# NUCA Contracts Risk Management Manual

# Indemnification Agreements



Atlanta, Georgia – Charlotte, North Carolina
Ft. Lauderdale, Florida – Las Vegas, Nevada – Tallahassee, Florida

## INTRODUCTION

## NOTES

Owners who hire general contractors typically want to be protected from lawsuits arising from the construction project. General contractors want like protection from their subcontractors. Two devices commonly used to provide this protection are: (1) indemnification agreements in the prime contract and the subcontracts, and (2) contract provisions requiring that the upstream party be afforded additional insured status on the CGL policy of the general contractor or the subcontractor.

In many states, some construction indemnity agreements have come to be viewed as void and unenforceable because they violate public policy. Currently, 42 states have some form of an anti-indemnity statute that prohibits one party from transferring responsibility for its own negligence to another in a construction contract's hold harmless clause. *See* **Exhibit 1** (chart used with express permission of ASA). The details of the statutes vary from state-to-state. Some states bar indemnity for sole fault, while others bar it for sole or partial fault. Generally, these statutes provide that Party "A" cannot contractually agree to indemnify (hold harmless) Party "B" from liability arising from Party "B's" own negligence on a construction project. There are strong public policy arguments against allowing a party to be held harmless from its own negligence because that party has little incentive to take measures to avoid causing injuries.

NOTES

Since it is a violation of these states' public policy for a subcontractor to be required to indemnify a general contractor for the general contractor's own negligence, an issue that must be considered in conjunction with indemnity is whether the subcontractor may be required to add the general contractor as an additional insured thereby insuring the general contractor's own negligence? In other words, can an additional insured endorsement be used to get around an anti-indemnity statute? The answer may be "yes," in all but three states. Montana, New Mexico and Oregon have attempted to close this additional insured loophole.

## INDEMNITY AGREEMENTS GENERALLY

Indemnity shifts liability from one party – possibly the one most responsible for the loss - to another party. Contractual indemnity is the promise by "one party (the indemnitor) … to hold another party (the indemnitee) harmless for loss or damage of some kind."[i] There are three types of indemnity agreements: (1) the broad form indemnity, (2) the intermediate form indemnity, and (3) the limited form indemnity. *See*, samples below. The broad form indemnity obligates the indemnitor to hold the indemnitee harmless from all liability arising from the project, regardless of which party's negligence caused the liability. Forty-two states make these types of construction indemnity agreements void. The intermediate form requires the indemnitor to hold the indemnitee harmless from all liabilities arising from the project, except for the indemnitee's sole negligence. Of the 42 states banning the broad form, 24 of them also ban the intermediate form. The limited form requires the indemnitor

NOTES

to hold the indemnitee harmless only for the indemnitor's own negligence. The limited form is not restricted by any of the anti-indemnity statutes.

## SAMPLE INDEMNITY AGREEMENTS

### BROAD INDEMNITY FORM

To the greatest extent permitted by law, Contractor agrees to defend, indemnify and hold harmless the Owner against all third-party claims and damages for bodily injury and property damage arising out of Contractor's work, whether caused by the acts or omissions, including but not limited to the sole negligence, of the Owner.

### INTERMEDIATE INDEMNITY FORM

To the greatest extent permitted by law, Contractor agrees to defend, indemnify and hold harmless the Owner against all third-party claims and damages for bodily injury and property damage arising out of Contractor's work, whether such injury to persons or damage to property are due or caused to be due by the negligence of the Owner, except for such injury or damage that has been caused by the sole negligence of the Owner.

### LIMITED INDEMNITY FORM

Contractor agrees to defend, indemnify and hold harmless the Owner against all third-party claims and damages for bodily injury and property damage arising out of the Contractor's work to the extent caused by the negligent acts or omissions of the Contractor and

NOTES

its subcontractors.

**ANTI-INDEMNITY STATUTES V. ADDITIONAL INSUREDS**

An "additional insured" is simply a party that has been added to another party's insurance policy as an insured party. The additional insured has a direct contractual relationship with the named insured's insurance carrier, but doesn't have to pay any premiums. Additional insured status is accomplished through an endorsement (an amendment) to the named insured's policy.

Additional insureds are common on construction projects. Owners typically make this demand of its general contractor, and the general contractor will demand the same from its subcontractors. Free insurance, you have to love the concept. Generally, construction contracts contain provisions in which the general contractor and the subcontractors promise to procure this insurance. Traditionally, the policy's language did not restrict coverage based on any negligence of the additional insured. In effect, what could not be accomplished through an indemnity clause—indemnifying a party for its own negligence—could be accomplished through insurance—insuring a party from its own negligence.

It has been argued that such a promise to procure insurance, because it is virtually the same as an indemnity agreement, should be void as against public policy in states with an anti-indemnity clause. The United States Court of Appeals for the Fifth Circuit shot down this argument. "An agreement to provide insurance is not the same as an agreement to indemnify. It is merely an agreement as to who will pay the premiums for the insurance. An indemnity agreement requires the burdened party to evaluate, predict and/or control

NOTES

risk."[ii] The court reasoned that when buying insurance there is no need for a contractor to evaluate or predict risk because the insurance company does that. There is no public policy against insurance covering one's own negligence.

The perceived inequity in allowing insurance coverage for an additional insured's sole negligence, when indemnification agreements for that same negligence are void and unenforceable in the vast majority of states, has been addressed by two developments. First, in 2004 the Insurance Services Office (ISO) revised its standard additional insured endorsements to require contributory negligence on the part of the named insured before the additional insured's coverage would apply. Second, as mentioned above, Montana, New Mexico and Oregon have statues that attempt to address this inequity.

Montana Code Annotated § 28-2-2111 states in pertinent part:

> [A] construction contract provision that requires one party to the contract to indemnify, hold harmless, *insure*, or defend the other party to the contract or the other party's officers, employees, or agents for liability, damages, losses, or costs that are caused by the negligence, recklessness, or intentional misconduct of the other party or the other party's officers, employees, or agents is void as against the public policy of this state. (emphasis added).

New Mexico Statutes Annotated § 56-7-1 states in pertinent part:

> A provision in a construction contract that requires one party to the contract to indemnify, hold harmless,

NOTES

> *insure* or defend the other party to the contract, including the other party's employees or agents, against liability, claims, damages, losses or expenses, including attorney fees, arising out of bodily injury to persons or damage to property caused by or resulting from, in whole or in part, the negligence, act or omission of the indemnitee, its officers, employees or agents, is void, unenforceable and against the public policy of the state. (emphasis added).

Oregon Revised Statutes Annotated § 30.140 states in pertinent part:

> [A]ny provision in a construction agreement that requires a person or that person's surety or *insurer* to indemnify another against liability for damage arising out of death or bodily injury to persons or damage to property caused in whole or in part by the negligence of the indemnitee is void. (emphasis added).

The key word in each statute is "insure" or "insurer," which can be construed to extend the reach of an anti-indemnity statute to also include the indemnitor's procurement of insurance for the benefit of the indemnitee. The court cases below review the reach of these statutes.

**RELEVANT CASE LAW**

***1. Walsh Construction Co. v. Mutual of Enumclaw***, 338 Or. 1, 104 P.3d 1146 (2005).

This case addresses a typical construction project on which the subcontract agreement required the subcontractor to procure general

NOTES

liability insurance and to name the general contractor as an additional insured on the policy. The subcontractor's CGL policy, which Mutual of Enumclaw had issued earlier, already contained a blanket additional insured endorsement that automatically extended the coverage that the subcontract required.

Subsequently, one of the subcontractor's employees was injured on the job site and made a claim against the general contractor. The general contractor tendered the claim to Enumclaw, which refused the tender, claiming the additional insured provision in the subcontract violated Oregon's anti-indemnity statute. The general contractor settled the case with the subcontractor's employee and then brought a breach of contract action against Enumclaw as an additional insured under the subcontractor's policy.

Enumclaw argued in court that the subcontract's additional insured provision violated Oregon's anti-indemnity statute and was therefore void and unenforceable. The general contractor argued that the statute applied to agreements to indemnify only, and that an agreement to procure insurance was a different animal and not prohibited by the statute. The Oregon Supreme Court agreed with the insurance company, holding that the additional insured provision in the subcontract violated Oregon's anti-indemnity statute because it required the subcontractor's insurer to indemnify the general contractor against liability caused in whole or in part by the general contractor's own negligence. The court noted the statute's use of the word *insurer*, and found that this reference could refer only to a provision that one party add the other to its insurance policy.

Therefore, Oregon's anti-indemnity statute prohibits not only

NOTES

"direct" indemnity arrangements between parties to construction contracts but also additional insured arrangements by which one party is obligated to procure insurance for losses arising in whole or in part from the other's fault. In *Walsh*, the general contractor never claimed that the subcontractor was wholly or partially responsible for its own employee's injuries, which leads to the next case.

***2. Hoffman Construction Co. of Oregon v. Travelers Indemnity Insurance Co.***, 2005 WL 3689487 (D. Or.).

In 2005, a federal judge ruled that Oregon's anti-indemnity statute does not invalidate a construction agreement which requires a subcontractor to obtain an additional insured endorsement on behalf of the general contractor with respect to an injury caused by the subcontractor.

In *Hoffman*, the general contractor ("Hoffman") hired a subcontractor ("ATG") to build a "clean room" on a Hewlett-Packard project in Corvallis, Oregon. The subcontract agreement required ATG to build and maintain temporary steps leading up to the raised floor of the clean room. ATG's subcontract required it to name Hoffman as an additional insured under ATG's CGL policy. Travelers was ATG's insurer.

An employee of one of Hoffman's other subcontractors was injured on the temporary steps. Hoffman tendered its defense and indemnity to Travelers, arguing that since the employee was injured on the temporary steps built and maintained by ATG, Hoffman qualified as an additional insured under Travelers' policy. Travelers, relying on the *Walsh* case, rejected Hoffman's tender, stating that under the Oregon anti-indemnity statute it owed no duty to defend or

indemnify Hoffman.

The federal court agreed with the Oregon Supreme Court that an agreement requiring a subcontractor to procure additional insured insurance covering a general contractor for the general contractor's own fault was void under Oregon law. However, the court went on to find that the Oregon anti-indemnity statute permits construction agreements that require a subcontractor to obtain an additional insured endorsement indirectly indemnifying the general contractor for the subcontractor's fault in causing injury.

***3. Fort Knox Self Storage, Inc. v. Western Technologies, Inc.***, 140 N.M. 233, 142 P.3d 1 (2006).

This case looked at the issue of whether a limitation-of-liability clause in a construction design services contract violated New Mexico's anti-indemnity statute, which prohibits parties to construction contracts from agreeing to indemnify any entity for its own negligence.

Here, Fort Knox Self Storage entered into a contract with Western Technologies, in which Western agreed to provide geotechnical engineering services in evaluating the subsurface conditions of a proposed building site. Fort Knox agreed to pay Western $1,750 for its engineering services. The contract contained a limitation of liability clause purportedly limiting Western's liability to $50,000.

Western performed the agreed services, and, shortly after construction of the facility was completed, Fort Knox employees noticed damage to walls, and cracks and fissures in the parking lot. Fort Knox sued claiming the damage resulted from the negligence of

Western. Western contended that its liability, if any, was limited to $50,000. Fort Knox argued that the limitation-of-liability clause was unenforceable because it violated New Mexico's anti-indemnity statute.

The court held that the statute did not prohibit a *limitation* of liability based on one's own negligence, but that the statute prohibited the avoidance of *all* liability for one's own negligence. The court found that the "limitation of liability clause in this case does not seek to contract away all liability for Western's negligence but seeks to limit the amount of damages Western must pay for its own negligence. The contract does not indemnify Western against its own negligence. Indeed, it provides that Western may be liable for damages, based on its own negligence, that are twenty-eight times higher than the amount of the contract."[iii] The court noted that limitation-of-liability clauses are enforceable as long as they are reasonable and not so drastic as to remove the incentive to perform with due care.

***4. Chrysler Corp. v. Merrel & Garaguso, Inc.***, 796 A.2d 648 (Del. 2002).

In states with anti-indemnity statutes that, unlike Montana, New Mexico and Oregon, do not contain the "insure" or "insurer" language, the requirement to purchase insurance to shield another party from its own negligence may be enforceable.

In the *Chrysler Corp.* case, Merrel was doing masonry work at the Chrysler plant in Newark, Delaware. A Merrel employee was injured when a Chrysler employee operating a forklift accidentally dropped a fence on the Merrel employee. The contract between

NOTES

Chrysler and Merrel required Merrel to indemnify Chrysler for all claims for property damage and personal injuries arising under the contract, including instances where Chrysler might be liable because of its own negligence. To accomplish this, Merrel provided Chrysler with a policy of liability insurance naming Chrysler as an additional insured. The injured Merrel employee sued Chrysler for the negligence of its employee. Chrysler, in turn, brought a third-party action against Merrel claiming that Merrel was required to indemnify and defend Chrysler from all claims arising under the construction contract.

The trial court ruled that the contract's indemnification provision was unenforceable because of Delaware's anti-indemnity statute, and that the provision requiring Merrel to secure insurance was also void as an indirect requirement to indemnify Chrysler. Chrysler appealed the trial court's ruling.

The Delaware Supreme Court reversed the trial court and ruled for Chrysler, holding that Delaware's anti-indemnity statute did not extend to the insurance aspect of indemnification. The Supreme Court noted that Delaware, and 19 other states with anti-indemnity statutes, had adopted an insurance savings provision that allowed liability insurance to create coverage for one's own negligence under an indemnity agreement, "even if the wrong party paid the premiums."

A typical insurance savings provision will come after the anti-indemnity language and state that nothing in the above section (i.e., the anti-indemnity section) "shall be construed to void or render unenforceable policies of insurance issued by duly authorized

NOTES

insurance companies and insuring losses or damages from any causes whatsoever."[iv]

**NEW CALIFORNIA LEGISLATION**

California Civil Code Ann. § 2782 contains the state's brand new anti-indemnity statute. A new subsection, § 2782.8, applies to any public agency contracts or amendments entered into on or after January 1, 2007. In contracts between a California public agency and an architect, landscape architect, professional engineer, or professional land surveyor, any agreement to indemnify the public agency, including a duty to defend, is void except for claims arising out of the design professional's own negligence.

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POINTS TO REMEMBER: Counsel, familiar with the laws of the jurisdiction, should review indemnification clauses, limitation-of-liability clauses, and requirements for additional insureds in all construction contracts.

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[i] E. Allan Farnsworth, *Contracts* § 6.3 (3d ed., Aspen L. & Bus. 1999).
[ii] *Woods v. Dravo Basic Materials Co., Inc.*, 887 F.2d 618, 622 (5th Cir. 1989).
[iii] *Fort Knox*, 142 P.3d at 5.
[iv] *See* 6 Del. C. § 2704(b).