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PROBLEMS OF CONTRACTORS AND THEIR CARRIERS*

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Following the close of World War II, a tremendous building and construction boom occurred in this country, and it is still continuing. One of the results has been a turnover of some long cherished notions of what the law is when related to property owners, builders, and their insurance carriers. This paper will attempt to outline and explain some of the problems now plaguing large industries and the general public, the effect of which is to increase construction costs substantially.

Once it could be said with conviction that one who hired an independent contractor to perform a job, retaining no control over the details of the work, was not liable for the negligent acts of his independent contractor. This was said to be the general rule. Today this is no longer the general rule. In fact there are now so many judge-made exceptions that the rule is a kind of scarecrow shot so full of holes as to be scarcely visible.

Obviously, if an owner employs someone to do a job but is himself negligent, he can be held responsible for the resulting injuries. Likewise, if the owner furnishes the tools to do the work and an accident occurs because of some defect in them, the damaged person may look to him for redress. Or if he retains control over the progress of the work, this, because the retention invades the independence of his employee, may make the owner liable simply because of his obligation to see to it that harm does not result from the execution of his wishes.[1] Further, he must not employ an incompetent to do the work. In these cases, then, the owner must take care to have the job progress safely and upon its completion to inspect and make reasonably certain that it will not harm others. The law has made him responsible for his own negligence.

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* Adapted from a lecture delivered to the Twin Cities Claims Managers Council in Minneapolis, Minnesota.

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1. Thill v. Modern Erecting Co., 272 Minn. 217, 136 N.W.2d 677 (1965).

Over the years, however, the law, sometimes by statute but more often by judicial fiat, has gone far further, and in the contracting field each lives with the doctrine of liability without fault. The owner may no longer leave full responsibility for the work with his independent contractor and "sleep easy." If an injury results from some neglect of the contractor, he may be held absolutely liable though he were a thousand miles away, though he may have selected the most competent contractor in the business leaving to him all of the details of the work and retaining no control whatsoever.

What is the reason for the development of something which superficially seems so contrary to common sense and fair play? Some courts have justified refusing to permit the owner to rely upon another by basing their decision upon "public policy" rather than any established rules of law. They say he may not shift his responsibility if the risk is a great one because the community must be protected and what is or is not great is usually a fact issue for determination by the jury. There is something quite inconsistent in the requirement, for example, in an automobile case, that negligence of the owner or agency between him and the driver must be shown, when in a building project such a showing is not essential. The difference lies, we are told, in that the activity of the one may be "inherently dangerous." Some call it "intrinsic danger" or work which is "ultrahazardous." It probably started with dynamite cases since the result of blasting was unpredictable, the use of vicious animals, electricity and fire. These, it was though, demanded extraordinary precautions and the owner should not be permitted to transfer to others, such as the independent contractor, the burden of making the work safe.[2]

It is not difficult to accept the fact that when an employee blows up a wall or a structure which lies adjacent to the sidewalk used by pedestrians, someone may get hurt unless ample safety measures are taken. The employer is held under a duty to recognize the high degree of risk as related to the premises and circumstances prevailing and to see to it that adequate measures are taken to eliminate the danger. His liability is predicated, not upon the negligence of his contractor, but upon the danger inhering in the performance of the work resulting directly from it.

North Dakota has distinguished between injuries resulting from or inherent in the work itself and a careless act relating to some collateral matter. In a case involving an unguarded telephone post

2. W. PROSSER, TORTS, § 360 (3rd ed. 1964).

hole into which the plaintiff's three year old child fell, the court said:

> . . . [A] distinction is made, indeed, between a contract whereby the independent contractor is required to dig a deep pit or well, and a third person is injured by falling into that well, and a case where a contractor is authorized to build a house, *which in itself is not dangerous*, but while building it he drops a plank upon the head of a passer-by. *In one case the injury is occasioned by the subject of the contract itself, or the thing constructed under the contract. In the other it is occasioned by an act collateral to the construction* . . . (Emphasis supplied.)[3]

The three North Dakota cases referring to this question[4] all relate to claims of third persons and not to employees working on the project itself. Of the older cases in which inherently dangerous activity was found, many had to do with hazards to a public thoroughfare; and the test of what should be considered inherently dangerous was based upon the danger inhering in the performance of the work resulting directly from it and not from the collateral negligence of the contractor or independent contractor.[5]

More recently, the doctrine of liability without fault has been extended to plain, ordinary construction work and those included as beneficiaries are not only members of the public but workmen on the job itself. For example, if a property owner plans on putting up a building and hires the most competent contractor in the business, he still may not be relieved of liability if an accident results and someone is injured even though the person is a workman employed by a subcontractor. Or perhaps a general contractor, because of one thing or another cannot do the project himself employs someone else who is competent, reliable, but unfortunately, not as financially responsible as thought. The inevitable occurs: the accident happens, suit is brought, and the expert testifies over strenuous objections that "this work is inherently dangerous because it involves heights and it is well known that objects are dropped and people fall from ladders." Because of that simple statement an issue of fact arises for the jury to determine which justifies a holding against either the property owner or the general contractor, notwithstanding a complete lack of control over the details of the work.[6]

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3. Ruehl v. Lidgerwood Rural Tel. Co., 23 N.D. 6, 135 N.W. 793, 796 (1912).
4. Newman v. Sears, Roebuck & Co., 77 N.D. 466, 43 N.W.2d 411 (1950); Taute v. J.I. Case Threshing Mach. Co., 25 N.D. 102, 141 N.W. 134 (1913); Ruehl v. Lidgerwood Rural Tel. Co., *supra* note 3.
5. Reilly v. Highman, 345 P.2d 652 (Kan. 1959).
6. Schultz & Lindsay Constr. Co. v. Erickson, 352 F.2d 425 (8th Cir. 1965).

Thus the owner will want to protect himself from the acts of the contractor or if he is the contractor, from the acts of his subcontractor. This may be done through the drafting and execution of a contract of indemnity, sometimes referred to as a "hold-harmless agreement." Its purpose of course is to indemnify against the negligent acts of the one performing the work, and this was thought important, even essential, in those instances where the "inherent danger doctrine" is applicable. Although in the absence of such an agreement, the owner might have a common law right of indemnification for the negligence of the employee, this does not follow where the injury results from the nature of the work itself and not the collateral acts of his performing it.

The property owner may then be furnished with an agreement which provides that the independent contractor must save him harmless from loss, cost or expense because of any failure to carry out faithfully the provisions of the contract, including the provision which requires him to do the job in such a way as to avoid injury or damage to persons or property and which makes him responsible directly to those damaged. The agreement may take many forms. One commonly in use among contractors includes specific provisions requiring the indemnitor to obtain "public liability insurance" protecting the contractor or subcontractor against claims for bodily injury, death or damage to property. While compliance with such a provision will give the needed protection to the independent contractor, it does not mean that the insurer will honor the hold-harmless provision of the contract.

The contractor *can* protect himself by purchasing contractual liability insurance to team up with his general or comprehensive policy. Too often he does not. He then finds himself in the position of locking the barn door after the horse has been stolen. In some respects the oversight is morally, although not legally, excusable. After all, the contractor looks at his general liability insurance policy and finds the provision:

> To pay on behalf of the Insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury, sickness or disease, including death at any time resulting therefrom, sustained by any person caused by accident.

And he thinks: "This should do it; if I am at fault, my insurance will take care of everything. I have complied with the contract." But has he complied? Probably if he had checked the exclusions in the policy, assuming it is a standard form, he would have seen the one which provides that there is no coverage for liability as-

sumed by the insured under any contract or agreement except a contract as defined therein. The contract "defined therein" is limited to a lease of premises, an easement, an agreement required by ordinance, a sidetrack, elevator or escalator agreement. There is no mention of a "hold-harmless agreement" or a contract of indemnity. Once the accident has happened, where does this leave the parties, the owner and contractor?

Perhaps the property owner felt secure in the knowledge that he not only selected a competent, reliable and independent contractor but one who guaranteed to hold him harmless from all loss and expense, and backed this up with a policy of liability insurance reciting adequate limits. Then he finds that the agreement is of no real consequence because the contractor did not purchase contractual liability insurance. Unfortunately, he himself may not be financially able to dole out the protection the owner thought he had. The most complete hold-harmless contract is only as good as the ability of the indemnitor to perform. This ability is most often dependent upon whether or not his promises are backed up by adequate contractual liability insurance.

Shifting the risk through a hold-harmless agreement and the purchase of some form of contractual liability insurance may not, however, be the complete answer to a problem which is so complex and difficult to solve. There *are* limitations which may make the agreement impractical or even inadvisable. The first of them is the element of cost. The construction business is intensely competitive. If the contractor is to be tied up with elaborate requirements of indemnity, even going so far as to require him to save his employer harmless from the employer's own negligence, the result may be to price the employer right out of the market. Presumably the insurer is going to scrutinize carefully any indemnity contract and this is going to be reflected in the premium charged. The contractor might decide that he wants no part of a bargain which is going to shave his profit margin or be so tied up with his indemnifying the insurance company so as to make it impossible for him to continue the business. There is also the problem of the insurer: is it willing to write contractual liability, something highly specalized, over and above its standard general liability protection? In fact, some years ago the American Institute of Architects, in commenting on the "hold-harmless provision," produced this cautionary statement:[7]

> Architects should remember that such policies (Contractor's liability insurance) protect the contractor from liabil-

7. THE A.I.A. STANDARD CONTRACT FORMS AND THE LAW.

> ities imposed by law. They specifically do not protect him against liabilities voluntarily assumed under a contract, known as 'contract liabilities'. The typical example of such a contract liability was the 'hold harmless' clause so familiar in the past and still found not infrequently in construction contracts. By such a clause the Contractor agreed to hold the owner harmless from any and all causes resulting from the Contract. This type of clause was eliminated from the Standard Documents. Architects should be careful not to include any such clause in their additional General Conditions. A claim under such a clause would not be recognized by the insurance company, in the absence of a specific provision for such coverage.

Probably the action taken by the A.I.A. is a reflection of the problems, especially the cost of indemnity. In any event, certain conclusions can be drawn:

1. The owner should obtain his own protection through insurance coverage written by a company for him and broad enough to cover not only his own acts but those of others for whom he may become vicariously liable.

2. Despite its drawbacks the hold-harmless agreement is becoming increasingly utilized and this use necessitates careful draftsmanship to be certain that it represents the real intentions of the parties.

3. The advise of a lawyer and an insurance agent should be sought and received to the end that adequate contractual liability insurance is procured and maintained to support the contract of indemnity.

For a long time the tendency of the courts has been to extend the coverage provided by an insurance contract through pinpointing some phrase and proclaiming that due to ambiguity the insurer must bear the burden.

Notably, a manufacturer and contractor's general liability policy provides for the coverage for premise operations and also, given a premium of course, for completed operations. The contractor normally purchases protection for only his premises and operations. Certainly this covers a wide field. After all, he usually does not manufacture anything and sells only his services or, at most, his materials and services. Therefore, he does not buy coverage for his products, as does the manufacturer; and the phrase Products-Completed Operations *is* confusing to one not schooled in the intricacies of insurance. Thus the contractor has insurance to protect against what he is doing at the time he does

it. Confident in this protection, he proceeds with the work, finishes it and leaves. After completion of the operation the inevitable accident occurs. Somewhere along the line a workman commits a negligent act resulting in an injury.

The contractor reports the accident to his insurer who replies:

> "Sorry, but your policy for which we charged a premium of thirty dollars, protects you only when the operation is in progress. That is what the policy says: 'Division 1. Premises-Operations. The ownership, maintenance or use of of the premises, and all operations during the policy period which are necessary or incidental thereto.' If you had wished to be protected after completing the job, then you should have obtained the additional coverage which is identified as 'Division 4. Products-Completed Operations . . . goods or products manufactured, sold, handled or distributed by the named insured . . . *if the accident occurs after possession of the goods or products has been relinquished to others* . . . and if such accident occurs away from premises owned, rented or controlled by the named insured . . . ; (2) operations, *if the accident occurs after such operations have been completed* or abandoned and occurs away from the premises owned, rented or controlled by the named insured . . .' "

These are words with which those in the insurance business have lived for many years and until modern times, specifically the last five or ten years, there was not much question. If the contractor had an accident while operating, he was covered. If it occurred long after the work was completed, because he may not have properly tightened some joint in a gas pipe, there was no protection. It was almost as simple as that.

Moreover there then developed the probelm of ambiguity, a cure-all which has exploded what was previously thought to be a well established principle, to wit: if the accident occurred *after* completion of the operations, the contractor was not protected unless he purchased and paid for "completed operations" coverage.

However, in New Jersey, not much more than ten years ago, one court[8] took a dim view of a liability policy purchased by a contractor. An injury occurred after a dirt excavator had completed a job in which he failed to fill a low spot or otherwise raise some guard to protect the unwary. The court found that the division applicable to products or completed operations was so ambiguous that a person of ordinary understanding could not be expected to understand its implications. It said that the normal

8. McAllister v. Century Indemnity Co. of Hartford, 24 N.J. Super. 289, 94 A.2d 345 (1953).

individual would naturally expect his policy to cover all operations, and that this should be broad enough to include liability arising from those operations—whether or not the accident occurred before or after its completion.

This decision loosened the dam; in the years following, court after court held that the products-completed operations coverage provision did not bar recovery under premises-operations. One writer referred to this reversal as a "judicial revolution;" but whether or not one calls it a "revolution," it is a fact in the insurance business.

With the trend of adverse decisions on this matter of completed operations coverage, one could:

1. Reappraise old positions and interpretations of coverage with a view of educating the prospective purchaser in obtaining the maximum protection he needs;
2. Revise and rework the policy provisions thus meeting the objections which judges throughout the country have raised;
3. Separate the so-called manufacturer and contractor's liability policy. (How many manufacturers are contractors and vice versa?).
4. Divide the products and completed operations coverage. (After all, there is little connection between them; and good draftsmanship would indicate that the simplicity attained would be well worth the additional cost.)

A discussion of indemnity as it affects contractors, whether the indemnity is expressed or implied, probably would not be complete without some reference to a case which eventually reached the United States Supreme Court.[9] There the shipowner entered into an agreement with the cargo loader to load the cargo. An employee of the cargo loader was hurt and his employer's compensation insurance carrier paid out compensation and medical costs to the employee. Thereafter the injured man brought suit, which—under the Longshoremen's Compensation Act—he could do, against the shipowner. He recovered a judgment on the ground that his injuries were due to the shipowner's negligence. The shipowner then filed a third party complaint against the employer claiming an implied agreement by the employer, the cargo loader, to hold the shipowner harmless. The Compensation Act had the usual provisions that the "liability of an employer [for compensation under the Act] shall be exclusive and in place of all other li-

9. Ryan Stevedoring Co. v. Pan Atl. S.S. Corp., 350 U.S. 124 (1956).

ability of such employer to the employee . . . and anyone otherwise entitled to recover damages from such employer . . . on account of the injury or death."[10] The Court held that the employer who paid the compensation was liable despite the exclusiveness of the compensation act.

The effect of this decision and many to follow makes the employer, in a sense, liable twice: once for the compensation payments to his employee directly or through an insurance carrier and again to the one responsible for those injuries whom he may have, by implication or otherwise, agreed to indemnify.

Various legislatures, while imposing absolute liability on employers under workmen's compensation to the extent of the benefits set forth, also appear to give employers certain counterbalancing advantages. Since their liability was to have been confined to the benefits provided under the acts, they had every reason to believe that, having purchased compensation insurance, they need have no further concern. As pointed out by the minority in the *Ryan*[11] decision:

> But the end result here is that this employer is actually mulcted in damages ($75,000 in fact) because its employee successfully prosecuted a third-party action. Liability is thus imposed because of the negligence of the employer's other employees. This the Act forbids. Whether called 'common-law indemnity,' 'contribution,' 'subrogation,' or any other name, the result is precisely the same. The employer has to pay more 'on account of' an injury to his employee than Congress said he should.

Hence, the decisions permitting recovery on the strength of an implied indemnity complicate the whole picture of compensation. They deprive the employer of his limited liability and discourage subrogation attempts against the wrongdoer. They are even disadvantageous to the employee in those states where the employer controls the litigation because most employers will think twice before agreeing to finance a suit against themselves.

The breaking of a traditional legal pattern with the adoption of liability based upon implied indemnity has also thrown a good deal of doubt into our negligence law (the theories of active or passive, primary or secondary negligence) and this in turn has created doubt and uncertainty respecting the rights and obligations of those involved. The development is especially important for contractors because of their association with the public, subcontractors and the like. Contractual indemnity may now be

10. *Id.* at 128-29.
11. *Supra* note 9.

implied, despite the absence of an agreement, merely from the relationship between or among them. Liability may be found regardless of negligence or contributory negligence on the part of the one claiming the indemnity.

One case especially contributed to the existing confusion.[12] General Electric shipped a load of its products with a trucking company under a simple transportation agreement. The goods were packed by General Electric in a trailer and then turned over to the trucker for delivery to the destination. The load shifted due to the negligence of General Electric in packing and the truck company's driver was injured. The driver collected workmen's compensation from his employer, then sued General Electric who in turn impleaded the employer, claiming indemnity. The driver recovered, of course, against General Electric; and that, one would think, should have been the end of the case. This did not occur, however. The court went on to hold the employer liable to the negligent shipper, General Electric, because of the transportation contract and some regulations of the Interstate Commerce Commission. This appears to have been the holding notwithstanding the lack of any indemnity provision in the contract and no intent whatsoever on the part of the trucker to guarantee General Electric against its own negligence.

Nonetheless, the employer may be face to face with the possibility that his court has held or will hold to the new pattern by placing this added burden on him and force him to indemnify the negligent actor who injures his employee. In that event, what might be done.

1. When the accident occurs, those concerned and their counsel must recognize that the matter of contracts, written, oral or implied, may be involved and all of the facts must be obtained.
2. There are some courts which will still recognize only express contracts of indemnity or at least will look to the evidence to negative indemnification. Consequently it is important to get the parties early committed in writing respecting their understanding and intentions.
3. The lawyer can be less quick in concluding that no liability exists and thus possibly mislead his employers in the absence of a meticulous examination of the applicable law.
4. Interested parties can promote new or clarifying legislation, particularly in some of the instances discussed where injustice is manifest.

12. General Elec. Co. v. Moretz, 270 F.2d 780 (4th Cir. 1959).