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How to Thrive at the Bottom of the Sewer Pipe

Hot Topics and Best Practices for Managing Indemnity Risk in Construction Defect Litigation

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Contractual Indemnity: The gift that keeps on giving (or taking)

Contractual indemnification provisions may circumvent Worker's Compensation Exclusivity and expose employers to double risk.

Introduction

Although workers' compensation is typically meant to provide the exclusive remedy for an employee's injuries and protect the employer from civil suit, some workers' compensation laws provide a "loophole" that leaves employers vulnerable to being doubly financially responsible for an employee's injuries. For instance, if a subcontractor's employee is injured and receives workers' compensation benefits, the subcontractor should, in theory, be immune from civil liability. However, if the employee were to sue the general contractor for his injuries, several courts have held under their respective state workers' compensation statutes that the subcontractor must fulfill its indemnification obligation to the general contractor if the contract between the subcontractor and the general contractor includes an express indemnification provision. Thus, the subcontractor no longer reaps the intended benefits of workers' compensation insurance.

All states have enacted workers' compensation statutes which guarantee an employee compensation for workplace injuries regardless of fault.[1] Workers' compensation statutes impose liability without fault on the employer and prohibit common-law suits by employees against their employer.[2] Workers' compensation is meant to provide the exclusive remedy for an employee's injuries and make the employer immune to civil suits.[3] However, the immunity workers' compensation is intended to provide to employers has been compromised in recent years by express indemnification provisions in contracts. Whereas implied indemnity arises out of the relationship between parties and is very fact dependent, express indemnity allocates the risk of loss more precisely by including an express indemnity provision in the contract.[4] Consequently, contractual indemnification provisions are utilized to control and allocate risk.[5] As all states have distinct workers' compensation schemes, courts have navigated the tension between workers' compensation immunity and contractual indemnification according to the language of their own workers' compensation laws.

Approaches to Contractual Indemnity and Workers' Compensation

Broad Interpretation

As it is explicitly stated in New York's Workers' Compensation Law, New York courts have long held that an employer could be obligated to indemnify a third-party tortfeasor when the employer's employee sues the third-party tortfeasor if there is a contract between the employer and tortfeasor that includes an express indemnification provision.[6] New York's Workers' Compensation Law provides that an employer can be liable to a third party if the employee has sustained a grave injury or where there is a "written contract entered into prior to the accident or occurrence by which the employer had expressly agreed to contribution to or indemnification of the claimant."[7] The two limited exceptions to workers' compensation immunity actually represent a reduction of an employer's exposure to liability; the statute was amended in 1996 to limit the judicially created right of a third party to seek contribution or indemnity from an injured employee's employer.[8] "[T]he purpose of [the amendment] was to abolish most third-party actions so as to enhance the exclusivity of the Workers' Compensation Law, thereby

reducing insurance premiums and decreasing the cost of doing business in New York."[9] However, express indemnification provisions contained in many construction contracts continue to leave the parties involved vulnerable to third party law suits seeking contribution or indemnification, even after a party has paid workers' compensation benefits to its injured employee.

In 2005, the Court of Appeals of New York reversed the trial court's finding that a subcontractor was not obligated to indemnify the general contractor in light of the indemnification agreement entered into by both parties.[10] In *Rodrigues v. N & S Building Contractors, Inc.*, N & S Contractors subcontracted with Caldas Concrete Company to erect the concrete foundation. Both parties entered into a contract, a provision of which stated:

> "[t]o the fullest extent permitted by law, Subcontractor [Caldas] shall indemnify and hold harmless N. & S. Building Contractors, Inc. and Owner against any claims, damages, losses, and expenses, including legal fees, arising out of or resulting from performance of subcontracted work to the extent caused in whole or in part by the Subcontractor or anyone directly or indirectly employed by the subcontractor."[11]

While working on the project, an employee of Caldas fell into a trench and was impaled on a piece of rebar.[12] The employee then sued the general contractor, N & S Building Contractors.[13] The court remarked that "there is no question that the Workers' Compensation Law allowed N & S and Caldas to enter into an agreement that would indemnify N & S for any losses it might suffer as a result of a personal injury action by a Caldas employee."[14] In holding so, the court relied on the New York workers' compensation law exception that "expressly permits indemnification claims 'based upon a provision in a written contract.'"[15] Moreover, the court noted that the indemnification provision does not need to specify the sites, persons and types of losses covered.[16] "So long as a written indemnification provision encompasses an agreement to indemnify the person asserting the indemnification claim for the type of loss suffered, it meets the requirements of the statute."[17]

In recent years, New York courts have continued to uphold the right of a third party to recover under an express contractual obligation between an employer and the third party. In April 2023, the New York State Appellate Division of the Supreme Court addressed the interplay of workers' compensation and contractual indemnification in *Velazquez-Guadalupe v. Ideal Builders and Construction Services, Inc*.[18] In *Velazquez-Guadalupe*, the owner and general contractor argued they were entitled to indemnification or contribution from the employer-subcontractor.[19] However, because there was no evidence that the subcontractor agreed in writing to contribute to or indemnify any party, the Court held that the subcontractor was not obligated to indemnify the owner of the property or the general contractor.[20]

Similar to the Court of Appeals of New York decision in *Rodrigues v. N & S Building Contractors, Inc.*, the Supreme Court of Virginia addressed the exclusivity of workers' compensation with regard to indemnification and found that the Virginia Workers' Compensation Act did not invalidate an express indemnification agreement between an employer and a third party.[21] In *Safeway, Inc. v. DPI Midatlantic, Inc.*, the court found that DPI was obligated to indemnify Safeway after an employee of DPI fell in a store owned and operated by Safeway.[22] The court relied on the written agreement of indemnification entered into by DPI and Safeway which obligated DPI "to indemnify, defend and hold [Safeway] harmless from

and against any and all claims, demands, actions and proceedings…."[23] The court reasoned that "DPI specifically contracted to indemnify Safeway for certain types of losses."[24] Therefore, although DPI had already paid workers' compensation benefits to their employee, "enforcing the [a]greement between Safeway and DPI is merely enforcing the loss distribution agreed to by them."[25]

Strict Interpretation

Some courts have been more particular in the language required to demonstrate that an employer intended to waive workers' compensation immunity and obligate themself to indemnify another. In March 2020, the United States District Court for the Eastern District of Pennsylvania held that language that "the parties agreed to indemnify each other from 'any and all claims' for bodily injury to 'any person' is plainly insufficient, under Pennsylvania law, to show that Manpower agreed to indemnify Northtec for claims by Manpower's own employees."[26] The court noted that the Pennsylvania Workers' Compensation Act allows a third party to seek contribution or indemnity for the employer if there is "an express provision for indemnity in a written contract."[27] To satisfy the requirement of an express provision for indemnity, "[t]he provision 'must either explicitly state that it covers such claims, or state that the employer's indemnity obligations are not limited by the protections of the Worker's Compensation Act.'"[28]

Texas courts have also focused heavily on the language of the indemnification provision and applied an "express negligence test" to the language of contractual indemnification provisions.[29] Under Texas law, "the payment of workers' compensation benefits is a bar to indemnity in the absence of a written agreement expressly assuming such liability."[30] Written agreements "expressly assuming such liability" must meet the express negligence test.[31] The test was established by *Ethyl Corp. v. Daniel Construction Co.* in 1987 and requires "[w]hen a party is seeking indemnity from the consequences of its own future negligence, that intent must be expressed in unambiguous terms within the four corners of the contract."[32] Texas courts have found language that states the indemnitor "assumes entire responsibility for any claim ... regardless of whether such claims ... are founded in whole or in part upon alleged negligence of [indemnitee], [indemnitee's] representative, or the employees, agents, invitees, or licensees thereof" met the express negligence test.[33] Additionally, contract language that stated, "that the indemnitor…agreed to hold harmless and unconditionally indemnify the indemnitee…for 'any negligent act of omission of…, its officer, agents or employees....'" satisfied the express negligence test.[34] Conversely, contract language that stated that "the subcontractor…would indemnify the contractor…for 'any negligent act or omission of the [subcontractor], arising out of or resulting from the performance of the Subcontractor's Work…regardless of whether it is caused in part by a party indemnified hereunder'" did not satisfy the express negligence test.[35]

In addition to requiring specific language to demonstrate express intent to indemnify, courts have also focused on traditional contract principles. For example, in *Precision Air, Inc. v. Standard Chlorine of Delaware, Inc.*, the Supreme Court of Delaware held that an employer cannot be held liable as a joint tortfeasor for contribution when it has already paid workers' compensation benefits but can be obligated to indemnify a third-party tortfeasor under a theory of contractual indemnity.[36] Specifically, the court held that the employer can be required to indemnify a third-party tortfeasor if the contract requires the employer to perform its duty to perform work in a workmanlike manner and indemnify the third-party tortfeasor.[37] The court focused on the independent duty aspect of the indemnification provision, rather

than only requiring an express indemnification provision generally.[38] The court reasoned the employer was obligated to indemnify the third-party tortfeasor because the indemnification claim was based on the employer's negligence in breaching its duty, rather than the third-party tortfeasor's negligence.[39]

Similarly, in *Holt v. Walsh Group*, the United States District Court for the District of Columbia held a general contractor was entitled to indemnification but not contribution under the Workers' Compensation Act's exclusivity provision because indemnification was a contractual obligation whereas contribution was a tort claim.[40] In *Holt*, an employee was working on a construction site when he fell through a hole in the roof.[41] Although the employee received workers' compensation benefits, he filed suit against the general contractor of the construction project for "negligent control of the construction premises and project."[42] The court found that the subcontractor was obligated to indemnify the general contractor because "it is 'well-settled in most jurisdictions' that an employer's agreement to indemnify a third party pursuant to an express contract is an exception to the exclusivity provision of a workers' compensation statute."[43] Like the court in *Precision Air, Inc.*, the court in *Holt* focused on the independent duty aspect of an indemnification claim and reasoned indemnification was permissible because "the duty involved is one voluntarily accepted by the employer and exist[s] separate and apart from either of the parties' relationship with the injured employee."[44] Therefore, the indemnification claim is based in contract and not barred by the workers' compensation laws.[45] However, the court did not allow the general contractor to seek contribution because a contribution claim "'sounds primarily in tort'" and is barred under the workers' compensation exclusivity provision that makes employers immune from tort actions by their employees.[46] The court also highlighted the importance of the language of the contract considering "[e]xpress indemnification agreements… are 'narrowly construed by the courts.'"[47] In analyzing the indemnification agreement in this case, the court was satisfied "[t]he use of the language 'indemnify' and 'save harmless' expressly and unambiguously created an indemnitor-indemnitee relationship between the contracting parties."[48]

Conclusion

As the ability to circumvent workers' compensation exclusivity seems to have become an accepted practice across the United States, there are several ways employers can attempt to shield themselves from the double exposure of both workers' compensation and indemnification obligations. First, many states have enacted statutes that require employers who contract out work that is part of their trade, business, or occupation to provide workers' compensation coverage.[49] The workers' compensation coverage then immunizes the statutory employer from tort liability to the statutory employee.[50] Consequently, an employee cannot collect workers' compensation benefits from the statutory employer and then sue the statutory employer for the same injury.[51] Instead of being exposed to double liability like the subcontractor was in the earlier example, if the general contractor was a statutory employer of the injured employee, the employee could not sue the general contractor for his injuries. If the general contractor is not sued by the injured employee, the subcontractor need not fulfill its indemnification obligation to the general contractor, even if the contract between the subcontractor and the general contractor includes an express indemnification provision. Thus, the subcontractor continues to reap the intended benefits of workers' compensation insurance.

Additionally, contract drafting is an important tool in avoiding double liability for workers' compensation and indemnification in the same occurrence. Express contractual indemnification

provisions could be drafted to clearly state that the indemnitor's obligation is limited by the protection afforded to it under workers' compensation acts. Rather than simply using language that creates general indemnities, like "all liability…arising out of the work undertaken by the subcontractor,"[52] employers can utilize the shield provided by workers' compensation laws and limit their future liability by including a specific exception to indemnification in the contract.[53]

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[1] 1 MODERN WORKERS COMPENSATION, Workers' compensation as exclusive remedy § 102:1 (2023).
[2] *Id.*
[3] *Id.*
[4] Jeffery M. Hummel & Z. Taylor Shultz, *Indemnification Principles and Restrictions on Construction Projects*, CONSTRUCTION BRIEFINGS, No. 2005-8.
[5] *Id.*
[6] N.Y. Workers' Compensation Law § 11 (McKinney 2022).
[7] *Id.*
[8] Majewski v. Broadalbin-Perth Cent. School Dist., 696 N.E.2d 978, 981 (1998).
[9] *Id.* at 983 (citing Morales v. Gross, 657 N.Y.S.2d 711, 711 (N.Y. App. Div. 2d Dept. 1997)).
[10] Rodrigues v. N & S Building Contractors, Inc., 839 N.E.2d 357, 358 (2005).
[11] *Id.*
[12] *Id.*
[13] *Id.* at 358–59.
[14] *Id.* at 359.
[15] *Id.*
[16] *Id.* at 360.
[17] *Id.*
[18] Velazquez-Guadalupe v. Ideal Builders and Construction Services, Inc., 188 N.Y.S. 3d 537 (N.Y. App. Div. 2d Dept. 2023).
[19] *Id.* at 541.
[20] *Id.* at 547.
[21] Safeway, Inc. v. DPI Midatlantic, Inc., 270 Va. 285, 286, 619 S.E.2d 76, 77 (2005).
[22] *Id.* at 286-87, 619 S.E.2d at 77.
[23] *Id.* at 287-88, 619 S.E.2d at 78.
[24] *Id.* at 290, 619 S.E.2d at 79.
[25] *Id.*
[26] Bookard v. Estee Lauder Companies, Inc., 443 F. Supp. 3d 561, 574 (E.D. Pa. 2020).
[27] *Id.* at 573.
[28] *Id.*
[29] Glendale Const. Services, Inc. v. Accurate Air Systems, Inc., 902 S.W.2d 536, 537 (Tex. App. 1995).
[30] *Id.* at 539.
[31] *Id.*
[32] David C. Wilkerson, *Are Contractual Indemnity Agreements Contracts of Insurance?*, 9 J. TEX. INS. L. 2 (Winter 2008-2009).
[33] *See* Glendale Const. Services, Inc., 443 F. Supp. 3d at 538 (*citing* Enserch Corp. v. Parker, 794 S.W.2d 2, 6-7 (Tex. 1990)).
[34] *See* Glendale Const. Services, Inc., 443 F. Supp. 3d at 538 (*citing* Atlantic Richfield Co. v. Petroleum Personnel, Inc., 768 S.W.2d 724, 724 (Tex. 1989).
[35] *See* Glendale Const. Services, Inc., 443 F. Supp. 3d at 538 (*citing* Atlantic Richfield Co. v. Petroleum Personnel, Inc., 768 S.W.2d 724, 724 (Tex. 1989).
[36] Precision Air, Inc. v. Standard Chlorine of Delaware, Inc., 654 A.2d 403, 407 (1995).

[37] *Id.*
[38] *Id.*
[39] *Id.*
[40] Holt v. Walsh Group, 316 F. Supp. 3d 274, 280-83 (D.D.C. 2018).
[41] *Id.* at 276.
[42] *Id.* at 278.
[43] *Id.* at 279 (*citing* Myco, Inc. v. Super Concrete Co., Inc., 565 A.2d. 293, 297 (D.C. 1989)).
[44] *Id.* at 280.
[45] *Id.*
[46] *Id.* at 283.
[47] *Id.* at 280.
[48] *Id.*
[49] 1 MODERN WORKERS COMPENSATION, Statutory employers § 103:17 (2023).
[50] *Id.*
[51] *Id.*
[52] James E. Joesph, *Indemnification and Insurance: The Risk Shifting Tools (Part I)*, 79 PA. BAR ASS'N Q. 156 (2008) (discussing indemnity language analyzed by Pennsylvania courts).
[53] Contractors working in New York should be guided by the *Brooks* decision when crafting contractual indemnification provisions. *Brooks v. Judlau Contracting, Inc.*, 11 N.Y.3d 204 (N.Y. 2008). In particular, the Court's holding that "there is no language within General Obligations Law § 5-322.1 that prevents partial indemnification provisions such as the one currently before us from being enforced in a case where it is shown that both a general contractor and its subcontractor are joint tortfeasors" suggests that, under New York law, contractual indemnification provisions utilizing the "fullest extent of the law" language contained in the provision at issue in *Brooks* will not violate General Obligations Law § 5-322.1 and will permit a contractor, even one that is partially negligent, to pursue a contractual indemnification claim for damages caused by the subcontractor's negligence. Also, some construction agreements have hold harmless/indemnity clauses which give rise to a duty to indemnify for liability "arising out of the work" and others have a negligence trigger, akin to "caused in whole or in part by acts or omissions." The two indemnity clauses are treated by the courts in New York as the language requires. The New York Court of Appeals ruled in *Burlington Ins. Co. v. NYC Tr. Auth.* that the language caused in whole or in part by acts or omissions requires that the other party proximately caused the accident and "in whole or in part" means one percent is enough to trigger additional insured language. 29 N.Y.3d 313, 51 N.Y.S.3d 489 (2017).