

MARKS & WEINBERG, P.C.

DISPATCHES FROM THE TRENCHES

INDEMNIFICATION, EXCULPATION AND NEGLIGENCE

It seems that more and more lease forms state that the indemnification does not cover claims that the lessor has been negligent. This language appears to be fair at first glance-- why should a party be indemnified for its own wrong doing? It can also prove to be a nice marketing tool with any lessees that actually read their indemnity section carefully. However, it results in real risk to the lessor since many courts will not require a lessee to indemnify a lessor against a claim that the lessor has been negligent unless the indemnity clause uses words like negligence or fault or otherwise clearly indicates that the lessee's indemnity obligations include holding the lessor harmless from and against its own negligence.

As discussed in previous editions of Dispatches from the Trenches, a third person who is injured by leased equipment may bring a claim directly against the lessor, alleging that it has somehow been negligent. For example, injured parties have argued that a lessor was liable for failing to inspect equipment and discover defects likely to cause injury; for failing to deliver operating manuals to the lessee; or for failing to warn a lessee of equipment defects of which the lessor knew or should have known. *See e.g. Indeck Power Equipment Co. v. Jefferson Smurfit Corp.*, 881 F. Sup. 338(NV. Ill 1995); *Black v Gorman-Rupp*, 655 So. 2d 717(La. Ct. App. 1995).

The first case below highlights the risks of not specifically mentioning negligence in the indemnity section of a lease agreement. The second case below warns that state laws regarding the enforceability of exculpatory clauses are also relevant. Cautious lessors should review their lease forms carefully to consider whether those documents protect the lessors from claims that they've somehow been negligent.

Indemnification for One's Own Negligence

In *McNally & Nimergood v. Neumann – Kiewit Constructors, Inc.*, 648 N.W.2d 564 (Iowa 2002), McNally & Nimergood (öLessorö) leased a construction crane to Neumann ö Kiewit Constructors (öLesseeö) pursuant to a lease which required Lessee to maintain the crane in good working order and to repair it as necessary.

When one of Lessee's employees was seriously injured by the crane, the employee sued both the Lessee and the Lessor for negligence. The claim against the Lessor alleged that it failed to inspect and maintain the crane prior to its delivery to the Lessee. The employee's recovery against Lessee was limited by workers compensation laws and Lessee was quickly dismissed from the suit. Lessor subsequently settled the claim for \$500,000 and immediately began demanding indemnification from Lessee pursuant to the terms of the lease agreement.

The court noted that indemnity provisions are generally subject to the same rules of formation, validity and construction as other contracts. However, the court articulated a special rule of construction when indemnity provisions are is claimed to relieve the indemnified party from liability resulting from its own negligence. In the instant case, the claims alleged negligence on the part of Lessor and this rule of strict construction was therefore applicable. The court held that, in Iowa, courts are allowed to ödiscern the intent of the partiesö even if the contract does not mention the negligence of the indemnified party. That flexibility did not help Lessor in this particular case and the court still held that the language did not manifest an intention for Lessee to indemnify Lessor for losses resulting from Lessor's own negligence. Had the lease expressly mentioned Lessor's negligence in the indemnity section, the result would have been much different.

The heightened standard of contract interpretation applied by the Iowa court, or some variant of that standard, is applicable in the majority of states. This application stems from §195 of The Restatement (Second) of Contracts which states that "[l]anguage inserted by a party in an agreement for the purpose of exempting [it] from liability for negligent conduct is scrutinized with particular care and a court may require specific and conspicuous reference to negligence. . "

Exculpation for One's Own Negligence

The case of *Caballero v Stafford*, 2006 WL 2422558 (MO. App. S.D.) highlights the potential distinction that a court might draw between an indemnity provision and an exculpation clause. In that case, Caballero entered into an Independent Contractor Operating Agreement

with New Prime, Inc. pursuant to which Caballero leased a Freightliner tractor to New Prime and also agreed to haul certain freight, as an independent contractor, for New Prime's customers in that leased vehicle. The arrangement allowed Caballero to operate the vehicle himself or to lease drivers from New Prime pursuant to the terms of a separate Personnel Service Agreement. One of the drivers leased by Caballero from New Prime (named Stafford) was driving the vehicle while Caballero was a passenger in the sleeping berth. When the vehicle driven by Stafford left the roadway and overturned on its side, Caballero was seriously injured and brought suit against both Stafford and New Prime.

The various agreements entered into between Caballero and New Prime generally provided that New Prime would not be liable to Caballero for any damages caused by leased drivers such as Stafford and that, indeed, Caballero was responsible for indemnifying New Prime for any losses which New Prime incurred.

The applicable provision in the Independent Contractor Operating Agreement provided that: "Caballero agree[s] to indemnify and hold harmless [New Prime], . . . from and against any and all liabilities and expenses whatsoever. . . which [it] may incur or become obligated to pay arising out of [Caballero's] acts or omission or those of [Caballero's] agents and employees (including drivers leased from [New Prime]). [Caballero] further agree[s] to hold [New Prime] harmless and to indemnify [New Prime] against all claims by [Caballero] and [Caballero's] agents and employees."

The applicable provision in the Personnel Services Agreement provided that: "Caballero agrees not to hold [New Prime] or the Drivers responsible for any damage or injuries suffered by [Caballero] or to [Caballero's] Equipment as a result of any action by Drivers and hereby releases [New Prime] and the Drivers from any such claims [and that because [Caballero] is responsible for the supervision and conduct of the Drivers, [Caballero], notwithstanding the fact that the Drivers are the employees of [New Prime], shall pay to [New Prime] all amounts required [the Indemnification paragraph in the Independent Contractor Operating Agreement]."

The trial court originally hearing the case held that the provisions quoted above relieved New Prime from any liability as a matter of law. On appeal, the Appellate Court reversed. At issue was: (1) a 1996 case named *Alack v Vic Tanny International of Missouri*, 926 S.W. 2d 330 (MO. 1996); and (2) whether the provisions at issue were indemnity provisions or exculpatory clauses.

The appellate court explained that an exculpatory clause is a "contractual provision relieving a party from liability resulting from a negligent or wrongful act" and that an indemnity clause is a "contractual provision in which one party agrees to answer for any specified or unspecified liability or harm that the other party might incur." Although the clauses at issue were found in the indemnification section of the two agreements, the appellate court held that they were exculpatory clauses, noting that under the doctrine of *Respondeat Superior*, Stafford's negligence would be imputed to New Prime and that the contractual provisions were therefore relieving New Prime from its own liability.

This holding addressed the varying opinions of New Prime, Cabalero and the trial court as to whether the *Alack* case was relevant. In that case, the Missouri Supreme Court stated "the words negligence or fault or their equivalent must be used conspicuously so that a clear and unmistakable waiver and shifting of risk occurs [and] there must be no doubt that a reasonable person agreeing to an exculpatory clause understands what future claims he or she is waiving." *Id.* at 337-8. The trial court had agreed with New Prime that the "magic language" from the *Alack* case need not be present within the indemnity provisions on which New Prime was relying since such the damages at issue were caused by a third party-- in this case Stafford. In pertinent part, the court stated: "[w]e have two entrepreneurs involved in a freight hauling venture enter into agreements, not to exculpate [New Prime] from their own negligence, but rather to make clear as between them, which party will be responsible for a third party's [e.g. Stafford's] negligence."

This distinction between exculpatory clauses and indemnity provisions may not have been as relevant for this particular case since the appellate court noted that a similar rule of contract interpretation applies to indemnity provisions, stating a contract of indemnity will not be construed so as to indemnify one against loss or damage resulting from his own negligent acts unless such intention is expressed in clear and unequivocal terms. (Referring to *Nusbaum v City of Kansas City*, 100 S.W.3d 101, 105 (MO. 2003)).

Nonetheless, this case provides a couple of warnings to cautious lessors leasing dangerous equipment. First, when determining whether the laws of a given state require the words negligence or fault or their equivalent to be used conspicuously, counsel should check cases involving exculpatory clauses in addition to cases involving indemnity provisions.

Secondly, lessors should consider whether language in their lease absolves them from liability where a Lessee (rather than a third party) is the injured plaintiff who is bringing the

same type of negligence claim that has harmed lessors in the past. For example, consider a situation where the lessee is a sole proprietorship and is the party injured while operating the leased equipment. Alternatively, consider a situation where lessee is found liable to a third party injured by the equipment and then brings a separate direct cause of action against the lessor alleging that the lessor's negligence was the root cause and seeking reimbursement. Lessors should read their forms carefully and ask themselves whether their contracts would protect them if such a lessee were to sue them under a claim that the lessor failed to warn the lessee about a known defect and that such failure resulted in the lessee's damages. What happens if the applicable court distinguishes indemnity provisions from exculpatory clauses, like the court in the *Caballerro* case, and holds that an indemnity provision simply defines which of the contracting parties is responsible for damages caused by a third party? Is there an effective exculpatory provision somewhere in the lease form? Does it cover lessor for its own negligence?

Recommendations

The key point here with respect to indemnity provisions is that each lessor should make sure the indemnity section of its lease form covers claims based on the lessor's negligence. Otherwise, there is a risk that a lessee will be absolved of any responsibility to defend such suits or make the lessor whole for any damages it incurs. A thorough review of applicable state laws may provide comfort as to whether the term "negligence" needs to be specifically mentioned. However, the safest course of action is to be as explicit as possible. It is very helpful if lessor-personnel who may be questioned by lessees are able to explain the type of unfair negligence claims that have been brought against finance lessors by injured parties and the need for the indemnity provision to protect the lessor.

The key point here with respect to exculpatory clauses is for each lessor to make sure that its lease forms adequately protect it from claims by the lessee (as opposed to third parties) that the lessor's negligence has caused the lessee to incur damages.

In both cases, alternative language can be used in situations where lessees push back in order to help more accurately define the types of negligence claims that must be covered by these provisions, such as claims of negligent entrustment; failure to inspect; failure to warn; or failure to force the lessee to comply with its insurance or maintenance obligations under the lease.

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