Risk Shifting Clauses: Is a Trend Emerging?

In Article 601 in our Fall 2008 newsletter, we discussed recent court decisions in Georgia, North Carolina, and Arizona pertaining to the enforceability of contract clauses attempting to limit one party’s liability in light of state anti-indemnity statutes. Since then, two more similar decisions have been issued. These recent decisions, as well as those previously discussed, are informative because they explain key distinctions in these contractual “risk shifting” provisions.

The courts’ analyses and explanations should aid the construction professional in understanding how states may differ in their interpretation of these contractual risk shifting clauses, and should help guide in the drafting of “risk shifting” provisions, such as limitation of liability and indemnification clauses. These decisions further show that some courts appear willing to strike a balance between the contracting parties’ rights to allocate risks amongst themselves and public policy seeking to avoid too much allocation of risk to one party, perhaps indicating a trend that bears watching.

Arizona’s Analysis

In 1800 Ocotillo, LLC v. WLB Group, Inc., 196 P.3d 222 (Ariz. 2008) (“Ocotillo”), the Arizona Supreme Court upheld both the trial court and the court of appeals’ finding that a contractual limitation of liability provision did not violate Arizona’s stated public policy against broad form indemnification.

In Ocotillo, a property owner contracted with a surveyor to perform a boundary survey in anticipation of building a residential development. A boundary dispute arose and the owner claimed damages against the surveyor for construction delays and increased design and survey costs resulting from the negligently prepared survey. The written contract between the owner and the surveyor contained a contractual limitation of liability clause in which the parties agreed that the surveyor’s liability related to services rendered to the owner “and to all persons having contractual relationships with them, resulting from any negligent acts, errors and/or omissions” of the surveyor would be limited to the total fees paid by the owner to the surveyor. The owner’s damages exceeded the fees paid to the surveyor.

The applicable Arizona anti-indemnity statute provided:

A covenant, clause or understanding in, collateral to or affecting a construction contract or architect-engineer professional service contract that purports to indemnify, to hold harmless or to defend the promisee from or against liability for loss or damage resulting from the sole negligence of the promisee or the promisee’s agents, employees or indemnitee is against the public policy of this state and is void.

The Ocotillo court reasoned that the contractual limitation of liability provision did not run afoul of this statutory provision because the anti-indemnity statute, on its face, only extends to indemnification provisions that attempt to shift liability for one’s sole negligence. The court reasoned that the contract clause at issue
only limited (or shifted) liability for the design professional’s contract liability and, therefore, was not at odds with the statutory prohibition.

The _Ocotillo_ court also distinguished its ruling from a seemingly contrary ruling penned by the Georgia Supreme Court in _Lanier at McEver, L.P. v. Planners & Engineers Collaborative, Inc._, 663 S.E. 2d 240 (Ga. 2008) ("Lanier"). In _Lanier_ (previously discussed in our Fall, 2008 newsletter), the Georgia Supreme Court held that a contractual limitation of liability clause somewhat similar to the one in _Ocotillo_, violated Georgia’s comparable anti-indemnity statute. The _Ocotillo_ court distinguished its ruling from the _Lanier_ ruling by contrasting the two contract provisions. The _Lanier_ contract clause included a similar liability cap tied to amounts paid to the design professional, but it also stated that this liability cap included claims brought by third parties—that is, persons who were not parties to the underlying contract. The contract clause at issue in _Ocotillo_ only capped liability for "contract" claims.

**New York’s Analysis**

Similarly, in _Brooks v. Judlau Contracting_, 898 N.E. 2d 549 (N.Y. 2008) ("Brooks"), the Court of Appeals of New York was asked to determine whether a contractual indemnification provision between a general contractor and subcontractor violated New York’s anti-indemnity statute. _Brooks_ takes up a slightly different, but all too familiar battle—the conflict between a general indemnification clause in a general contractor/subcontractor arrangement and an anti-indemnity statute. In _Brooks_, an ironworker employed by a subcontractor, was injured on a highway construction project, having fallen after grabbing onto a perimeter safety cable that came loose. The injured ironworker sued the general contractor, Judlau Contracting, claiming that it had improperly installed the safety cable. The general contractor then sued the subcontractor/employer, under the subcontract’s general indemnification clause. The trial court dismissed the general contractor’s complaint against the subcontractor on grounds that the contractual indemnification clause violated New York’s anti-indemnity statute, and this decision was later affirmed by another New York appellate court.

This contract’s general indemnity provision required the subcontractor to, “to the fullest extent permitted by law, hold the [general contractor] harmless from all liability, costs, damages, attorneys’ fees, and expenses from any claims or causes of action of whatever nature arising from the Subcontractor’s work ....” (Emphasis added). New York’s anti-indemnity statute, which is much broader than Arizona’s, states in pertinent part:

A covenant, promise, agreement or understanding in, or in connection with … a contract or agreement relative to the construction, alteration, repair or maintenance of a building … purporting 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, his agents or employees, or indemnitee, whether such negligence be in whole or in part, is against public policy and is void and unenforceable.

In overturning the lower courts’ rulings, New York’s highest appellate court found that the contractual indemnification provision
did not violate the anti-indemnity statute. The court reasoned that, while the general contractor could not seek indemnification from the subcontractor for its own negligent acts without violating public policy, the general contractor could still seek indemnification for the subcontractor’s negligent acts. Based upon a detailed analysis of the subcontract language, “To the fullest extent permitted by law,” the Brooks’ decision limited the scope of the indemnification clause such that the contractor could seek indemnification from the subcontractor’s negligent acts.

Comment

The reader should take away two key points from these cases about the enforceability of construction contracts indemnity clauses. First, the Brooks decision shows that enforceability of a construction indemnity clause depends on whether governing state law has an anti-indemnity law. As parties in the construction industry may have contracts in several states, it might be impossible to use a single, enforceable anti-indemnity clause, because laws vary from state to state.

Second, the language of the governing state law may be decisive. The importance of statutory language is compounded by the fact that different states regulate indemnity clauses differently. Many states, such as Georgia (See O.C.G.A. § 13-8-2), prohibit contract indemnity clauses that allow a party to be indemnified for its own negligence or misconduct. Other states, such as North Carolina (See N.C. Gen. Stat. 22B-1), prohibit indemnity clauses as a general matter, but allow each party to accept liability for its own negligence. Finally, several states have enacted statutes that reflect individual policies and considerations deemed uniquely important in those states. Florida, for example, prohibits indemnity contract clauses generally, but creates its own set of exceptions allowing enforcement of indemnity agreements. (See Fla. Stat. Ann. § 725.06(2).) The same or similar results might be reached in all of these states, but the contract language used may have to be different from state to state. Thus, the enforceability of an indemnity clause depends on specific language in the statute (if any) of the state whose law governs.

The Brooks case suggests that some of the obstacles to enforcement of an indemnity clause may be overcome by an indemnity clause that applies “to the fullest extent of, but no farther than, the indemnity allowed by state law”. In the end, however, to insure a valid indemnity clause for use in a particular state may require knowledge of both the law of the state that will apply and the language of the clause that is employed in the contract. It is essential for any contractor or subcontractor to know and understand that the law varies from state to state on the extent to which contractual risk shifting provisions may be deemed enforceable. Therefore, the prudent contractor or professional must understand the laws of the state in which it will be contracting for, and performing, work when developing, or attempting to enforce, such contractual provisions.

Second, and more generally, a trend appears to be emerging in the courts. Broad contractual limitation clauses attempting to avoid liability for claims coming from “non-contracting” parties (i.e., third parties), and broad indemnification clauses attempting to require the indemnitor to assume liability for the indemnitee’s negligent acts, appear to be disfavored. As such, they will probably not be enforced when challenged. With this understanding, the
prudent construction professional would be wise to review and, possibly, revise his contractual risk shifting clauses to account for these restrictions and, hopefully, avoid being faced with unenforceable contract provisions.