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CONSTRUCTION LAW

Revisiting Indemnification Provisions

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Two recent judicial and legislative developments have raised issues regarding the coverage and interpretation of indemnification provisions in construction contracts. These developments—dealing with first-party attorney fees and the liability for the actions of third parties—should cause counsel for owners and contractors to revisit their indemnification provisions to determine that there is adequate protection for their clients.

In *Shah v. 20 E. 64th St., LLC*, —NYS3d —, 2021 NY Slip Op 04587 [1st Dept. 2021], the Appellate Division found that the indemnification provisions at issue (contained in a neighbor access agreement) allowed the recovery of plaintiff's attorney fees incurred in its direct action against the defendant, despite the absence of third-party claims. The legislation, dealing with "wage theft" (2021 NY Senate-Assembly Bill S2766C, A3350), assigns joint and several liability to prime contractors in any action against a subcontractor by the subcontractor's employees for wages and benefits.

First-Party Attorney Fees

Shah involved a dispute between neighboring property owners relating to construction on the principal defendant's property causing damage to plaintiff's property. The Appellate Division found that the particular indemnification provision in the access agreement allowed the plaintiff (a "first-party") to recover attorney fees from the defendant which, on first blush, appeared to run counter to the seminal case of *Hooper Associates v. AGS Computers*, 74 N.Y.2d 487 (1989), which interpreted indemnities, generally speaking, to apply to third-party claims.

In *Shah*, after years of litigation, the plaintiff, having prevailed in the action, sought to recover its attorney fees pursuant to the indemnification provision in the access agreement executed by the parties prior to construction. The court ruled in favor of plaintiff on the strength of specific language in the indemnification covering first-party claims (called "intraparty" claims by the court) as opposed to third-party claims covered by a typical indemnity and which was the subject of *Hooper*.

In *Hooper*, the parties entered into a written contract under which the defendant undertook to design, install and supply a computer for the plaintiff. Three years after the contract was executed, the plaintiff brought an action for breach of contract and other first-party claims, as well as a claim for attorney fees.

With regard to attorney fees, the plaintiff relied upon an indemnity provision in the contract that provided for the defendant to indemnify the plaintiff for certain claims but which did not "exclusively or unequivocally" refer to first-party claims or support an inference that the defendant intended to indemnify the plaintiff for first-party claims.

Ultimately, the Court of Appeals found that the indemnity provision relied upon by the plaintiff did not extend to the breach of contract or other first-party claims. As a result, the attorney fees were not recoverable.

In *Hooper*, the court relied on two general propositions. The

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first is that words in a contract are read to achieve the apparent purpose of the parties. Therefore, absent language specifically requiring the indemnifying party to pay for the costs of enforcing the indemnity, the court will not read this obligation into the contract.

The second is that since attorney fees are costs of litigation, a prevailing party may not collect such fees unless the agreement specifically states that these fees are recoverable or there is a statute or rule allowing for such recovery. The court also noted that the indemnity serves the purpose of covering third-party claims and the defense of third-party claims, but not covering attorney fees and court costs in a first-party claim.

Thus, absent a prevailing party clause, first-party litigation costs would be borne by the indemnitee. However, in a situation where there is no prevailing party clause, the indemnitee may still wish to recover its first-party litigation costs for the *enforcement* of the indemnity, which has been a generally accepted provision in light of *Hooper*. The indemnification provision should therefore include language not only allowing for the recovery of attorney fees for defending third-party actions but for the enforcement of the indemnity in a first-party action.

Indemnification for Economic Loss

Traditional indemnities in favor of owners or general contractors, including those found in AIA documents, deal, essentially, with personal injury, bodily injury and property damage. They do not include indemnification for claims of third parties seeking monetary damages, such as unpaid subcontractors, neighbors, or civil authorities, which claims can be considered "economic loss."

In order to address this omission, we recommend that economic loss be covered by indemnification provisions on behalf of owners in agreements with general contractors and constructions managers, and on behalf of the latter with subcontractors.

In his Construction Law column, Kenneth Block discusses two recent developments regarding indemnification provisions in construction contracts and advises counsel for owners and contractors to revisit their indemnification provisions to make sure there is adequate protection for their clients.

We often get push back from contractor counsel in our negotiations for owners; they argue that such economic loss is not covered by insurance and that the indemnity should be limited to insurable losses. We disagree, and take the position that an owner should be indemnified for any claim brought by a third-party (following the teaching of *Hooper*), provided that the contractor is responsible for the third-party claim because of the contractor's negligence or breach of contract.

The new wage theft legislation makes our point, at least from a prime contractor's position. As noted above, under the law, the door is opened for laborers to file actions directly against prime contractors for non payment of wages and benefits not paid by their employers. Obviously, prime contractors must now expand their indemnification provisions to cover such claims, even though the subcontractor would not be covered by insurance. (The indemnification we recommend for owners, which covers economic loss, would likewise protect prime contractors against third-party claims for nonpayment of wages and benefits.)

Conclusion

In light of *Shah* and *Hooper*, in order for indemnitees to recover attorney fees, either resulting from first-party or third-party claims, the indemnification provision must expressly state that such fees are recoverable. Absent a broad prevailing party clause, the indemnification provision should state that attorney fees are recoverable by the indemnitee for the enforcement of the indemnity. The new wage theft legislation highlights the need to have economic loss covered by indemnification provisions.