CLAIMS JOURNAL

View this article online:
http://www.claimsjournal.com/news/national/2014/04/03/246663.htm

You Break It, You Buy It: Understanding Anti-Indemnity Statutes

By Gary Wickert | April 3, 2014

- Article
- Comments

The song we learn in our youth is the song we sing for life. Children often blame others for their mistakes and misdeeds – a desperate effort to shift responsibility and avoid unpleasant consequences. As adults engaging in commerce, we are not much different. It is virtually impossible to find a construction contract which does not contain "indemnification", "hold harmless", "additional insured", and/or "waiver of subrogation" provisions. These risk transfer clauses often seek to hold the subcontractor and its insurers legally accountable for jobsite accidents and injuries which are not the fault of the subcontractor. This finger pointing can unfairly shift the financial responsibility for accidents caused by others to the innocent subcontractor or it's insurance company by increasing insurer liability and destroying subrogation potential – both of which raise the cost of insurance and give the owner and/or general contractor a license to act carelessly.

Indemnity and Hold Harmless Clauses

He who has the gold makes the rules. Owners and general contractors have been able to insist on indemnity clauses which *shift* the responsibility to pay damages (often including attorney's fees and litigation costs) from one party (indemnitee) to another (indemnitor), without regard to who actually caused the loss. An example of such a clause reads as follows:

Subcontractor shall indemnify and hold harmless the Owner, Architect, General Contractor, and agents and employees of any of them from and against claims, damages, losses and expenses, including, but not limited to, attorneys' fees, arising out of or resulting from performance of the Work.

The above language also serves as a "hold harmless" clause by which one or both parties agree to absolve the other party and not hold it responsible for any loss, damage, or legal liability. Such clauses are often woven together and intertwined in contract language.

Anti-Indemnity Statutes

Many states have enacted legislation intended to right this wrong and place the financial responsibility for accidents and injuries on the party responsible for causing them. Forty-five (45) states have enacted anti-indemnity statutes that limit or prohibit enforcing indemnification agreements in construction settings. Anti-indemnity legislation is intended to prevent the party with superior bargaining power (owner/general contractor) from taking advantage of the party with inferior power (subcontractor). Also, some states with anti-indemnity legislation protect only the government by limiting the application of these rules to public projects.

There are three forms of indemnity agreements:

(1) Limited: Subcontractor assumes only the responsibility for its own negligence – if it is solely at fault. There is no protection if the owner/general contractor is even partially at fault. All states allow limited indemnity provisions.

(2) Intermediate: Subcontractor assumes responsibility for its own sole negligence or partial negligence. If the owner/general contractor is solely at fault, there is no indemnity. There are two types of intermediate indemnity:

(a) Full Indemnity: If the subcontractor is partially at fault, he pays all the damages. This allows an owner/general contractor who was 99 percent at fault to receive indemnity from the subcontractor who was only 1 percent at fault.

(b) *Partial Indemnity*: Indemnity is on a sliding scale based on the extent of the subcontractor's negligence. This sets a cap on the amount of indemnity that can be had. If the owner/general contractor is 51 percent at fault it is indemnified only for 49% of the total damages.

(3) *Broad*: The subcontractor is at fault, regardless of who is at fault, and indemnifies the owner/general contractor for the owner/general contractor's sole negligence, the subcontractor's sole negligence, and any joint negligence of the two. The entire risk of loss is transferred to the subcontractor. This is the most onerous of indemnity clauses and the one most targeted by anti-indemnity legislation.

There are many varieties of indemnity clauses and not every state deals with them in the same way. Understanding them and their interaction in a multi-state economy is not always easy. We can start with the simple fact that every state allows limited indemnity agreements. However, that is where the agreement ends.

Broad Indemnity Prohibited

Seventeen (17) states prohibit only broad indemnity where the subcontractor must indemnify another party for its *sole* fault. They allow intermediate indemnity. These states are Alaska, Arizona, Arkansas, California, Georgia, Hawaii, Idaho, Indiana, Maryland, Massachusetts, Michigan, New Jersey, South Carolina, South Dakota, Tennessee, Virginia and West Virginia. Arizona prohibits broad indemnity in private contracts only. Utah allows such indemnity, but for the owner only. A loss is said to arise from the "sole negligence" of a party if no other party's negligence contributed to the damage. In these states, indemnity is usually allowed. In these states, the owner/general contractor (indemnitee) can be indemnified even if it is partially at fault.

Intermediate Indemnity Prohibited

Twenty-four (24) states ban intermediate indemnity clauses which require a subcontractor to indemnify another party even for the other party's partial/concurrent fault *and* the broad indemnity prohibited by the above sixteen (17) states. These states are California, Colorado, Connecticut, Delaware, Florida (public contracts only), Illinois, Iowa, Kansas, Kentucky, Louisiana (protects prime contractors on public works projects only), Minnesota, Mississippi, Missouri, Montana, New Hampshire, New York, North Carolina, Ohio, Oklahoma, Oregon, Rhode Island, Texas, Utah and Wisconsin.

Broad Indemnity Allowed

Six (6) states (Alabama, Maine, Nevada, North Dakota, Pennsylvania and Vermont) and the District of Columbia allow broad indemnity whereby a subcontractor can be required to indemnify the owner/general contractor even if the owner/general contractor is 100 percent at fault. These states do so either by statute or case law, and some of them require that such indemnity is allowed only if it is "clear and unequivocal."

The anti-indemnity landscape is quite complicated and incapable of proper treatment in a short article such as this. For this reason, articles such as this appropriately serve only as a starting point for understanding the anti-indemnity law in a particular jurisdiction. For example, even though a broad form indemnity clause, which requires the subcontractor to indemnify an owner/general contractor even for the latter's sole negligence, is prohibited by law, the question of whether the enforceability of the indemnity provision must wait for a determination by a jury as to whether the owner/general contractor was solely responsible for a loss. Obviously, nobody knows the result until a jury allocates fault. In the meantime, the indemnitee will surely have tendered its defense and indemnity obligation to the indemnitor and significant questions regarding the handling of the underlying litigation must be made.

In addition, most of the anti-indemnity statutes apply only to construction contracts, while others have a broader application and apply to additional insured contractual requirements as well.

Additional Insured Clause

Indemnity agreements provide "assurance" not "insurance." They are only as good as the indemnitor's ability to make good on its indemnity obligations. Therefore, indemnity clauses are often intertwined with additional insured clauses which require the subcontractor to amend its liability policy to make the owner or general contractor an insured under the policy. An example of such a clause is as follows:

The Contractor shall cause the commercial liability coverage required by the Contract Documents to include (1) the Owner, the Owner's lender(s), the Owner's landlord, the Architect and the Architect's Consultants as additional insureds for claims caused in whole or in part by the Contractor's negligent acts or omissions during the Contractor's operations; and (2) the Owner as an additional insured for

claims caused in whole or in part by the Contractor's negligent acts or omissions during the Contractor's completed operations.

Additional insured clauses in contracts are legally separate and distinct, but are often interwoven with indemnity clauses. The reason for this is that most Comprehensive General Liability (CGL) policies exclude coverage for "bodily injury" or "property damage" for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement.

A subcontractor may be required by contract to purchase insurance which names the owner/general contractor as an "additional insured." They usually require an additional insured endorsement to the insurance policy of the subcontractor. The additional insured endorsement adds the general contractor and/or owner as an insured under the subcontractor's policy and extends the benefits of the policy to the additional insured and obligates the subcontractor's carrier to insure it.

The parties may limit the additional insured requirements (in the contract and/or the insurance policy) to provide coverage only as to the other party's indemnification obligations and not any liability of the additional insured that is beyond the scope of the contractual indemnification. This is usually carefully spelled out in the policy's additional insured provisions and/or endorsements. However, in some situations, the additional insured contract provisions and the policy provisions can be construed to provide the additional insured/indemnitee with coverage well beyond liability for contractual indemnification, possibly even extending to the sole negligence of the additional insured. A loophole could exist whereby the indemnity is invalid, but the indemnitee still obtains relief as a result of its status as an additional insured under the subcontractor's liability policy.

Three (3) states (Kansas, Ohio, and Oregon) extend their anti-indemnity prohibition to additional insured requirements as well. Only eleven (11) states currently have legislation that addresses the additional insured loophole by prohibiting owners from requiring additional insured protection from downstream contractors and subcontractors, but the trend is definitely in this direction. These states are Arizona (public work contracts only), California, Colorado, Kansas, Louisiana, Montana, New Mexico, Oklahoma, Oregon, Texas and Utah. Twelve (12) states currently bar additional insured endorsements either by statute or court decision and the count is rising. Some states, such as Arkansas, expressly provide in their statutes to allow policies to name the owner/general contractor as an additional insured under the subcontractor's policy. Ark. Code § 4-56-104.

Oilfield Anti-Indemnity Statutes

In addition to the general anti-indemnity statutes discussed generally above, four (4) states have enacted oilfield anti-indemnity legislation which specifically addresses the oilfield-services industry. These states are Texas, Louisiana, New Mexico, and Wyoming. Their purpose is to create a level playing field when owners and operators of oil and gas wells enter into a Master Service Agreement (MSA) with contractors providing services and materials on a well or rig. The MSA usually requires the contractor to indemnify the operator and carry a minimum amount of insurance which names the operator as an additional insured. These oilfield anti-indemnity statutes generally prohibit an MSA from requiring the contractor to indemnify the operator against its sole or concurrent negligence. Wyoming and New Mexico do not prohibit an operator from seeking indemnity from the contractor for the contractor's percentage of negligence resulting in a claim or loss. Louisiana, however, provides that any negligence on the part of the operator invalidates that party's right to any indemnity, even to the extent of the other party's concurrent negligence. These oilfield anti-indemnity statutes differ when it comes to invalidating insurance coverage of indemnity liability.

Summary

The existence of anti-indemnity statutes can have a dramatic effect on not only a subcontractor's liability, but also its insurers' liability and/or subrogation potential. Whether you are a liability carrier looking to limit liability for a construction site accident or a workers' compensation carrier interested in subrogating against another party to a construction contract, it is important to obtain copies of all contracts and policies immediately after a loss in order to evaluate your options.

Indemnity clauses, hold harmless language, additional insured requirements, and waiver of subrogation agreements must be understood and addressed by liability claims professionals and subrogation professionals in order to make informed decisions on the appropriate claims strategy and recovery options available to them. A great starting point to assist insurance professionals and lawyers in understanding indemnity clause enforcement issues and navigating the anti-indemnity minefield is a chart detailing the anti-indemnity and additional insured legislation in all 50 states which can be found on the Matthiesen, Wickert & Lehrer, S.C. website by clicking here.