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Applying General Obligations Law to Lease Agreements

Much has been written about the application of General Obligations Law 5-321 to lease agreements. As a general rule, an entity cannot be indemnified for its own negligence if the nature of the agreement falls under one of the applicable sections of the General Obligations Law.

However, through the recent Court of Appeals decision of *Great Northern Insurance Company v. Interior Construction Corp., et al.*, 7 NY3d 412, 823 NYS2d 765 (2006), the Court of Appeals has reaffirmed its prior 1977 decision of *Hogeland v. Sibley, Lindsay & Curr Co.*, 42 NY2d 153, 397 NYS2d 602 (1977).

The 'Hogeland' Case

In *Hogeland*, the Court set forth certain parameters under which an indemnity agreement which does indemnify an entity for its own negligence, will be deemed not to be violative of the General Obligations Law. However, recent court rulings have created some confusion as to specifically what is required so that such indemnity language will be deemed permissible. As it will be noted below, there appears, in this writer's opinion, to be some contradictions between the rules set forth by the Court of Appeals, and a narrower scope envisioned by the Second Department. In order to fully understand the applicable rule, we will discuss this issue commencing with the initial decision in *Hogeland*, supra.

The Court of Appeals decision in *Hogeland*, supra, way back in 1977, while being good law, was a decision not widely cited nor closely followed by many lower courts. This may be due, to some degree, to the familiarity that most practitioners have with other various provisions of the General Obligations Law

which prohibit an indemnity agreement which indemnifies an entity for its own negligence and the willingness of courts to simply apply this rule to most circumstances, including lease agreements.

However, the *Hogeland* decision, supra, was a fairly detailed determination in which the Court recognized the fact that the agreement in question had indemnity provisions which contemplated the obligation to indemnify the lessor. In fact, the *Hogeland* Court does not actually set forth specific requirements, but recognizes the fact that where you are presented with an agreement, that by its very terms, was negotiated at arm's-length between two sophisticated business entities, it will "no longer be construed as not intending indemnification of a party for its own negligence unless that intention is set forth in specific and unequivocal terms."

In determining whether such intent is present, the Court will look at the agreement and examine whether it is an agreement that was negotiated without either side having the upper hand. Specifically, the Court notes that the obligation to indemnify in *Hogeland*, supra was set forth in a broad manner to include "any accident in or about the Tenant's demised premises."

The Court found this to be an express intent to indemnify the lessor for its own negligence. For support of this interpretation it was noted by the Court that the insurance procurement provision in the lease agreement specifically referenced the obligation to provide insurance for the indemnity obligations set forth.

Finally, the Court notes that General Obligations Laws 5-321 was historically set forth as a provision to prevent exculpatory clauses in lease agreements whereby the lessor would be excused from its direct liability for valid claims. The Court notes that where the parties allocate the liability to a third party (insurance) between themselves, no such exculpation occurs.

What is interesting, is that the Court does not necessarily set forth that any of these previously mentioned provisions are necessary for the agreement to be permissible, merely that these are examples of provisions which demonstrate the parties' intent.

'Stern's Department Stores'

It was in 2004 that the Second Department addressed this issue in *Stern's Department Stores, Inc. v. Little Neck Dental, et al.*, 11 AD3d 674, 783 NYS2d 645 (2004). In *Stern's*, supra, the Second Department properly determines that the *Hogeland* rule does not apply, but by the utilization of additional language, appears to attempt to set constraints as to when that rule would apply.

Specifically, *Stern's* dealt with a situation where a landlord/managing sought indemnification from its tenant for property damage. While the indemnity language and other lease provisions are not set forth, the Court notes that the lease agreement apparently does set forth "that the tenant would not be liable for claims occasioned by the negligent acts or omissions of the landlord, its agents, contractors, employees or invitees."

As such, on its face, it appears quite clear that the intent of this agreement is not to indemnify the landlord, as the lease language clearly sets forth an intent to the contrary. That, however, should have been the end of the analysis.

Instead, the Second Department goes on

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further to note that in *Hogeland,* the lease contained additional language whereby the landlord sets forth that it would not be responsible for any loss or damage caused in whole or in part by its own negligence where such loss or damage was not covered or recoverable by the tenant from insurance. As previously noted, in *Hogeland,* this was simply an example of the intent of the parties not, in and of itself, a necessary provision. However, the Second Department holds this provision out as something necessary notwithstanding the fact that the indemnity language in the agreement clearly sets forth that the intent is not indemnifying the landlord's negligence.

Hogeland, supra, was reaffirmed by the Court of Appeals in October 2006 in the *Great Northern Insurance Company* matter, supra. In *Great Northern,* the Court of Appeals attempts to clarify and reassert the *Hogeland* ruling. It notes that a contract which provides indemnity for a party's own negligence would only be construed in that manner where the intent is unmistakable. In the instant matter, the Court found that the language in the indemnity agreement requiring the indemnitee to indemnify the indemnitor for "any" accident unless caused solely by [lessor's] negligence meets this unmistakable intent. As long as the lessor is not found to be 100 percent negligent, the Court notes that it is clearly the intent to indemnify the lessor.

'Great Northern,' 'Hogeland'

In analyzing the agreement in the *Great Northern* matter to the one in *Hogeland,* the Court notes that in *Great Northern*, the landlord again is not exempting itself from liability to the victim, rather the parties are allocating the risk to third parties between them, through the employment of insurance. It notes that there is no meaningful distinction between *Hogeland* and the *Great Northern* matter. The Court noted that the lease agreement was negotiated between two sophisticated parties "included an indemnification provision, coupled with an insurance procurement requirement." The Court of Appeals sets forth:

> Where, as here, a lesser and lessee freely enter into an indemnification agreement whereby they use insurance to allocate the risk of liability to third parties between themselves, General Obligations Law §5-321 does not prohibit indemnity.

Most interesting, in footnote 4, the Court finds that the absence of a contractual provision limiting the recovery to the insurance proceeds is not fatal. This footnote's interest is reinforced by the fact that the Court does not seem to be constrained by the presence or absence of any particular provision other than that which just shows the intent of the parties. The Court of Appeals does not appear to base this determination upon the inclusion or exclusion of any particular provision such as subrogation language or otherwise, only that the contract was drawn between two sophisticated insureds clearly demonstrate their intent within the contract to pass that liability to insurance.

The Court does not seem constrained by the absence of any provision other than that which shows the intent of the parties.

In fact, as demonstrated, it is not even required that the intent is to indemnify 100 percent of all negligence and appears to permit partial indemnification, again, as long as it is the clear intent to pass that liability to a third-party insurer.

The Second Department addressed this issue more recently in June 2007 in the matter entitled *Po W. Yuen et al. v. 267 Canal Street Corp., et al,* 41 AD3d 812, 839 NYS2d 518 (2nd Dept., 2007). In this matter, the owner again seeks to enforce an indemnity agreement as against the lessee. The Court dose not reference the actual contract language, but finds the indemnity agreement unenforceable under the General Obligations Law. The Court's rationale for not utilizing *Hogeland* or *Great Northern*, and instead finding the provision violative of General Obligations Law §5-321 is that (1) the agreement failed to make an exception for the lessor's own negligence and (2) it did not limit the recovery of the lessor to insurance proceeds.

While we do not have the actual indemnity language to examine, it should be noted that the Court of Appeals did not require either of these two items for *Hogeland* to be applicable. The Court of Appeals decisions in *Hogeland* and *Great Northern* did not require a limitation to the lessee's own acts or omissions or that an exception be made for the landlord's own negligence. Merely that the intent of the provision has been demonstrated in that the intent and obligation is broad enough to cover the landlord's indemnity. Obviously, without the actual language, it cannot be determined whether the language of the agreement met this intent. However, the Second Department's ruling that a specific exception for the landlord's own negligence is required, does not follow the Court of Appeals decision. Further, it is not required that the recovery be limited to the insurance proceeds. This was merely utilized previously as an example of the parties' intent, not a requirement. Specifically, as previously noted in *Great Northern,* footnote 4 addresses this issue and finds such provision not required.

Conclusion

What we can draw from the applicable decisions is that it is the Court of Appeals' intent to apply the *Hogeland* ruling in a broad manner. General Obligations Law §5-321 will not be applicable where the lease agreement clearly demonstrates that the parties were both sophisticated and that the agreement was drafted at arm's-length with the intent to indemnify, in whole or in part, the lessor. This can be exemplified by provisions in the lease agreement that work to both parties' favor as well as by the drafting history of the agreement. Once this determination is made, the indemnity provision language is examined and unless the intent is clearly shown to the contrary, the agreement will not be automatically deemed to not indemnify a party for its own negligence. The agreement will be examined to see if the intent is clear by the utilization of insurance procurement provisions to pass the liability to a third party. No specific other provisions are required and the agreement will be looked at as a whole to determine this intent.

Under such conditions, the General Obligations Law does not prohibit the indemnification of the lessor. This will apply even if there is an issue of the liability being in excess of the insurance procured. As noted in *Great Northern*, supra, the issue of whether the landlord may seek such indemnification in excess of the insurance has not been addressed. However, the Second Department has sought to set constraints on *Hogeland* by requiring more specific express language to demonstrate the intent. The Second Department requires reference to the landlord's negligence specifically and a limitation of recovery to the insurance proceeds. It is anticipated that any such decision that is brought to the Court of Appeals may be further clarified, but, however, when approaching this matter within the Second Department, these constraints should be given consideration. In the utilization of depositions, each side must now address these issues as well as the party's intent when deposing the other side as to the nature of the contract, indemnity provisions and what was so envisioned.