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Indiana Abandons the Pro-Contractor "Acceptance Doctrine"

by Thomas F. Bedsole

A recent decision issued by the Indiana Supreme Court will have a dramatic effect on contractors' potential liability to third parties. In *Peters v. Forster*, 804 N.E.2d 736 (Ind. 2004), the court abandoned the long-standing "acceptance doctrine" that held contractors didn't generally owe a duty of care to third parties after the owner accepted the work.

In *Peters*, the Hamms, who owned a home in Vincennes, decided to install a ramp to replace the stairs to their home. The Hamms purchased a ramp from a neighbor. The Hamms hired Donald Forster to move the ramp to the Hamms' home and install it. Although Forster did not know the building code requirements for ramps, Forster knew that this ramp did not meet building code requirements for a wheelchair ramp. Following installation of the ramp, Wayne Peters slipped and fell on the ramp after delivering a meal to the Hamms' home, suffering serious injuries. Peters sued Forster and the Hamms for negligently failing to maintain the ramp. Invoking the acceptance doctrine, the trial court held that the contractor (Forster) owed no duty to a third party (Peters) because the owner (the Hamms) accepted the contractor's work.

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In its opinion, the Indiana Supreme Court acknowledged the existence of the long-standing "acceptance doctrine." Under Indiana law, if a third party files a negligence-based lawsuit against a contractor, the plaintiff ordinarily must prove that the contractor owed a duty of care to that third party, the contractor breached the duty, and the third party's injury was caused by the contractor's breach. Under the acceptance doctrine, however, courts had held that contractors did not owe a duty of care to third parties after the owner has accepted the work, negating any negligence claim against the contractor. See e.g. *Wilson v. Haimbaugh*, 482 N.E.2d 486, 487 (Ind.Ct.App. 1985).

In *Peters*, following the lead of many other jurisdictions, the court concluded that the acceptance doctrine has become outmoded. Traditionally, courts held contractors were only liable to the party with whom the contractor contracted. Although Indiana courts long ago held manufacturers liable for injuries to third parties, Indiana courts had not yet extended the "modern rule" to contractors and builders, opting instead to create various exceptions to the accepted doctrine.

The Indiana Supreme Court held that Indiana no longer requires a contract between parties to trigger a duty of care to bring a negligence claim against a contractor. As the court explained:

> [a] rule that provides that a builder or contractor is liable for injury or damage to a third person as a result of the condition of the work, even after completion of the work and acceptance by the owner, where it was reasonably foreseeable that a third party would be injured by such work due to the contractor's negligence, is consistent with traditional principles of negligence upon which Indiana's scheme of negligence law is based.

Although the court's opinion in *Peters* dramatically impacts builders' and contractors' potential liability to third parties, exceptions still exist that may limit the imposition of such liability.

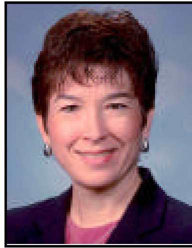
"The Indiana Supreme Court held that Indiana no longer requires a contract between parties to trigger a duty of care to bring a negligence claim against a contractor."

For example, in *Peters*, recognizing the potential breadth of the new standard, the court was quick to stress that "a contractor's liability under this reasoning is not absolute…," noting that a contractor may not be held liable "where the contractor merely follows the plans or specifications given [to] him by the owner so long as they are not so obviously dangerous or defective that no reasonable contractor would follow them."

As the law develops after *Peters*, new exceptions will undoubtedly be created that further shield contractors from lawsuits. However, the law has fundamentally changed and contractors need to fully consider their potential liability both during, and now after, construction. ♦

How Independent Are Your "Independent Contractors?"

by Thomas E. Deer &
Deborah K. Hepler



Your biggest construction project is on a tight schedule, and the best way to keep the job moving is to hire some "casual laborers" to assist with the framing. Your foreman hires two workers, telling them they are "independent contractors" and not employees. He even goes so far as to have the workers sign an acknowledgment that they are not employees of yours, but independent contractors.

After beginning work on the project, one of the independent contractors carelessly assembles scaffolding. Shortly thereafter, the scaffolding collapses causing your best framer and the other "independent contractor" to fall, seriously injuring both of them. Both of the injured workers file worker's compensation claims. What is your liability exposure for their injuries?

While the framer certainly has a worker's compensation claim, so may the injured "independent contractor." If he can demonstrate he is actually an employee rather than an independent contractor, the casual laborer may be treated as an employee for purposes of worker's compensation recovery from you.

Employers can increase the probability that temporary, consulting, or other types of contract labor will be treated as independent contractors if they heed three simple guidelines. First, the more control you exercise over how, when, where, and by whom the work will be performed, the more likely the worker will be considered an employee.

Second, merely papering the relationship as a temporary, casual or even subcontractor relationship does not necessarily make the worker an independent contractor. Finally, basing pay on the job to be completed, and not the amount of time worked, is often crucial to a true independent contractor relationship.

The Indiana Supreme Court has identified the following ten factors that help distinguish between employees and independent contractors:

1. Extent of control the employer exercises over the details of the work;
2. Whether the worker *is engaged* in a distinct occupation or business (as opposed to performing unskilled labor);
3. The type of work performed and whether it is usually done under the direction of the employer, or by a specialist without supervision;
4. Skill required in the particular occupation;
5. Who supplies the tools, the means, and the place for the work to be performed;
6. Length of time the worker will be employed;
7. Method of payment (e.g., hourly or by the job);
8. Whether the work is part of the employer's regular business;
9. The parties' belief as to the type of relationship they are creating; and
10. Whether the employer is or is not in business. *Moberly v. Day*, 757 N.E.2d 1007, 1010 (Ind. 2001).

Although no single factor is decisive, the factor that is most often weighed against employers is the degree of control exercised over the details of the work.

Two recent cases illustrate how courts apply this ten-factor test. In *Moberly v. Day,* 757 N.E.2d 1007 (Ind. 2001), a farmer was sued by his son-in-law, who was injured while helping on the farm. The farmer successfully proved the son-in-law was an independent contractor. Pivotal in the Court's reasoning was the fact the farmer had merely asked his son-in-law to dig up and repair some drainage tile, without instructing him on how to do it.

In *Expressway Dodge, Inc. v. McFarland*, 766 N.E.2d 26 (Ind.Ct.App. 2002), the Court disagreed with the employer, finding that Mr. McFarland was an employee rather than an independent contractor. Expressway runs a car dealership that occasionally hires retirees, such as Mr. McFarland, to drive vehicles to and from auctions or other sites.

While so engaged, Mr. McFarland was seriously injured in a one-car accident. He applied for worker's compensation benefits and his status--employee or independent contractor--came into question.

Key to determining Mr. McFarland's employment status was the fact that he was not engaged in a separate business and only provided Expressway with his driving abilities, which the court deemed unskilled labor "typically performed by employees." Moreover, Mr. McFarland performed services integral to Expressway's business--purchasing and selling vehicles--and his injuries occurred while performing that work.

A company that inadvertently treats an employee as an independent contractor also faces potential liability from other sources beyond worker's compensation. It may be exposed to liability for negligent or intentional acts of the worker, including harassment, discrimination or acts of violence. The Indiana Worker's Compensation Act is the exclusive remedy only when workers' injuries arise "out of and during the course of employment." Not all employee injuries fall into this category.

State and federal tax laws may also impose penalties, fines and interest on employers for unpaid employment taxes. To be sure your company has minimized its exposure, consult with counsel about how to establish a true independent contract relationship. ♦

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Does Your Indemnification Clause Fully Protect You?

by Steven J. Strawbridge & Daniel P. King

Is the indemnity language contained in your contract strong enough to indemnify you (pass-down the responsibility) for your own negligence or negligent acts? Many contractors, subcontractors and other industry professionals have been scratching their heads, puzzled by this seemingly simple question since 2000. In December 2000, the Indiana Court of Appeals handed down its decision in *Hagerman v. Long Electric*, 741 N.E.2d 390 (Ind.Ct.App. 2000), finding the standard indemnification clause contained in the AIA A401 contract insufficient to indemnify a general contractor for its own negligence. The *Long Electric* decision left the construction industry guessing as to what language is necessary to ensure indemnification to the fullest extent permitted under Indiana law. For now, the guesswork may be over.

Recently, the Indiana Court of Appeals provided the construction industry some much needed guidance by enforcing an indemnification clause to the fullest extent permitted by law in *GKN Co. v. Starnes Trucking, Inc*., 798 N.E.2d 548 (Ind.Ct.App. 2003). In *GKN*, a subcontractor truck driver for Starnes Trucking, Inc., fell while working on an Indianapolis construction project for which GKN served as general contractor. GKN had built a concrete batch plant with an area for fueling trucks that hauled the concrete. The fueling area included a containment wall surrounding the perimeter of the fueling area consisting of a concrete berm, which was designed to control fuel spills. While working on the project, the truck driver stopped in the fueling area to refuel his truck. While refueling, he stepped on the concrete berm and fell.

The employee sued GKN for his injuries. Based on the subcontract's indemnity provision, GKN, in turn, filed suit against Starnes seeking indemnification for both its negligence and Starnes own negligence. The contract's indemnification language provides:

> Starnes shall indemnify and hold harmless…GKN…from and against all claims, damages, causes of action, losses and expenses, including attorney's fees, arising out of or resulting from the performance of the work, provided that such claim, damage, loss or expense (1) 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; and (2) is caused in whole or in part by any negligent act or omission of [the subcontractor] or any of his subcontractor's [sic], anyone directly or indirectly employed by any of them or for anyone for whose acts any of them may be liable, regardless of whether it is caused in part by a party indemnified hereunder.

Under Indiana law, the court performs a two-step analysis: (1) the indemnification clause must expressly state in clear and unequivocal terms that negligence is an area where the indemnitor (in this case, GKN's subcontractor) has agreed to indemnify the indemnitee (GKN); and (2) determine to whom the indemnification clause applies. Also, the indemnification clause must cleanly and unequivocally state that it applies to indemnification of the indemnitee by the indemnitor for the indemnitee's own negligence.

<u>The first step</u>: The *GKN* court found that GKN's indemnification clause specifically included negligence claims. In fact, GKN's indemnification provision used the term "negligent act" in describing Starnes' agreement to indemnify GKN. Note that the standard indemnification language found in AIA A401 also specifically references "negligence" or "negligent acts." It is well-established that your indemnification clause must specifically reference "negligence" or "negligent acts."

<u>The second step</u>: The court next considered whether Starnes was responsible for indemnifying GKN for GKN's own negligence. It is well-settled Indiana law that Starnes was not obligated to indemnify GKN for any injury which resulted from GKN's sole negligence. Indiana Code § 26-2-5-1 provides that "provisions…affecting any construction or design contract…which purport to indemnity… against liability for…[certain types of injury] from the sole negligence or willful misconduct of the promisee…are against public policy and are void and unenforceable." However, so long as GKN is not solely negligent, Starnes can agree to indemnify GKN for both Starnes' negligence and also for GKN's own negligence.

GKN's indemnification clause clearly states that Starnes was obligated to indemnify GKN for damages for bodily injury where the injury was caused partly by the negligence of Starnes. Specifically, GKN's indemnification clause provided that Starnes would indemnify GKN for damages resulting from bodily injury:

> …caused in whole or in part by any negligent act or omission of Starnes…regardless of whether it is caused in part by a party indemnified hereunder.

The *GKN* court found that unlike the AIA A401 provision addressed in *Long Electric*, GKN's indemnification clause specifically alerted Starnes that it was obligated to indemnify GKN even when GKN is partly at fault. Stated differently, Starnes' liability for indemnification to GKN would not be negated merely because GKN was partly at fault. An additional factor the court found important was Starnes extensive contracting experience and its ability to recognize the burdens (including the indemnification clause) to which it agreed.

Dust off your contracts. Review your indemnification language. Will your indemnification clause be fully enforced like *GKN* or will it suffer a similar fate as the standard indemnification clause found in AIA A401 in *Long Electric*? ♦

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Risky Business: The Uncertainty of Lien Rights of Contractors Hired By Lessees

by Terrence L. Brookie

In a recent case decided by the Indiana Court of Appeals, the court held that for mechanic's lien liability to attach, a landowner must consent to the improvements on which the mechanic's lien is based. This decision greatly impacts contractors and subcontractors who perform work for entities other than a landowner of real estate (such as lessees in strip malls or other developments).

In *Cho d/b/a Ace Const. & Interior Design v. Purdue Research Foundation*, 803 N.E.2d 1161 (Ind.Ct.App. 2004), Ace contracted with Optolynx to design as well as act as the construction manager for construction of a "clean room" used in high-tech manufacturing. Optolynx was leasing space from the Purdue Research Foundation ("PRF") in the Purdue Technology Center. The PRF-Optolynx lease provided that Optolynx could not make alterations, changes or improvements without PRF's prior written consent.

The clean room was to be built in a separate building from space Optolynx was already leasing from PRF. Optolynx and PRF still had not negotiated the lease of the new space. After completing the project's design phase, and while waiting for Optolynx and PRF to complete their negotiations, Ace demolished a ceiling in the not-yet-leased, proposed clean room space. Unfortunately for Ace, the PRF-Optolynx negotiations broke down. Optolynx never leased the space where Ace demolished the ceiling. Ace was not paid for any of its work.

Predictably, Ace filed a mechanic's lien on the PRF-owned real estate. The court refused to enforce Ace's lien finding, among other things, that PRF did not actively consent to Ace's construction work. The court held that a landowner must consent to improvements on which the lien is based. For a lien to be valid, the landowner must give more than inactive or passive consent; the lien claimant bears the burden to prove active consent, especially when improvements are requested by someone other than the landowner (such as a lessee). In this case, Ace argued that PRF (the landowner) actively consented to Ace's actions, because: 1) the PRF-Optolynx lease called for improvements to be made; 2) PRF was actively involved in the clean room design and construction project; and 3) PRF insisted on approving and reviewing the clean room design plans. However, the court found that PRF's review of the design plans focused solely on technical matters and how the construction would impact other tenants. The court also found that PRF employees continuously informed Ace that PRF's approval was required before any construction could begin. Finally, the court found evidence that PRF never gave Ace its approval for construction of the clean room. More importantly, PRF and Optolynx never executed a lease agreement which covered the proposed clean room space.

While PRF was clearly aware of the construction, this awareness did not establish the active consent necessary to trigger lien rights. The required focus is on how closely the improvements resemble a direct bargained for benefit to the owner. In this case, PRF did not receive a direct benefit from Ace's demolition work. To the contrary, PRF incurred an additional expense of nearly $10,000 to replace the ceiling which Ace demolished.

As the *Purdue Research Foundation* decision clearly illustrates, mechanic's lien rights do not automatically arise from work performed directly for lessees. A lease calling for improvements--even very detailed improvements--standing alone will not provide the consent necessary for a contractor hired by a lessee to enforce a mechanic's lien. The court will look not only for the owner's active participation in decisions, but also will ask how much of a benefit (if any) the owner received from the improvements constructed by the mechanic's lien claimant. ♦

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