

Heppler v J.M. Peters Co.: Review Your Construction Contract Indemnity Provisions

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When things go wrong on a construction project, the express indemnity provisions of the construction agreements move to center stage and become a major focus of attention. A carefully drafted indemnity provision is a risk-allocation mechanism that can literally save a party from economic ruin. See [2 California Construction Contracts and Disputes, chap 9 \(3d ed Cal CEB 1999\)](#). On the other hand, a carelessly drafted indemnity clause, or one treated as mere boilerplate, can have catastrophic consequences. In a recent California case, [Heppler v J.M. Peters Co. \(1999\) 73 CA4th 1265, 87 CR2d 497](#), the court of appeal reexamined the issue of express indemnity clauses, and provided a road map for drafting them. This is an important case for all attorneys representing parties who sign contracts containing indemnity provisions.

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Heppler involved two appeals arising from construction defect litigation regarding a residential development in San Diego. Plaintiffs were a certified class of homeowners in the development. Plaintiffs alleged that the project contained defective roofs, foundations, and other soil-related conditions. The developer settled the class action suit by paying over \$5 million and assigning its indemnity rights against nonsettling subcontractors (the mass grader, the roofer, the landscaper, and the designer-builder of the concrete foundations).

The class action plaintiffs, standing in the shoes of the developer, proceeded to trial, seeking contractual indemnity from the nonsettling subcontractors. In a series of pretrial rulings, the trial court decided, among other things, that plaintiffs would have to prove each subcontractor’s fault (negligence and causation) to trigger the subcontractor’s indemnity obligation. The jury heard the case and returned defense verdicts in favor of all but one of the subcontractors. On appeal, plaintiffs attacked the trial court rulings, claiming they resulted in the jury hearing a negligence case rather than a breach of contract case.

To determine whether the subcontractors’ fault was a prerequisite to indemnity, the court of appeal reviewed California law regarding indemnity agreements. Indemnity is a legal obligation of one party to make good a loss or damage to another party. An indemnity clause is a contract provision by which one party

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(indemnitor) agrees to hold the other party (indemnitee) harmless from the consequences of the acts or omissions of one of the parties or some other person or entity. [CC §2772](#).

Traditional “Three-Type” Analysis of Indemnity Clauses

For the past quarter of a century, California courts have divided express indemnity agreements into three groups and analyzed them under a fundamentally mechanical classification that focuses on the indemnitee’s active or passive negligence. See, e.g., *MacDonald & Kruse, Inc. v San Jose Steel Co.* (1972) 29 CA3d 413, 419, 105 CR 725.

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A Type I indemnity provision “expressly and unequivocally” obligates the indemnitor to indemnify the indemnitee for, among other things, the consequences of the indemnitee’s negligence. This type of indemnity applies even if the indemnitee was actively negligent. Courts require clear and explicit language for this broad indemnity, and strictly construe Type I provisions against the indemnitee.

A Type II agreement provides indemnity for losses resulting in part from the indemnitee’s passive negligence, but not the indemnitee’s active negligence. If an indemnity clause does not address the issue of the indemnitee’s negligence, it is referred to as a “general” indemnity clause and placed in the Type II classification.

Finally, in a Type III indemnity agreement, the indemnitor promises to be responsible for the indemnitee’s liabilities caused by the indemnitor, but not for the indemnitee’s liability caused by anyone else. Under Type III provisions, the indemnitor is held responsible for the indemnitee’s liabilities that result solely from the indemnitor’s negligence, but is not responsible if the indemnitee’s negligence contributed to the liability. For further explanation of these types of indemnity clauses, see [2 Construction Contracts §9.54](#).

Recent Cases Look to Parties’ Intent

Under the traditional classification test, the courts developed what was often a formalistic approach based on how specific language had been interpreted in other cases. See *MacDonald & Kruse, Inc. v San Jose Steel Co.*, *supra*. At times, this mechanical approach seemed to ignore the intent of the parties to the agreement. More recently, some courts have taken the opposite approach by ignoring the interpretation of specific language in other cases, and even disregarding the general classification rules discussed above. Instead, these cases hold that the intent of the parties controls. For example, some courts have found that an indemnity obligation can apply to the indemnitee’s active negligence even if the indemnity agreement

does not expressly address the issue of the indemnitee's negligence. See *Morton Thiokol, Inc. v Metal Bldg. Alteration Co.* (1987) 193 CA3d 1025, 238 CR 722; *Rooz v Kimmell* (1997) 55 CA4th 573, 64 CR2d 177; *Maryland Cas. Co. v Bailey & Sons, Inc.* (1995) 35 CA4th 856, 41 CR2d 519. This state of the law makes it critical for parties who wish to obtain the benefit of their bargain to express precisely their intent in the contract. See 2 *Construction Contracts* §§9.53–9.56.

The *Heppler* Indemnity Clauses

In *Heppler*, the developer's subcontracts with the grader and the landscaper provided for indemnity from all claims (73 CA4th at 1272)

arising out of or in connection with Subcontractor's . . . performance of the Work and for any breach or default of the Subcontractor in the performance of its obligations under this Agreement. However this indemnification shall not apply if such claims, demands or liability are ultimately determined to have arisen through the sole negligence of Contractor.

The subcontracts signed by the roofer and the designer-builder of the concrete foundations provided that "Contractor does agree to indemnify and save Owner harmless against all claims . . . growing out of the execution of the work, and at his own expense to defend any suit or action brought against Owner founded upon a claim of damage." 73 CA4th at 1273.

Trial Court Ruled Indemnity Triggered by Subcontractor Negligence

The trial court found the first provision to be a Type I indemnity and classified the second as Type II. After applying this traditional analysis, the trial court held that both indemnification provisions required proof of the subcontractors' negligence and causation to trigger the indemnity obligation. 73 CA4th at 1281.

Court of Appeal Required Examination of Parties' Intent

On appeal, the court began its analysis by noting that recent supreme court decisions had cautioned against a mechanical application of the three-type test. The *Heppler* court rejected the active/passive dichotomy in favor of a traditional contract interpretation approach. Citing *E.L. White, Inc. v City of Huntington Beach* (1978) 21 C3d 497, 507, 146 CR 614, the court stated that express indemnity is contractual and permits the parties "great freedom of action" in establishing their indemnity arrangements and at the same time subjects the resulting contract to "established rules of construction." See 73 CA4th at 1276. The *Heppler* court agreed with the supreme court's conclusion in *Rossmoor Sanitation, Inc. v Pylon, Inc.* (1975) 13 C3d 622, 633, 119 CR 449, that "[w]hen the parties knowingly bargain for the protection at issue, the protection should be afforded." 73 CA4th at 1277. Accordingly, in deciding whether an indemnity agreement covers a specific situation, the court must examine the intent of the parties as expressed in the agreement. The *Heppler* court acknowledged that, under this test, each case will turn on its own facts because the analysis will require an inquiry into the circumstances of the damage or injury and the language of the contract.

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Reduced to its simplest terms, the court said that merely classifying indemnity clauses as Type I, II, or III does not answer all of the questions. A court must first examine the indemnity clause to see whether the parties intended to provide indemnification for negligence (passive or both active and passive) on the part of the *indemnitee*, and whether the clause was intended to apply only if the *indemnitor* is negligent. After this analysis is complete, the court will apply the intent of the parties to the circumstances of the damage or injury.

Limitations on Indemnity Clauses in Construction Contracts

The court in *Heppler* stated that the parties to an indemnity contract can allocate risk as they see fit, as long as their language is clear, with two exceptions. The first exception, found in [CC §2782](#), is that construction contracts cannot provide for indemnification for injury caused *solely* by the indemnitee’s negligent or willful conduct. See [2 Construction Contracts §9.55](#).

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In dictum, the court identified another possible limitation on the parties’ freedom to allocate risk if the parties to the indemnity agreement are a developer of mass-produced housing and a subcontractor. 73 CA4th at 1279. Under California law, a developer of a mass-produced housing project is strictly liable for construction defects, but a subcontractor working on the project is not. An indemnity provision that requires a subcontractor to indemnify the developer regardless of the subcontractor’s fault would transfer the developer’s strict liability obligation to the subcontractor. Although the *Heppler* court did not decide this issue, it indicated that shifting a developer’s strict liability to a subcontractor may be contrary to public policy, at least in the context of mass-produced housing, in which many subcontractors have discrete jobs in the project and the developer controls the component parts. The decision in *Maryland Cas. Co. v Bailey & Sons, Inc. (1995)* [35 CA4th 856](#), [41 CR2d 519](#), reached the opposite result. In that case, the court approved the indemnity arrangement, stating that “general contractors should be permitted to spread the cost of strict liability to culpable subcontractors.” 35 CA4th at 872.

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Broader Indemnity Clauses Require Greater Specificity

With the exceptions discussed above, the *Heppler* court held that an indemnity provision can require one party to completely indemnify another party, even if the indemnified party is actively negligent and the indemnifying party is not negligent. The court did caution that indemnity provisions are strictly construed against the indemnitee and that “to obtain greater indemnity, more specific language must be used.” 73 CA4th at 1278. If the *Heppler* parties had intended that indemnity “would apply regardless of the subcontractor’s negligence, they would have had to use specific, unequivocal contractual language to that effect.” 73 CA4th at 1278. If the agreement does not expressly address the indemnitor’s negligence, the court will require proof of the indemnitor’s negligence to trigger indemnity.

Drafting for Maximum Indemnity Protection

On the issue of what specific language will provide the maximum indemnity, the *Heppler* court cited with approval *Continental Heller Corp. v Amtech Mechanical Servs.* (1997) 53 CA4th 500, 61 CR2d 668. In that case, the court rejected an argument that every action for indemnity requires a showing of fault on the part of the indemnitor. The *Continental Heller* court held that an indemnity provision that required the subcontractor to indemnify a general contractor for loss that “arises out of or is in any way connected with the performance of work under this Subcontract,” and that applied “to any acts or omissions, willful misconduct or negligent conduct, whether active or passive, on the part of the Subcontractor,” left no doubt that the parties intended indemnity to apply regardless of the subcontractor’s fault. 53 CA4th at 505.

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The *Heppler* decision makes it clear that owners and general contractors may obtain indemnity from subcontractors even if the owner or general contractor is actively (but not solely) negligent and the subcontractor is not negligent. To obtain maximum indemnity, the contract should

- Provide for indemnity for any loss that arises out of or is in any way connected with the performance of the work under the contract, regardless of the active or passive negligence of the *indemnitee*, except if the loss is determined to have arisen through the *sole* negligence of the indemnitee;
- Specify that the indemnity will apply to any acts or omissions, willful misconduct or negligent conduct, whether active or passive, on the part of the *indemnitor*; and
- Expressly state the parties' intent that indemnity will apply regardless of whether the indemnitee's loss results from the indemnitor's negligence or any other cause, except for the sole negligence or willful misconduct of the indemnitee.

An indemnity clause should be a negotiated provision of the contract. Owners and general contractors will try to include language that creates the maximum indemnity for their benefit, while subcontractors and materialmen will resist these provisions with all the leverage they can muster.

Drafting Attorney Fee Clause

An indemnity provision that includes attorney fees only as an item of loss on the indemnity obligation does not permit recovery of attorney fees incurred in an action to enforce the indemnity contract. For these fees to be recoverable, the agreement must specifically provide for them. *Otis Elevator Co. v Toda Constr.* (1994) 27 CA4th 559, 32 CR2d 404; *Hillman v Leland E. Burns, Inc.* (1989) 209 CA3d 860, 257 CR 535. See also 1, 2 Construction Contracts §§6.28, 9.58.

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Therefore, when drafting an agreement containing an indemnity provision, counsel intending to obtain the maximum indemnity protection for the indemnitee should either expand the general attorney fee clause or add language to the indemnity clause that provides for the recovery of attorney fees incurred to enforce the indemnity rights.

Conclusion

In light of the *Heppler* case, it is time to give special attention to all those standard indemnity clauses that have been treated as boilerplate and taken for granted. All attorneys who deal with indemnity agreements should understand the scope and consequences of the language used in the indemnity provisions (and attorney fee clauses) that they draft or may have to enforce. After a dispute arises, the finger pointing will start, and those who understand the rules of the game and

have an indemnity clause in the contract that protects their interests will have a significant advantage. For comprehensive discussion of express indemnity, see 2 *California Construction Contracts and Disputes* §§9.53–9.60 (3d ed Cal CEB 1999). On negotiating indemnity agreements, see Akawie, *Down to Earth: Tips on Negotiating Indemnity Provisions*, 21 CEB Real Prop L Rep 101 (May 1998).