

Shifting Loss: Significant Issues Related to Contractual Indemnity, Additional Insureds and Certificates of Insurance

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Indemnity Provisions

Why are they important?

- An enforceable indemnity provision is the lynchpin to contractual liability coverage.
- “Legalese” and other (valid) complaints

“It is hard to imagine another set of legal terms with more soporific effect than indemnity, subrogation, contribution, co-obligation and joint tortfeasorship. Perhaps because the words describe legal relationships between multiple parties, they are vaguely reminiscent of complex mathematical equations which, after all, also describe relationships, except in numbers rather than words – and for most of us, they are about as easy to understand. Even lawyers find that words like ‘indemnity’ and ‘subrogation’ ring of obscure Martian dialect.”

Herrick Corp. v. Canadian Ins. Co. of California, 29 Cal.App.4th 753, 34 Cal.Rptr.844 (4th Dist. 1994).

Additional Insured v. Indemnitee

<u>ADDITIONAL INSURED</u>	<u>INDEMNITEE</u>
Must comply with policy conditions just like any insured (i.e. notice, request for defense etc.)	Not bound by policy conditions; not an insured
Insurer owes duties to AI just like any other insured; rights depend on the policy	Insurer owes no direct duty to them as it would an insured; rights depend on the contract with the insured
May be entitled to direct defense as an AI	Limited to recovering defense costs as part of overall indemnity claim v. insured Exceptions: Recent ISO forms – supplemental payment Practical considerations
Standing to sue the carrier	No standing to sue carrier directly

Indemnity Provisions 101

- Enforceability varies dramatically from state to state
 - Which law applies?
 - Choice of law provision
 - Other factors (location of parties, where was contract negotiated/signed, place of performance)
- Generally, agreements are categorized by courts as one of three types:
 - (1) broad form
 - (2) intermediate form
 - (3) limited form
- Many provisions are not easily categorized or mix elements of each “type”

Broad Form Indemnity Agreements

- Indemnitor indemnifies the indemnitee for
 - (1) indemnitor's sole negligence;
 - (2) indemnitee's sole negligence; and,
 - (3) joint negligence of indemnitor and indemnitee
- Seeks to transfer *entire* risk of loss to indemnitor
- Numerous obstacles to enforcement
- Enforceability prohibited or severely restricted in many states

Intermediate Form Indemnity Agreements

- Indemnitor indemnifies the indemnitee, for:
 - (1) indemnitor's sole negligence; and
 - (2) joint negligence of indemnitor and indemnitee
- Indemnitor assumes all risk of loss except where indemnitee is solely at fault
- Source of numerous conflicts between indemnitor and indemnitee
- Frequently requires indemnitor to provide defense pending ultimate resolution

Limited Form (Comparative Fault) Indemnity Agreements

- Basically provides that each party will take care of their own negligence
- Will usually be enforced by courts
- May actually be less favorable than what jurisdiction provides

Issues in Analyzing Enforceability

- What degree of fault can be transferred in the particular jurisdiction?
- Can sole negligence be transferred?
- Special concerns regarding “construction” contracts
 - Anti-indemnity statutes / the Subcontractors’ Relentless Effort

H.B. No. 2093

(Tex. Ins. Code 151.001)

- Effective January 1, 2012
- Voids provisions in construction contracts requiring indemnity or *additional insured status* to party for its fault, negligence, or statutory/contractual breach.
- Effect:
 - Void broad form and “concurrent indemnification” provisions.
 - Companion additional insured requirements also void.
 - Exceptions:
 - Claims made by indemnitor’s own employees or subcontractor below it against other party (maintain indemnity on “third party-over suits”)
 - Residential construction (single family homes, townhomes, duplexes)
 - Multi-family residences / apartment and condominium complexes?
 - “Public works projects”

Enforceability Under Texas Law: “We don’t like liars, cheaters, and tricksters”

- “Fair Notice” Doctrine
 - (1) “Express Negligence” Rule
 - (2) “Conspicuousness” Requirement
- Caveat: Doctrine does not apply if indemnitee had “actual knowledge”.

“Express Negligence” Rule

- Party seeking indemnity for its own negligence must state it specifically within the contract. *Dresser Industries, Inc. v. Page Petroleum, Inc.*, 53 S.W.2d 505 (Tex. 1993)
- Does not require use of the term “negligence”. *Banzhat v. ADT Sec. Sys. Southwest, Inc.*, 28 S.W.3d 180 (Tex.App. – Eastland 2000, pet. denied)
- **Correct inquiry:** whether parties made clear in agreement intent of the indemnitor to indemnify the indemnitee for its own acts of negligence.

“Express Negligence” Rule (cont’d)

- Example No. 1:
 - “Contractor shall indemnify and hold Owner harmless against any loss or damage to persons or property as a result of operations growing out of the performance of this contract and caused by the negligence or carelessness of Contractor, Contractor's employees, Subcontractors, and agents or licensees.”
 - **NOT ENFORCEABLE**—*Ethyl Corp. v. Daniel Construction*, 725 S.W.2d 705 (Tex. 1987)

“Express Negligence” Rule (cont’d)

- Example No. 2:
 - “Application of indemnities. Except as otherwise provided in this contract, any indemnification and defense obligation in this contract applies regardless of (1) the cause of or reason for any covered loss or liability; (2) the sole, joint or concurrent negligence or other fault, whether active or passive, of the indemnified party; and (3) whether the loss or liability results from actions of [Conoco], its agents or employees.”
 - **ENFORCEABLE**—*Ayers Welding Co. v. Conoco, Inc.*, 243 S.W.3d 177 (Tex. App.—Houston [14th Dist.] 2007).

“Conspicuousness” Requirement

- Must attract the attention of a reasonable person.
 - *Ling & Co. v. Trinity Sav. & Loan Ass’n*, 482 S.W.2d 841 (Tex. 1972)
- Separate provision, bold, capitalization, contrasting font/color.

Examples

Asset Purchase Agreement

* * *

(e) *Payments.* Payments of all amounts owing by an Indemnifying Party pursuant to this Article X relating to a Third Party Claim shall be made within 30 days after the latest of (i) the settlement of such Third Party Claim, (ii) the expiration of the period for appeal of a final adjudication of such Third Party Claim or (iii) the expiration of the period for appeal of a final adjudication of the Indemnifying Party's liability to the Indemnified Party under this Agreement. Payments of all amounts owing by an Indemnifying Party pursuant to Section 10.04(d) shall be made within 30 days after the later of (i) the expiration of the 60-day Indemnity Notice period or (ii) the expiration of the period for appeal of a final adjudication of the Indemnifying Party's liability to the Indemnified Party under this Agreement.

(f) *Escrow Deliveries.* For so long as the Escrow Agreement is in effect and for so long as Shares are held by the Escrow Agent, the rights of the Purchaser Indemnitees to indemnification pursuant to this Article X shall be satisfied with the Shares deposited with the Escrow Agent under the Escrow Agreement, valuing such Shares as set forth therein. If and to the extent that any indemnifiable Claim exceeds the value of the Shares so disposed or if the Escrow Agreement is no longer in effect, the Sellers and the Holders, subject to Sections 10.08 and 10.10, shall pay such Claim, jointly and severally. In no event, however, shall defense costs of the Sellers and the Holders as Indemnifying Parties be paid from the Shares so deposited.

Section 10.05 NEGLIGENCE. THE INDEMNIFICATION PROVIDED IN THIS AGREEMENT SHALL BE APPLICABLE WHETHER OR NOT THE SOLE, CONCURRENT, CONTRIBUTORY OR COMPARATIVE NEGLIGENCE OR THE SOLE OR CONCURRENT STRICT LIABILITY OF THE PERSON ENTITLED TO INDEMNIFICATION HEREUNDER IS ALLEGED OR PROVEN.

Examples

“Boilerplate” Subcontractor Agreement

* * *

11. **CONTRACTOR'S INDEMNITY AND WAIVER.** TO THE FULLEST EXTENT PERMITTED BY LAW, CONTRACTOR HEREBY AGREES TO PROTECT, DEFEND, INDEMNIFY, AND HOLD OWNER, ITS PARENT CORPORATION, SUBSIDIARIES AND AFFILIATES, AND ANY OF THEIR RESPECTIVE OFFICERS, DIRECTORS, PARTNERS, EMPLOYEES, AGENTS AND INSURERS, (HEREIN COLLECTIVELY REFERRED TO AS THE "INDEMNITEE"), FREE AND HARMLESS FROM AND AGAINST ANY AND ALL CLAIMS, DEMANDS, CAUSES OF ACTIONS, SUITS, OR OTHER LITIGATION OF EVERY KIND AND CHARACTER (INCLUDING ALL COSTS THEREOF AND ATTORNEYS' FEES), WHETHER ASSERTED BY THE HOMEOWNER, CONTRACTOR, OR ANY THIRD PARTY (INCLUDING, BUT NOT LIMITED TO, PERSONNEL FURNISHED BY CONTRACTOR, ITS SUPPLIERS AND PERMITTED SUBCONTRACTORS OF ANY TIER), ON ACCOUNT OF BODILY OR PERSONAL INJURY, DEATH, OR DAMAGE TO OR LOSS OF PROPERTY (INCLUDING THE LOSS OF USE THEREOF), (HEREIN COLLECTIVELY REFERRED TO AS "LOSS"), IN ANY WAY OCCURRING, INCIDENT TO, ARISING OUT OF, OR IN CONNECTION WITH: (I) A BREACH OF THE WARRANTIES, REPRESENTATIONS, OBLIGATIONS, AND COVENANTS PROVIDED HEREIN BY CONTRACTOR; (II) THE WORK PERFORMED OR TO BE PERFORMED BY CONTRACTOR OR CONTRACTOR'S PERSONNEL, AGENTS, SUPPLIERS, OR PERMITTED SUBCONTRACTORS; OR (III) ANY NEGLIGENT ACTION AND/OR OMISSION OF THE INDEMNITEE RELATED IN ANY WAY TO THE WORK, EVEN WHEN THE LOSS IS CAUSED BY THE FAULT OR NEGLIGENCE OF THE INDEMNITEE. ANY PAYMENTS BY CONTRACTOR UNDER THIS PARAGRAPH ON BEHALF OF THE INDEMNITEE SHALL BE IN ADDITION TO ANY AND ALL OTHER LEGAL REMEDIES AVAILABLE TO THE INDEMNITEE AND SHALL NOT BE CONSIDERED THE INDEMNITEE'S EXCLUSIVE REMEDY. CONTRACTOR AND CONTRACTOR'S EMPLOYEES, PERSONNEL, AGENTS, AND PERMITTED SUBCONTRACTORS SHALL BE SOLELY RESPONSIBLE FOR THEIR RESPECTIVE TOOLS AND EQUIPMENT, AND HEREBY WAIVE ANY RIGHT OF RECOVERY AGAINST THE INDEMNITEE WITH RESPECT TO ANY LOSS INVOLVING SUCH TOOLS OR EQUIPMENT IN ANY WAY OCCURRING, INCIDENT TO, ARISING OUT OF, OR IN CONNECTION WITH, THE WORK TO BE PERFORMED HEREUNDER.

12. **Representations and Warranties.** Contractor represents and warrants to Owner that: (i) the person executing this Agreement on behalf of Contractor is duly authorized and has full power to execute and deliver this Agreement, (ii) all corporate, partnership, or other action requisite for the due execution of this Agreement has been duly and effectively taken or shall be taken prior to the execution and delivery of this Agreement, (iii) this Agreement is or will be (when executed) valid and binding obligations of Contractor, enforceable in accordance with its terms, (iv) this Agreement and Contractor's performance thereof, does not and will not violate any provisions of Contractor's constituent or organizational documents, or any contract, agreement, or governmental requirement to which Contractor is subject, and the same do not require the consent or approval of any governmental authority, (v) Contractor has, and each Contractor's employees, agents or permitted subcontractors shall have, the requisite skills, expertise, experience, licenses, and knowledge to perform the Work, (vi) Contractor is in compliance with all governmental requirements to which it is subject, and (vii) Contractor has the financial ability and resources to perform the Work and all other obligations, duties, and covenants of Contractor under this Agreement.

13. **Insurance.** Contractor agrees to carry: (a) Broad Form Commercial General Liability Insurance on an Occurrence Form, naming the Indemnitee as an additional insured with completed operations coverage and containing a per occurrence limit of no less than One Million Dollars (\$1,000,000.00), and an aggregate limit of no less than One Million Dollars (\$1,000,000.00) protecting against bodily injury, broad form property damage, and personal injury claims arising from the exposures of: (i) premises operations; (ii) products and completed operations including materials designed, furnished, and/or modified in any way by Contractor; (iii) independent subcontractors; (iv) contractual liability risk covering the indemnity obligations set forth in this Agreement; and (v) property damage resulting from explosion, collapse, or underground (x, c, u) exposures; (b) Worker's Compensation Insurance that provides statutory benefits and coverage such that Owner will have no liability to Contractor's personnel, employees, or agents; and (c) Professional Liability Insurance for Architects, Engineers, Surveyors, and other Professional Service Organizations, that provides a per claim limit of no less than One Million Dollars (\$1,000,000.00) and an aggregate of no less than One Million Dollars (\$1,000,000.00) protecting against faulty design and faulty professional judgement. Owner and Contractor (collectively, the Parties) intend and agree that the coverage obtained by Contractor naming Owner as an additional insured as set forth herein shall apply on a primary basis with any insurance of Owner being excess coverage. Such coverages will be carried continuously during the term of this Agreement with insurance companies acceptable to Owner in its sole and absolute discretion. Such insurance shall provide for a waiver of subrogation.

INITIALS:

Owner:

[Signature]

Contractor:

[Signature]

Maximizing Enforceability

- Work closely with legal department on drafting/review of contracts.
- Analyze jurisdiction's indemnity law carefully
- Avoid “boilerplate” provisions for use in multiple states
- Separate indemnity provisions for different types of activities
- Document specific contracting intent
- Be particularly cautious with “construction”/design contracts
- Establish who controls defense/settlement of claim
- Place indemnity provisions and insurance provisions in separate parts of contract

If seeking coverage under indemnitee's policy, enforceability isn't the end of the story

- Does Coverage Exist?
 - Insuring Agreement
 - Exclusions

Coverage for Additional Insureds

– Types of Additional Insured Endorsements

- Limited to claims arising out of the A/I's "ongoing operations for the named insured" ;
- A/I specifically required to be named v. blanket "as required" by contract.
- Excluding any bodily injury sustained by any employee of the named or additional insured as well as employees of any contractors or subs;
- Coverage limited to the A/I's acts/omissions in the general supervision of the named insured's operations.
- **Actual coverage may be different than what was represented on the Certificate of Insurance.**

Additional Insureds - Advantages

- Creates a direct contractual relationship with insurer and policy rights for A/I.
- Provides coverage independent of indemnity rights.
- Insurer owes equal duty of good faith to both named insured and A/I.

Additional Insureds - Disadvantages

- Potential dilution of policy limits.
 - Per occurrence
 - Aggregate
- Potential adverse impact on loss experience.
- “Other insurance” issues between the A/I coverage and the indemnitee’s own coverage.
- Notice of cancellation issues.
- Scope of coverage limitations.

Additional Insureds - Strategies

- Identify/review A/I endorsement being used.
- Require certain exclusions be eliminated.
- Have evidence of coverage specifically state “primary non contributory.”
- Synchronize your own coverage with A/I coverage.

Application of Policy Exclusions to A/I's

- Unless the wording of the exclusion uses the term “you” or “your” to require a causal connection between the excluded conduct and the named insured or its products, work, etc., then exclusions must be applied to each insured, including A/Is.
 - This is especially true if the exclusion speaks in terms of some excluded category of conduct of “any insured”.
- Exclusions j5, j6, l and m in CGL refer to “your work”, “your product” and “work on your behalf” thereby only applying to the **named insured's** work/product.

Exclusions in CGL typically applicable to A/Is as well:

- Intentional injury;
- Contractual liability;
- Liquor liability;
- Worker's compensation obligations;
- Employer's liability;
- Pollution;
- Auto/watercraft;
- Mobile equipment;
- Care, custody or control.

The Duty to Defend the A/I

- Same general “duty to defend” rules apply.
- Often complicated by A/I endorsements that condition A/I status on certain conditions being met. What if the suit allegations are silent on such things?
 - Does the claim arise out of the N/I’s “ongoing operations”?
 - Does the claim arise out of the N/I’s work for the A/I at all?
 - What if the suit does not mention the N/I’s work at all but it is undisputed that the claim against the A/I is related thereto?

The Duty to Defend the A/I (cont'd)

- *Pine Oak Builders Inc. v. Great Am. Lloyds Ins. Co.*, 279 S.W.3d 650 (Tex. 2009)- homebuilder could NOT rely on extrinsic evidence to show that the defective work was performed by a sub so as to invoke the “subcontractor work” exception to the “insured’s work” exclusion (exclusion L).
 - Query: Does that same reasoning mean that the homebuilder cannot present extrinsic evidence of the sub’s work being involved in order to trigger the sub’s A/I coverage for the builder?
 - Court could have but did not answer that question in *D.R. Horton v. Markel*, 300 S.W.3d 740 (Tex. 2009).

Certificates of Insurance

- “Evidence” of Coverage?
 - Sometimes not the best evidence of coverage.
 - May not evidence all of the coverage intended to be transferred.
 - Conflicts between COI and policy.
 - *Policy governs*; COI *is not* an insurance policy and will not alter or amend its terms.
 - “Moment in time” document – coverage may not be available when needed.

Practical Pointers

- Secure a copy of the policy *if feasible*.
- Compare the contract requirements with the policy.
- Review the policy to ensure that likely claims scenarios may be covered.

New ACORD Forms

- ACORD 25 – Certificate of Liability Insurance
- Background
 - DOI activity (South Dakota)
 - ACORD working groups

Notice of Cancellation Changes

Old Text	New Text
<p>Should any of the above described policies be cancelled before the expiration date thereof, the issuing insurer will endeavor to mail ___ days written notice to the certificate holder named to the left, but failure to do so shall impose no obligation or liability of any kind upon the insurer, its agents or representatives.</p>	<p>Should any of the above described policies be cancelled before the expiration date thereof, notice will be delivered in accordance with the policy provisions.</p>

Notice of Cancellation Changes

- Reason:
 - Policy provisions on cancellation govern
 - Different states have different notice periods
 - Texas Cancellation Endorsement – (IL 02750907, ISO 2006)
 - Notice to First Named Insured within 10 days
 - Condo Association: 30 days to First Named Insured
30 days to Unit Owners with COIs
- Problems:
 - COI holder has no rights to receive notice.
 - Brokers cannot issue older forms.
 - Brokers cannot amend new COI to provide notice.

Practical Pointers

- Seek policy amendment to specifically provide notice.
- Include requirement in contracts that named insured must forward notices immediately/10 days/30 days.
- Develop procedures to closely track cancellation, expiration and renewal.
- Issues:
 - Long-term contracts with “old” notice provisions?