Indemnity in Construction Agreements: Preserving the Site Owner's Rights

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In the construction context, it is understandable that a site owner would want to eliminate all risks from liability for the negligence of its independent contractor. This can generally be accomplished through insurance or indemnity agreements. Since insurance can be costly, the site owner often prefers to be indemnified or insured by its contractor. In the construction context, such indemnity provisions can be difficult to enforce under R.C. § 2305.31. The purpose of this article is to examine how the purchaser of services, otherwise known as the site owner, can enforce its indemnity rights to avoid future unbudgeted costs.

Generally, indemnity is the right of complete reimbursement for a person who has been compelled to pay what another person should have paid. The obligation may arise from an express or implied contract. The scope of the indemnity obligation is determined by the express language in the contract.

In a purchase agreement for construction services, a typical indemnity provision provides that the contractor (promisor) agrees to indemnify and defend the site owner (promisee) from and against any and all demands and claims for property damage or injury caused by the contractor's negligent acts in performing work under the purchase order. However, R.C. § 2305.31 renders such agreements void in the construction context if the site owner seeks indemnity for its own negligent acts rather than for acts of the contractor.

Legal actions for injury or death to a contractor's employee injured or killed at a construction site normally involve claims against both the contractor and the site owner. If the plaintiff is employed by the contractor, the theory for recovery will be intentional tort in the workplace against the contractor, otherwise known as a *Blankenship* claim. See *Blankenship v. Cincinnati Milacron Chemicals, Inc.*, 69 Ohio St.2d 608, 433 N.E.2d 572 (1982). The cause of action against the site owner will sound in ordinary negligence.

The site owner named in the lawsuit will tender the defense and indemnity for the litigation to the contractor under the indemnity provision. Since the contractor has likely included its insurance and risk costs into the quote for the project, the site owner believes that it has paid for this indemnity right as an indirect cost of the project. However, the construction company will likely want to avoid incurring these added costs by asserting that the indemnity agreement is void under public policy pursuant to R.C. § 2305.31.

In order to analyze whether R.C. § 2305.31 renders the particular indemnification clause void, there must be an inquiry into four general issues:

1. Does the contract deal with construction or maintenance of a building or appliance?;
2. Do the claims arise out of the contractor's work in connection with the agreement?;
3. Do the claims assert damages for personal injury or property loss?; and
4. Does the clause require the contractor to indemnify the site owner from the site owner's own negligence? If these factors are met, the clause will likely be rendered void. The site owner will then be forced to defend the lawsuit and pay any judgment that is rendered.

Is the indemnity clause in a construction agreement?

R.C. § 2305.31 voiding indemnity clauses pertains only to agreements in "connection with or collateral to" contracts relative to construction or maintenance of a building or appliance. If the site owner can demonstrate that the contract does not fit within this definition, then the prohibition against indemnity under R.C. § 2305.31 does not apply.

Construction agreements under R.C. § 2305.31 have been broadly defined to include many types of maintenance and construction functions. See, *Davis v. LTV Steel Co., Inc.*, 128 Ohio App.3d 733, 737, 716 N.E.2d 766 (Ohio Ct. App. 11th Dist. Trumbull County 1998), appeal not allowed, 83 Ohio St.3d 1475 (R.C. § 2305.31 applies to industrial cleaning contract); *Schwierking v. Sun Petroleum Prod Co.*, 1984 WL 4207 (Ohio Ct. App. 6th Dist. Lucas County 1984) (activity of dismantling was included within the scope of R.C. § 2305.31); *Waddell v. LTV Steel Co., Inc.*, 124 Ohio App.3d 350, 357, 706 N.E.2d 363 (8th Dist. Cuyahoga County 1997) (R.C. § 2305.31 is applicable to contracts relating to repair or maintenance of pipelines at the work site, towers and equipment at electrical substations, and tanks or vessels located at the work site); *Toledo Edison v. ABC Supply Co.*, 46 Fed. Appx. 757, 2002 WL 2025960 (6th Cir. Ohio 2002) (R.C. § 2305.31 applies to tree trimming contract because it relates to the maintenance of power lines).

Likewise, courts have determined that certain activities secondary to construction agreements are not covered under the statute. *Coulter v. Dayton Power & Light Co.*, 134 Ohio App.3d 620, 731 N.E.2d 1172 (Ohio Ct. App. 2nd Dist. Montgomery County 1999) (R.C. § 2305.31 did not apply when the contract at issue only granted an easement and did not involve performance of construction work); *Lamb v. Armco, Inc.*, 34 Ohio App.3d 288, 291, 518 N.E.2d 53 (Ohio Ct. App. 12th Dist. Butler County 1986) (the claimant's fall from a semi-trailer was not within the statute's definition in a cleaning contract).

The Supreme Court addressed the issue of whether an agreement constitutes a "construction contract" in *Glaspell v. Ohio Edison Co.*, 29 Ohio St.3d 44, 505 N.E.2d 264 (1987). *Glaspell* involved a contract granting rights of access for a utility cable company to use poles owned by an electric utility company. In *Glaspell*, the plaintiff filed a personal injury claim against the utility after he fell from a pole in connection with his work for the cable company. The electric utility sought indemnification from the plaintiff's employer, a cable television provider.

The cable provider in *Glaspell* agreed to indemnify the electric utility for costs and damages resulting from its use and access to the electric utility's poles under the agreement permitting it to use the poles jointly. The Supreme Court held that an agreement for the joint use of poles did not constitute a "construction agreement" as defined in the statute. The indemnity clause was then upheld as agreed in the context of the free understanding and negotiation of these two sophisticated business entities.

Other Ohio cases since *Glaspell* have likewise underscored the importance of the relative size and sophistication of the two contracting parties for enforcing indemnity agreements outside of the construction context. In *Horning v. Fletcher*, 2005-Ohio-7078, 2005 WL 3642343 (Ohio Ct. App. 7th Dist. Mahoning County 2005), the indemnity agreement consisted of a release of liability between individual sellers in a small real estate brokerage firm. The size and sophistication of the signing parties was disparate, and the indemnity clause was held to be unenforceable.

In *McKay v. Promex Midwest Corp.*, 2004-Ohio-3576, 2004 WL 1510597 (Ohio Ct. App. 2nd Dist. Montgomery County 2004), the court was asked to enforce an indemnity agreement outside of the construction context between a nursing home and a uniform and towel rental company. The court held that the indemnity agreement was valid because it was negotiated between business entities of sufficient size and quality such that a significant degree of sophistication between the contracting parties was presumed.

Accordingly, the indemnity clause outside of a construction agreement is more likely to be given effect if the two parties are of equal size and bargaining power.

Do the claims arise out of the contractor's work?

Assuming the indemnity clause is found to be enforceable under R.C. § 2305.31, the contractor typically argues in the alternative that it does not owe indemnity because the plaintiff's claims do not "arise out of" its work on the project. This is a fact-specific question that involves interpretation of the scope of work as defined in the purchase order. The specific language in the Scope of Work section of the contract between the parties therefore takes on added importance for this analysis. It should be broadly drafted to optimize the site owner's scope of protection under the clause.

Aside from a review of the language in the Scope of Work provision, the attorney representing the site owner should also review the work actually performed at the site by the contractor on the job. If the accident occurred in the general vicinity of work performed by the contractor, or work that should have been performed by the contractor, the accident will likely "arise out of" its work. If not, the contractor may successfully argue that the indemnity clause has no application.

Are the claims for property loss or personal injury?

Even if the claims are found to arise out of the scope of the contractor's work, R.C. § 2305.31 will not void the indemnity obligation unless damages for property loss or personal injury are alleged. For example, in *Tobias v. FirstEnergy Nuclear Operating Co.*, 2004 WL 4910146 (N.D. Ohio 2004), a contractor's employee alleged wrongful discharge against his employer and tortious interference against the site owner. The court held that R.C. § 2305.31 did not apply to the claims because they alleged damages for back pay rather than "bodily injury or property damage." Accordingly, the site owner was entitled to indemnity and defense from its contractor on the tortious interference claim even though the discharged employee was working under a construction agreement.

Does the provision require indemnification for the site owner's negligence?

Assuming the contract is a construction agreement, the claims "arise out of" the contractor's work and the claims are for bodily injury or property damage, the indemnity clause may be void if it requires the contractor to indemnify for the site owner's negligence rather than for the negligence of the contractor.

Even in a construction agreement, there is no prohibition under R.C. § 2305.31 for provisions that involve indemnity and defense for the contractor's negligence. However, the determination of which party is negligent may be difficult to ascertain where the plaintiff has made allegations against both the contractor and the site owner.

In *Kemmeter v. McDaniel Backhoe Svc.*, 89 Ohio St.3d 409, 2000-Ohio-209, 732 N.E.2d 385 (2000), the court upheld an indemnity clause on its face in a construction agreement that required indemnity for the contractor's negligence rather than for the site owner's negligence. The *Kemmeter* court then instructed that the lower court must determine whether the cause of action against the site owner arose from activities under the contractor or site owner's contractual control. If the allegations arose from duties under the contractor's control, the contractor must assume the site owner's defense. If, on the other hand, the claims arose from activities under the site owner's contractual control, the site owner would have to pay its own defense costs, no matter the outcome at trial. According to the Supreme Court in *Kemmeter*, this is a matter for the court to decide regardless of the jury outcome.

The practitioner should carefully draft the clause so that it is not void on its face. The best way to avoid such a determination is to ensure that indemnity is provided only for the acts of negligence of the contractor.

Insurance as alternative protection

Since an indemnity agreement is only as good as the financial stability of the company providing the promise of indemnity, the site owner typically requires the contractor to obtain insurance naming it as an additional insured for liabilities assumed by the contractor. Generally, the insurance policy provides coverage to the site owner with respect to liability "arising" out of the operations of the contractor. Using the same arguments addressed in the preceding sections, the insurance company may argue that additional insured protection cannot be afforded in a construction agreement under R.C. § 2305.31 because the underlying indemnity obligation is void under public policy.

It is important to note that, by its express terms, R.C. § 2305.31 does not prohibit any person from purchasing insurance or a construction surety bond for his/her own protection. In *Stickovich v. City of Cleveland*, 143 Ohio App.3d 13, 2001-Ohio-4117, 757 N.E.2d 50 (Ohio Ct. App. 8th Dist. Cuyahoga County 2001), the court observed that a commercial liability insurance policy is not a construction indemnity agreement within the scope of R.C. § 2305.31. Therefore, insurance for the site owner may be valid and enforceable under its own terms even in a construction agreement.

In *Stickovich*, the additional insured clause provided coverage for the City of Cleveland with respect to liability arising out of "work for the City." The court held that the phrase "arising out of" provided very broad insurance coverage and did not violate Ohio's public policy, even if it covered the site owner's own negligence. Accordingly, the insurer had a duty to defend the City and was conditionally liable for any judgment against the City.

However, *Stickovich* must be read in conjunction with the well-established Ohio case law holding that additional insured coverage may only afford protection for the vicarious liability of the contractor. See *Davis v. LTV Steel Co., Inc.*, 128 Ohio App.3d 733, 716 N.E.2d 766 (11th Dist. Trumbull County 1998); *Liberty Mut. Ins. Group v. Travelers Property Cas.,* 2002-Ohio-4280, 2002 WL 1933244 (Ohio Ct. App. 8th Dist. Cuyahoga County 2002); *Danis Bldg. Const. Co. v. Employers Fire Ins. Co.*, 2002-Ohio-6374, 2002 WL 31641229 (Ohio Ct. App. 2nd Dist. Montgomery County 2002); *C.J. Mahan Construction Co. v. Mohawk Re-Bar Serv.*, 2005-Ohio-5427, 2005 WL 2562600 (Ohio Ct. App. 5th Dist. Stark County 2005); *Lubrizol Corp. v. Lichtenberg & Sons Constr., Inc.*, 2005-Ohio-7050, 2005 WL 3610468 (Ohio Ct. App. 11th Dist. Lake County 2005). Therefore, the site owner must point to the allegations in the complaint to show that the plaintiff has alleged vicarious rather than direct liability against it in order to secure coverage as an additional insured.

The difficulty for the site owner is that its insurance coverage depends entirely upon whether allegations of vicarious liability are pled in the complaint. Such allegations are, of course, completely outside of the site owner's control. Unless the plaintiff specifically alleges vicarious liability against the site owner, there is a strong likelihood that the court will find that the additional insurance coverage does not apply.

A difficult situation arises where the contractor reaches a settlement with the claimant before suit is filed. In that case, there will be no direct allegations against the contractor in the complaint at all. The site owner must then consider bringing the contractor back into the litigation through a third-party complaint in order to judicially determine the extent of the contractor's liability. In the end, if the contractor is not found to be liable to the claimant to establish the site owner's vicarious liability, there will be no additional insurance coverage for the site owner.

Waiver may preserve indemnity

An argument that the insurance coverage or indemnity clause is void under R.C. § 2305.31 may be waived unless timely raised by the contractor or its insurer. Relying upon Ohio Civ. R. 8(C) requiring a party to set forth the affirmative defense of "illegality", the court in *Stickovich v. City of Cleveland*, 143 Ohio App.3d 13, 757 N.E.2d 50 (8th Dist. Cuyahoga County 2001), found that the Defendant contractor waived its right to assert the defense that the indemnity clause was void because it was not raised in the answer. The insurer in *Stickovich* likewise did not refer to R.C. § 2305.31 in its letter to the potential additional insured denying coverage. Thus, the defense was waived under these facts. See also, *State ex rel. Plain Dealer v. Cleveland*, 75 Ohio St.3d 31 (1996); *Blount v. Digital Equipment Corp.*, 2000 WL 126734 (Ohio Ct. App. 8th Dist. Cuyahoga County 2000).

The practitioner representing the site owner should carefully review the pleadings and all correspondences from the insurer or contractor to determine whether R.C. § 2305.31 was expressly cited in the denial of coverage or answer. If R.C. § 2305.31 was not cited, the insurer or contractor may be estopped from asserting that the indemnity provision is void.

Conclusion

Enforcing indemnity and additional insured coverage poses special challenges for the site owner in a construction agreement. In order to avoid surprise costs for litigation that arises after the project is complete, the attorney representing the site owner should carefully analyze the provision and scope of the plaintiff's allegations to ensure that the right of indemnity for the site owner is preserved.

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