Azurak-Compliant Indemnification Clauses

By Molly Hurley Kellett and Shefali Kotta

I. General Rules for Indemnification after Azurak

As a general rule, parties are liable for damages caused by their own negligence. Parties to construction contracts nevertheless often mutually agree to shift the risk using what's known as an indemnification clause, a tool usually providing that a party, which might otherwise bear liability, can be held harmless for its negligence or may at least customize the risk for which it is willing to be liable. However, the New Jersey Legislature has limited the enforceability of this liability-shifting tool in the construction context, citing the rationale that clauses indemnifying a party from its own "sole negligence" are contrary to public policy and, therefore, void. Specifically, N.J.S.A. 2A:40A-1 provides in part that "[a] covenant. . . purporting to indemnify or hold harmless a [party] against liability for damages arising out [of] . . . or resulting from the sole negligence of the [same party] . . . is unenforceable[.]"

Despite clear legislative intent to disallow risk-shifting in construction contracts using indemnification clauses, sophisticated contracting parties often include them, because, while these clauses might not be enforceable in a court of law, the benefit of their inclusion – and the likelihood that they will be enforced– remains significant. The likelihood of an indemnification clause being unenforceable is largely dependent, however, on the clarity of its language or the likelihood of it being held subject to multiple interpretations. New Jersey courts make enforceability – and the resultant shifting liability – contingent on whether the clause contains express and unequivocal language.[1] When the meaning of such a clause is ambiguous, the provision shall be "strictly construed against the indemnitee."[2] Overall, indemnification provisions will be read in accordance with the general rules of contract interpretation.[3]

Given these considerations, drafters of contracts that include indemnification clauses should take particular care to avoid ambiguities in the clause. This is especially important in construction, as each project involves numerous contracts and agreements between different parties (e.g., the general contractor, subcontractors, engineers, etc.).

But inconsistent outcomes occur despite the overwhelming viewpoint that an indemnification clause must be specific and explicit to successfully indemnify the indemnitee from damages relating to its own negligence or fault. In one case, *Sayles v. G&G Hotels, Inc.*, the New Jersey Appellate Division held that inartful language alone was not an automatic bar to indemnification.[4] The court noted that, as long as the true intent of the parties is clear, "less artful expressions" would not void the indemnification clause.[5] As a result of the *Sayles* opinion, the "clear and unequivocal" language requirement for an indemnification clause to be held enforceable became less stringent.

In another opinion, *Pepe v. Township of Plainsboro,* the court found that the following language not specific enough to trigger indemnification: "any injury . . . on account of any act of omission or commission of any contractor."[6] Conversely, the Appellate Division deemed valid a provision providing indemnification for injury caused by "anyone directly or indirectly employed by [the party] or anyone for whose acts they may be liable, regardless of whether it is caused in part by a party indemnified" was deemed valid.[7] This clause's use of the terms "direct or indirect" and "anyone" provides quite broad coverage.

II. Examples of Enforceable and Unenforceable Indemnification Clauses.

The best guidance for drafters post-*Azurak* are cases in which courts deemed indemnification clauses enforceable based on their clear language. Here are some examples.

A. Enforceable Indemnification Clauses

2. *Estate of D'Avila v. Hugo Neu Schnitzer East*, 442 N.J. Super. 80 (App. Div. 2015).

In *Estate of D'Avila*, the Appellate Division found that the indemnification clause at issue was enforceable. Here, the subcontractor argued that the phraseology "arising out of" rendered the indemnity clause unenforceable because the damages were not proximately caused by the subcontractor. The court, however, stated that there need only be proof of a "substantial nexus" between the injury and the activity contemplated by the contract.[8] The indemnification provision of the contract contained the following language:

> "any and all claims . . . *arising, or allegedly arising,* from and out of (a) the work incident to or resulting from any and all operations performed by [subcontractor] under or pursuant to any of the provisions of [this subcontract]."
>
> "(b) any injury to, or death of, any person or persons . . . occurring wholly or in part in connection with or resulting from the work or by reason of any act, omission or negligence of [the subcontractor.]"
>
> (c) any breach or default hereunder by [the subcontractor][.]"[9]

The subcontractor also agreed to indemnify "whether or not any acts, errors, omission[s] or negligence of any of the [i]ndemnities [] contributed thereto in whole or in part[.]"[10] This is an example of an enforceable indemnification provision with the type of unambiguous language that supports enforceability that drafters can use.

3. *Mass. Bay Ins. Co. v. Hall Bldg. Corp.*, 2018 N.J. Super. Unpub. LEXIS 7858 (Law Div. 2018).

In *Mass. Bay*, the claims arose out of the subcontractor's employee's injuries suffered while working on a construction project. The indemnification clause in the subcontract at issue stated:

> 11.1 SUBCONTRACTOR'S PERFORMANCE. To the fullest extent permitted by law, the Subcontractor shall indemnify and hold harmless the Owner, the Construction Manager, the Architect/Engineer, the Contractor (including its affiliates, parents and subsidiaries) and other contractors and subcontractors and all of their agents and employees from and against all claims, damages, loss and expenses, including but not limited to attorney's fees, arising out of or resulting from the performance of the Subcontractor's Work provided that:
>
> (a) any such claim, damages, loss or expense is attributable to bodily injury, sickness, disease, or death, or to injury to or destruction of tangible property (other than the Subcontractor's Work itself) including the loss of use resulting therefrom, to the extent caused or alleged to be caused in whole or in part by an negligent act or omission of the Subcontractor or anyone directly or indirectly employed by the Subcontractor or anyone for whose acts the Subcontractor may be liable, regardless of whether it is caused in part by a party indemnified hereunder;
>
> (b) such obligation shall not be construed to negate, or abridge, or otherwise reduce any other right or obligation or indemnity which would otherwise exist as to any party or person described in this Article 11.
>
> The Subcontractor agrees to reimburse the Contractor for all sums which the Contractor may pay or be compelled to pay in settlement of any claim hereunder, including any claim under the provisions of any worker's compensation law or any plan for employees' benefits which the Contractor may adopt.[11]

The court found this provision complied with the *Azurak* requirement that the indemnification agreement be clear and unequivocal, despite the inclusion of the phrases "to the extent" and "regardless of," which were previously held to create ambiguity in *Englert v. The Home Depot*, 389 N.J. Super. 44 (App. Div. 2006). Explaining this disparity, the court stated that the broader phrase "regardless of whether [the damage] is caused in part by a party indemnified hereunder" created an explicit shift of liability, leaving no ambiguity as to the parties' intent.[12] This case appears to provide one example of an enforceable liability-shifting tool.

4. *AvalonBay Cmtys., Inc. v. Utica Ins.*, 2016 N.J. Super. Unpub. LEXIS 1882 (Law Div. 2016).

The contract at issue in *AvalonBay* contained multiple indemnification provisions. One provision created a clear and unequivocal indemnification obligation; the second did not.[13] However, rather than finding that the conflicting provisions created ambiguity, the court read them

as a whole and found the language satisfied the *Azurak* requirements.

This case arose from on-the-job injuries on a construction site, during the injured plaintiff's work for a fourth-tier subcontractor. The general contractor, AvalonBay, hired a subcontractor to do framing work. That subcontractor hired its own third-tier subcontractor, which in turn hired a fourth-tier subcontractor to complete the work.[14] AvalonBay and Mid-Atlantic's subcontract contained multiple indemnification clauses requiring the subcontractor to indemnify the general contractor, an obligation the subcontractor fulfilled during the litigation.

The subcontract with the third-tier subcontractor also contained two indemnification provisions. The contractor and subcontractor argued that those provisions obligated the third-tier subcontractor to indemnify both the subcontractor and AvalonBay, the prime contractor.[15]

This is the language that the court considered critical:

> b. Subcontractor[16] shall indemnify and hold Contractor, its agents, officers and employees, harmless from and against all claims, damages, losses and expenses, including Litigation Costs arising out of or resulting from performance of the Work under this Agreement, including such claim, damage, loss or expense that is attributable to bodily injury, sickness, disease, death, injury or destruction of personal property and loss of use resulting therefrom, regardless of whether such claim is caused in whole or in part by any act or omission of [the third-tier subcontractor], or its employees or agents or any other person and regardless of whether it is caused in whole or in part by [Mid-Atlantic].[17]

The court found this language explicit and unequivocal enough to create a binding obligation to indemnify the subcontractor for its own negligence.[18]

A. Unenforceable Indemnification Clauses

The following case provides a good example of an unenforceable indemnification clause:

1. *Englert v. The Home Depot*, 389 N.J. Super. 44 (App. Div. 2006).

In *Englert*, the New Jersey Appellate Division found the indemnification clause void due to its unclear and ambiguous nature, created at least in part by inconsistencies between the provision and other contractual language.[19]

In this case, the general contractor agreed to construct a new store. The general contractor then signed an agreement with a subcontractor that contained a provision titled "Indemnification," wherein the subcontractor agreed:

> [T]o the fullest extent permitted by law, [subcontractor] *shall indemnify* and hold harmless [the owner] . . . and [the general contractor] and all of their agents and employees from and against *all claims*, damages, losses and expenses, including but not limited to attorney's fees, *arising out of or resulting from the performance of [the subcontractor's] Work under this Sub-contract*, provided that any such claim, damage, loss, or expense *is attributable to bodily injury*, sickness, disease, or death, or to injury to or destruction of tangible property (other than the Work itself) including the loss of use resulting therefrom, to the extent caused *in whole or in part by any negligent act or omission of [subcontractor] or anyone directly or indirectly employed by [subcontractor] or anyone for whose acts [subcontractor] may be liable,* regardless of *whether it is caused in part by a party indemnified hereunder.* Such obligation shall not be construed to negate, or otherwise reduce any other right or obligation of indemnity which would otherwise exist as to any party or person described in this Paragraph.[20]

The court reasoned that, although the "regardless of" phrase clearly provided that the general contractor's negligence did not prevent its indemnification claim, "the phrase does not distinguish between allowing indemnification for the negligence of others and allowing indemnification for the general contractor's own negligence."[21] Additionally, the court stated, the phrase "to the extent caused" could have multiple meanings, specifically: (1) that the subcontractor would be required to indemnify the general contractor only if the subcontractor was *also* found negligent, or (2) that the subcontractor would be required to indemnify the general contractor only to the extent of its own actual share of the fault.[22] That ambiguity rendered the subject provision neither clear nor unequivocal, making it void as unenforceable.[23] The additional indemnification provision in the contract only created further ambiguity, demanding the same result.

II. What satisfies Azurak's clear and unequivocal requirement remains unclear for drafters

Even more than 20 years post-*Azurak*, there are still no magic words to create a *per se* enforceable indemnification clause. But there are examples that offer guidance. Generally, courts adhere to certain principles when interpreting indemnification clauses, with the primary principle to look at the indemnification clauses' specific wording. Because of this, outcomes are fact-specific and turn on each court's reading of each clause.

The New Jersey Courts and the Legislature are aligned in their clear intent that contractual liability must only shift where there is a clear and unequivocal intent to do so. And while *Azurak's* "bright-line" rule that "a contract will not be construed to indemnify the indemnitee unless such an intention is expressed in unequivocal terms" remains in force, the definition of "unequivocal" in this context remains unclear.[24] Ensuring enforceability – and liability-shifting – in practice, therefore, remains difficult. And there continues to be no standard form to guarantee indemnification.

When drafting a construction contract, a primary goal is to avoid language that is overbroad or unclear, and to write the indemnification provision as clearly and concisely as possible to avoid grammatical ambiguity. This is particularly true for contracts containing multiple indemnification provisions, which in itself creates a risk of ambiguity and resultant invalidity.[25]

A common pitfall of indemnification provisions is the failure to specify that the subcontractor will indemnify the contractor/owner for the contractor/owner's own negligence, as long as the contractor's negligence is not the sole cause of the injury. While this might serve the owner or contractor's goals, it's disfavored by courts – something that is important to communicate to subcontractor clients. Absent any form to rely on, the provision in *Mass Bay* is a good example of a specific, clear, unequivocal provision that should be deemed enforceable.

Ultimately, parties are shifting full risk of liability to a party at little fault, or sometimes even no fault at all. The import of these provisions, therefore, cannot be understated and they must be drafted with the utmost care. Failure to do so creates a risk of unenforceability, something for which drafters should prepare their clients even when they have included a clear and unequivocal clause that should be upheld. Without that notice, clients could be in for an unexpected, and unwelcome surprise.

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Endnotes

1. *Mantilla v. NC Mall Assocs.*, 167 N.J. 262, 273 (N.J. 2001).
2. *Id.* (citing *Ramos v. Browning Ferris Indus. of S. Jersey, Inc.*, 103 N.J. 177, 191 (N.J. 1986)).
3. *Azurak v. Corporate Property Investors*, 347 N.J. Super. 516, 521 (App. Div. 2002).
4. *Sayles v. G&G Hotels, Inc.* 429 N.J.Super. 266, 274. (App. Div. 2013).
5. *Id.*
6. *Pepe v. Township of Plainsboro* 337 N.J. Super. 209 (App. Div. 2001) (quoted in *Azurak*, 347 N.J. Super. at 521).
7. *Leitao v. Damon G. Douglas Co.*, 301 N.J. Super. 187, (App. Div. 1997) (quoted in *Azurak*, 347 N.J. Super. at 521).
8. *Id.* at 115.
9. *D'Avila*, 442 N.J. Super. at 114 (emphasis in original).
10. *Id.*
11. *Mass. Bay*, 2018 N.J. Super. Unpub. LEXIS 7858, at *5–7 (emphasis in original).
12. *Id.* at *47.
13. *Avalon Bay*, 2016 N.J. Super. Unpub. LEXIS 1882, at *20.
14. *Id.* at *1, *2.
15. Id. at *5.

16. In the agreement, "Subcontractor" referred to the third-tier subcontractor, and "Contractor" referred to the subcontractor/second-tier contractor.
17. *Avalon Bay*, 2016 N.J. Super. LEXIS 1882, at *19.
18. *Id.*
19. *Englert*, 389 N.J. Super. at 55-58.
20. *Englert*, 389 N.J. Super. at 47, 48 (emphasis in original).
21. *Englert*, 389 N.J. Super. at 56.
22. *Id.*
23. *Id.*
24. *Azurak*, 347 N.J. Super. at 519.
25. *See Englert*, 389 N.J. Super. 44.