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When Indemnitors And Indemnitees Jointly Cause A Loss

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Often, contractual indemnification clauses require an indemnitor to pay the indemnitee's loss that is "caused by" the indemnitor's actions. What does this language mean when the indemnitor and indemnitee are jointly responsible for the loss? A recent decision from the California Court of Appeal, Oltmans Construction Co. v. Bayside Interiors Inc., shows how a simple modifying phrase — "to the extent" — can avoid the uncertainty created by less precise language.[1] Oltmans confirms that those three additional words unambiguously clarify that the indemnity obligation applies (or is reduced) only "to the extent" that each of the parties is responsible for causing the loss.

Oltmans provides useful guidance for drafting indemnity clauses in a way that provides a clear and unambiguous allocation of responsibility. In California, if the contract does not provide additional clarity on this issue, an indemnity clause can plausibly be interpreted in a number of contradictory ways:

- The indemnitor must pay 100 percent of the indemnitee's loss if the indemnitor's conduct was a contributing cause of the loss, even if the indemnitee was also responsible for causing the loss.[2]
- The indemnitor must pay only the proportionate share of the loss that it proximately caused.[3]
- The indemnitor pays *only if* it was the *sole* cause of the loss, and it pays nothing because the indemnitee contributed to the loss — even if the indemnitee was only 1 percent responsible for the loss.[4]

As Oltmans shows, the best way to avoid these interpretive problems is to draft your indemnity provision in a way that clearly provides for the intended result. Clear language can avoid the possibility of an unpredictable result. Anyone who is involved in drafting indemnity provisions should strongly consider using specific language to clarify the parties' rights and obligations, and anyone who litigates indemnity clauses should be on the lookout for certain key phrases (or their absence) when crafting arguments about potential indemnification recoveries or liabilities.

The Problem of Unpredictable Judicial Interpretations

First, a bit of history to illustrate the problem of imprecise language. Two California Court of Appeal

decisions — MacDonald & Kruse Inc. v. San Jose Steel Co.[5] and Hernandez v. Badger Construction Equipment Co.[6] — reached diametrically opposed results when interpreting similar contract language in the parties' indemnity clauses. These cases underscore the importance of negotiating and drafting clear contractual language that reflects the parties' mutual intent.

MacDonald & Kruse. In a heavily cited decision issued 45 years ago, the Court of Appeal concluded in MacDonald & Kruse that an indemnitee could not recover *anything* from the indemnitor when the indemnitee was partly responsible for causing the loss. The parties' indemnification clause required the indemnitor (a construction subcontractor) to pay any losses "in any way caused by" its conduct.[7] The indemnitee (the project's general contractor) suffered liability at least in part because of its own negligence (the parties disputed, and the court did not resolve, whether the indemnitor was also responsible for the loss). Because the indemnitee was at least partly responsible for causing the loss, the court concluded that the loss had not been entirely "caused by" the indemnitor and thus the indemnitor was not obligated to indemnify any portion of the loss. Because the indemnitor "did not purport to indemnify [the indemnitee] for liabilities caused other than by" the indemnitor, the indemnitee's partial fault completely barred it from recovering any indemnification.[8]

Hernandez. Two decades later, the Court of Appeal in Hernandez interpreted the same triggering language — "in any way caused by" — to mean something completely different. The court held that the phrase "caused by" called for a "proportional indemnity analysis" requiring the indemnitor to pay only the portion of the loss that it actually caused.[9] To reach this conclusion, the court emphasized that much had changed since MacDonald & Kruse. A few years after the decision in MacDonald & Kruse, the state Supreme Court downplayed the importance of default rules of interpretation — in particular, the Supreme Court shed some doubt on the strength of the rule that indemnitees could not be indemnified for their own "active" negligence, absent specific language providing such indemnification.[10] Instead, the Supreme Court emphasized that the overarching goal in interpreting an indemnification contract is to identify "the intent of the parties as expressed in the agreement …. [O]f necessity, each case will turn on its own facts."[11]

Even though the basic factual scenario in Hernandez was the same as in MacDonald & Kruse — the indemnitee was partially at fault in causing the loss — the Hernandez court declined to bar indemnification completely as the court had done in MacDonald & Kruse.[12] The parties' agreement required the indemnitor (a shipbuilder) to indemnify the indemnitee (a rental company) for losses "in any way caused by" the indemnitor while it was using the indemnitee's product.[13] The court concluded that the parties intended "to shield [the indemnitee] from liability for accidents occurring while" the indemnitor was using the product, and nothing in the contract suggested that the indemnitee would lose that protection if it "were found in any degree negligent."[14] That did not mean, however, that the indemnitee would be indemnified for its *own negligence*. Because the indemnitee was entitled to indemnification only for losses that were "caused by" the indemnitor, the court concluded that the indemnitee could recover the specific portion of its liability to the underlying claimant that was attributable to the indemnitor's negligence.[15]

Post-Hernandez cases. There is much to commend to Hernandez's analysis. After all, if the indemnitor is contractually obligated to pay for losses it causes, why should it be immunized from liability because another party partially contributed to the loss? However, even after Hernandez, courts have reached seemingly inconsistent results when interpreting similar contract language. For example, one court followed Hernandez where the parties' contract used "substantively identical language" as the contract in Hernandez.[16] But in another case, the court refused to interpret Hernandez as adopting a general rule that actively negligent, partially-at-fault indemnitees are entitled to contractual indemnification

under a "comparative indemnity" analysis.[17] Instead, in the absence of clear language addressing the issue, the court applied the rule that indemnitees are generally not entitled to indemnification if their active negligence contributed to the loss. On that basis, the court barred the indemnitee from recovering from the indemnitor.[18]

Solving the Problem with Clear Contract Language

This unpredictability in the case law leads to an obvious but important question—how can parties draft their indemnification clauses to provide greater certainty about their rights and obligations?

Full Indemnification. Where the parties intend for the indemnitor to pay *all* of the indemnitee's losses regardless of whether the indemnitee's conduct contributed to the loss, they should say so. For example, in Ralph M. Parsons Co. v. Combustion Equipment Associates, Inc., the contract required the indemnitor to indemnify any losses relating to the indemnitor's work "except such loss or damage which was caused solely by the negligence" of the indemnitee.[19] Because the contract barred indemnification in only one instance — where the indemnitee was the sole cause of the loss — the court concluded that the contract "necessarily" required the indemnitor to pay losses that resulted from the "concurrent negligence" of both the indemnitor and the indemnitee.[20] This type of provision can be even clearer if the parties specify that the indemnitor is responsible for the full loss without regard to comparative fault or comparative indemnification principles.

No indemnification. In contrast, where the parties intend for the indemnitor to pay *none* of the indemnitee's losses whenever the indemnitee's conduct contributes to the loss, they can clearly provide for that result as well. For example, in Regional Steel Corp. v. Superior Court, the original contract required the indemnitor to pay losses that it "'caused in whole or in part,'" but the parties executed an amendment that limited the indemnitor's obligation to losses that it "'caused in whole … .'"[21] In other words, if the loss was caused even partially by the indemnitee, there would be no coverage because the loss was not "caused in whole" by the indemnitor. Although the court did not specifically address the effect of this language (it held only that the existence of the contractual indemnity clause barred a claim for equitable indemnity), it seems clear that the parties' amended contract — both on its face and in light of the contrast with the parties' original language — barred any indemnification for losses that were caused by the parties' joint negligence.[22]

Comparative Indemnification. Another option is to specify that the parties will be responsible proportionally for their respective share of responsibility — a comparative indemnification approach.

In the recent decision in Oltmans, the Court of Appeal concluded that a short phrase — "to the extent" — was "unmistakably clear" in providing for a comparative indemnity approach.[23] The parties' contract required the indemnitor (a subcontractor) to indemnify the indemnitee (the general contractor) for losses arising out of the indemnitor's work "except to the extent the claims arise out of, pertain to, or relate to the active negligence or willful misconduct" of the indemnitee.[24] The trial court had concluded that the indemnitee's active negligence *completely* barred it from recovering any indemnification.[25] The Court of Appeal disagreed, as the contract clearly provided that the subcontractor had to pay the general contractor's losses arising out of the subcontractor's work *except* "to the extent" that the general contractor was actively negligent.[26]

The court noted that if the parties wanted to bar coverage completely whenever the general contractor was actively negligent, "that prohibition could have been stated simply and straightforwardly."[27] For example, in its brief, the subcontractor repeatedly suggested the phrase "to the extent" meant the same

thing as the word "where" — arguing, for example, that "[t]he express language excludes any duty to defend or indemnify [the general contractor] *where* the claims 'arise out of, pertain to, or relate to [the general contractor's] active negligence ….'"[28] But the contract did not provide such a broad carve-out to indemnification. Instead, the court explained, the contract limited the general contractor/indemnitee's ability to recover "only 'to the extent' of [its] active negligence, and no more."[29]

If there were any doubts about the plain meaning of the phrase "to the extent," the Oltmans court put those doubts to rest by citing 10 cases from other states that interpreted the phrase in a similar manner.[30] The court also cited extensive legislative history from a similarly worded California statute that deems indemnity provisions in construction contacts to be "'void and unenforceable *to the extent*'" they purport to indemnify general contractors for a subcontractor's active negligence or willful misconduct.[31] The legislative history confirmed that the Legislature intended to provide for an equitable allocation of proportionate liability between general contractors and subcontractors — exactly what the court achieved through its plain-language contractual analysis.[32]

Notably, although the court's result seems obvious in light of the parties' clear contractual language and the extensive supporting authority, the court believed that its decision was sufficiently important for the bench and the bar that it published the opinion even though the parties settled their dispute while the appeal was pending.[33]

Conclusion

Oltmans provides an important reminder of the importance of clearly addressing issues of proportionate fault in indemnification clauses. Where the indemnitor and indemnitee jointly cause a loss, there are a number of possible outcomes — the indemnitor may have to indemnify the loss in full, the indemnitor may not have to indemnify at all, or the indemnitor may have to pay its proportionate share of the loss.

- If the intent is to provide *full* indemnification regardless of the indemnitee's contributory fault, the contract should state that the indemnification obligation applies regardless of the indemnitee's contributory fault.[34]
- If the intent is to provide *no* indemnification when the parties are jointly responsible, the contract should state that the indemnitor is liable *only* if it was the sole cause of the loss,[35] or, stated differently, that the indemnitee may not recover "when" or "if" it contributed to the loss.
- Finally, if the intent is to provide indemnification for only the indemnitor's proportionate share (or, alternatively, to reduce the indemnification obligation by the amount of the indemnitee's proportionate fault), the contract should state that the indemnitor is responsible only "to the extent" that it caused the indemnitee's losses. Oltmans confirms that those three simple words can be "unmistakably clear" in imposing proportionate indemnification.[36]

Using clear language along these lines will reduce the chances that the courts interpret vague language to reach a result that the parties never actually intended. Oltmans provides a helpful reminder that contract language matters.

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[1] See Oltmans Construction Co. v. Bayside Interiors, Inc., No. A147313, __ Cal. Rptr. 3d __, 2017 WL 1179391 (Cal. Ct. App. Mar. 30, 2017).

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

[3] E.g., Hernandez v. Badger Construction Equipment Co., 28 Cal. App. 4th 1791 (1994).

[4] E.g., MacDonald & Kruse Inc. v. San Jose Steel Co., 29 Cal. App. 3d 413 (1972).

[5] MacDonald & Kruse, Cal. App. 3d 413.

[6] Hernandez, 28 Cal. App. 4th 1791.

[7] MacDonald & Kruse, 29 Cal. App. 3d at 417.

[8] Id. at 421.

[9] Hernandez, 28 Cal. App. 4th at 1820.

[10] Rossmoor Sanitation Inc. v. Pylon Inc., 13 Cal.3d 622, 632 (1975).

[11] Id.

[12] Hernandez, 28 Cal. App. 4th at 1821-22.

[13] Id. at 1818.

[14] Id. at 1822.

[15] Id.

[16] St. Paul Mercury Insurance Co. v. Frontier Pac. Insurance Co., 111 Cal. App. 4th 1234, 1246 (2003).

[17] McCrary Construction Co. v. Metal Deck Specialists Inc., 133 Cal. App. 4th 1528, 1541 (2005).

[18] Id.

[19] Ralph M. Parsons Co. v. Combustion Equipment Associates Inc., 172 Cal. App. 3d 211, 221 (1985) (emphasis omitted).

[20] Id. at 221; see also C.I. Engineers, 140 Cal. App. 3d at 1015 (indemnitor was required to pay loss jointly caused by the indemnitee where the contract required indemnification of losses “save and except claims or litigation arising through the sole negligence or sole willful misconduct” of the indemnitee).

[21] Regional Steel Corp. v. Superior Court, 25 Cal. App. 4th 525, 527 (1994).

[22] See also Western Contracting Corp. v. Southwest Steel Rolling Mills Inc., 58 Cal. App. 3d 532, 540-41 (1976) (holding that the contract's exclusion for losses caused by the indemnitee barred the indemnitee from recovering if it partially caused the loss, even though the contract was silent regarding indemnification of jointly caused losses).

[23] Oltmans, 2017 WL 1179391, at *5.

[24] Id. at *2 (emphasis omitted).

[25] Id.

[26] Id. at *5.

[27] Id.

[28] Oltmans Construction Co. v. Bayside Interiors Inc., No. A147313, Respondent's Brief, 2016 WL 6399013, at *3 (emphasis added).

[29] Oltmans, 2017 WL 1179391, at *5; see also Greer v. City of Philadelphia, 795 A.2d 376, 380 (Pa. 2002) (noting in similar circumstances that "to the extent" had different meaning than "when" or "if").

[30] Oltmans, 2017 WL 1179391, at *5.

[31] Id. at *6 (quoting Cal. Civ. Code § 2782.05) (emphasis added).

[32] Id.

[33] Id. at *7.

[34] E.g., Ralph M. Parsons Co., 172 Cal. App. 3d at 220.

[35] E.g., Regional Steel Corp., 25 Cal. App. 4th at 527.

[36] Oltmans, 2017 WL 1179391, at *5.
