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CO-OP, CONDO & REAL ESTATE ADVISOR

Seeking Indemnification? Avoid Overreach

By Deborah B. Koplovitz

Indemnification is a word with Latin origins, pertaining to "damnum" or damages. It relates to two situations. The first is where one person, A, is required to compensate another person, B, for some loss or damage. The second is where person A is required to secure person B against legal responsibility for their actions. These two situations are distinct in that one takes away legal responsibility from person B, and the other takes away the consequences of any responsibility on person B's part.

It is not always easy to require that one person pay for a loss on someone else's behalf. Normally, a person needs a statute or a contract (which for our purposes would include a bylaw provision in a condominium) to require another person to pay a claim for damages on that person's behalf. As an example, New York state has five statutory sections in the Business Corporation Law addressing indemnification of a corporation's directors and officers by that corporation, as well as related insurance coverage issues.

Within the realm of contractual interpretation, there are certain legal requirements that must be met in order to have a valid contractual provision entitling person B to indemnification from person A and it is important that each of those requirements is met.

Three important wrinkles under New York state's General Obligations Law for contractual indemnification pertain to co-ops, and one of them to condos as well. Below, we show how to avoid being tripped up by these provisions.

Indemnification and Leases or Agreements Arising out of Leases

In New York state, the law provides that "[e]very covenant, agreement or understanding in or in connection with or collateral to any lease of real property exempting the lessor from liability for damages for injuries to person or property caused by or resulting from the negligence of the lessor, his agents, servants or employees, in the operation or maintenance of the demised premises or the real property containing the demised premises shall be deemed to be void as against public policy and wholly unenforceable." *NY CLS Gen Oblig § 5-321*

Courts have held that broad indemnification clauses such as those normally found in a proprietary lease and often in standard alteration agreements, which are not limited to the lessee's acts or omissions, and which fail to make exceptions for the lessor's own negligence, are unenforceable pursuant to General

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Obligations Law § 5-321. Courts have held that this is especially so where the alteration agreement is not negotiated at arm's length by two sophisticated business entities. *Nolasco v. Soho Plaza Corp.*, 129 A.D.3d 924, 925 (2d Dep't June 17, 2015)

This means that an overly sweeping indemnification agreement presented to shareholders when they remodel could be unenforceable. Even if the co-op doesn't intend for the shareholder to cover the co-op's own negligence, and the co-op only wants a shareholder to cover the co-op for losses caused by the tenant or its agents, if this is not spelled out, a tenant against whom the indemnification clause is invoked for just cause could still claim that they do not have to indemnify the landlord. The landlord could then be on the hook for damages they didn't even cause!

The safest course of action for any co-op is, therefore, to amend your alteration agreements (and proprietary leases, if possible) to make sure your documents are in full compliance with New York's General Obligations Law and that the shareholder is only agreeing to cover losses that they cause, and not ones caused by the co-op.

Indemnification and Construction Contracts

Another indemnification pitfall that can ensnare a condominium, as well as a co-op, is a second provision of the General Obligations Law, Section 5-322.1. The problem arises when, for example, the co-op or condominium engages a contractor to perform repairs. In these situations, the General Obligations Law has a similar requirement that the contractor does not have to indemnify the owner of a property for any of the owner's negligent acts. Unlike the provision relating to leases, however, the New York State Court of Appeals has permitted owners to state that they are only being indemnified "to the fullest extent permitted by law." *Brooks v. Judlau Contracting, Inc.*, 11 N.Y.3d 204 (2008). Therefore, if a co-op or condominium is hiring a contractor, the building needs to make sure that the contract only asks the contractor to indemnify the co-op or condo "to the fullest extent permitted by law."

Indemnification of Officers and Directors of Co-Ops

The third issue relating to indemnification pertains to co-op board members seeking indemnification from the corporation pursuant to the bylaws.

While most bylaws permit a board member to ask the corporation to cover them in the event of a lawsuit relating to their participation in board activities, there is a limit in the Business Corporation Law with respect to the corporation's requirement to reimburse a board member who is sued.

BCL 721 precludes indemnification of an officer or director whose "acts were committed in bad faith or were the result of active and deliberate dishonesty and were material to the cause of action ..., or that he personally gained in fact a financial profit or other advantage to which he was not legally entitled." So, if a board member is found to have acted with bad faith or deliberate or even criminal bad acts, including housing discrimination, that board member could not ask to be indemnified by the co-op in the event of a negative court outcome.

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