hold harmless CITY, its officers, officials, employees and volunteers from and against all liability, loss, damage, expense, cost (including without limitation reasonable attorneys fees, expert fees and all other costs and fees of litigation) of every nature arising out of or in connection with CONSULTANT's performance of work hereunder or its failure to comply with any of its obligations contained in this AGREEMENT to the degree determined in a final and non-appealable judgment to be proportionate to its liability. Should conflict of interest principles preclude a single lawyer from representing both CITY and CONSULTANT, or should CITY otherwise find CONSULTANT'S legal counsel unacceptable, then

[20] See footnote 11.

> CONSULTANT shall reimburse the CITY its costs of defense, including without limitation reasonable attorneys fees, expert fees and all other costs and fees of litigation. The CONSULTANT shall promptly pay any final judgment rendered against the CITY (and its officers, officials, employees and volunteers) with respect to claims determined by a trier of fact to have been CONSULTANT's allocated share of liability. It is expressly understood and agreed that the foregoing provisions are intended to be as broad and inclusive as is permitted by the law of the State of California and will survive termination of this Agreement.

Another formulation of this idea is as follows:

> To the extent permitted by law, Consultant agrees to indemnify and hold harmless the City, its officers, employees and agents from any and all claims, damages (including court expenses and reasonable attorneys' fees) to persons or property, penalties, obligations or liabilities that may be claimed by any person, firm, entity, corporation, political subdivision or other organization arising out of the negligent acts, errors or omissions or willful misconduct of Consultant, its agents, employees, subcontractors, or invitees related to performance or nonperformance of this Agreement. To the fullest extent permitted by law, a party's total liability to the other party and anyone claiming by, through, or under the other party for any cost, loss, or damages caused in part by the negligence of the party and in part by the negligence of the other party or any other negligent entity or individual, shall not exceed the percentage share that the party's negligence bears to the total negligence of City, Consultant, and all other negligent entities and individuals.

Finally, a mutual indemnity also accomplishes this objective:

> To the fullest extent permitted by law, the parties agree to save, indemnify, defend, and hold harmless each other from any and all liability, claims, suits, actions, arbitration proceedings, administrative proceedings, and regulatory proceedings, losses, expenses, or any injury or damage of any kind whatsoever, whether actual, alleged or threatened, attorney fees, court costs, and any other costs of any nature without restriction incurred in relation to, as a consequence of, or arising out of, the performance of this Agreement, and attributable to the fault of the other. Following a determination of the percentage of fault and or liability by agreement between the Parties or a court of competent jurisdiction, the Party responsible for liability to the other will indemnify the other Party to this Agreement for the percentage of liability determined.

D. Type II Language for Construction Contracts.

Construction contracts typically include a long-form and very inclusive indemnity provision. The following paragraph, when added to an indemnity clause, will create a Type II indemnity provision compliant with state law:

> Contractor's obligations under this section apply regardless of whether or not such claim, charge, damage, demand, action, proceeding, loss, stop notice, cost, expense, judgment, civil fine or penalty, or liability was caused in part or contributed to by an Indemnitee. However, without affecting the rights of City under any provision of this agreement, Contractor shall not be required to indemnify and hold harmless City for liability attributable to the active negligence of City, provided such active negligence is determined by agreement between the parties or by the findings of a court of competent jurisdiction. In instances where City is shown to have been actively negligent and where City active negligence accounts for only a percentage of the liability involved, the obligation of Contractor will be for that entire portion or percentage of liability not attributable to the active negligence of City.

This language mirrors that used by the court in *C.I. Engineers & Constructors, Inc.* as an example of the type of language that would protect an indemnitee against its own passive negligence.[21]

IV. Conclusion

Examples of indemnity clauses abound. The California Joint Powers Insurance Authority publishes a booklet on the subject. The list serve archives include discussions on the subject. At bottom, when you craft your indemnity clauses, make certain that your indemnification is not merely boilerplate, but reflects the intentions of the parties regarding allocation of risk and does not inadvertently eliminate the protection you are intending to provide to the city.

[21] *C.I. Engineers & Constructors, Inc. v. Johnson & Turner Painting Co.*, supra, 140 Cal.App.3d at 1018.