NOWHERE TO RUN, NOWHERE TO HIDE: INDEMNIFICATION AND INSURING THE INDEMNITY IN CONSTRUCTION CONTRACTS – IS A NEW TREND EMERGING?

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I. Indemnification in Construction Contracts

There is a great amount of risk shifting in construction contracts. One way to shift liability is the use of indemnity clauses. Construction contracts commonly include indemnity provisions requiring one party to indemnify another for losses on a project, whether in broad form, providing indemnity for the indemnitee's sole negligence, or in a more limited form, providing indemnity for vicarious liability only or for only that portion of damage attributable to the indemnitor's acts. Either through incorporation-by-reference clauses or express indemnity provisions, these indemnity obligations usually land on lower-tier subcontractors, requiring a subcontractor to indemnify higher tiers or others for losses that the subcontractor did not control or create.

Given the perception that subcontractors generally lack effective bargaining power to remove or limit these indemnity provisions, and to address the actual and perceived inequity of indemnifying another party for its own acts, most states have passed anti-indemnity legislation, limiting indemnification obligations in construction contracts. These statutes generally fall into three categories: (1) statutes barring indemnity for the indemnitee's sole negligence;[1] (2) statutes

[1] Alaska Stat. § 45.45.900; Ariz. Rev. Stat. Ann. § 34-226; Ark. Code Ann. § 4-56-104; Cal. Civ. Code § 2782; Ga. Code Ann. § 13-8-2(b); Haw. Rev. Stat. § 431:10-222; Idaho Code § 29-114; Ind. Code § 26-2-5-1; Md. Cts. & Jud. Proc. Code Ann. § 5-401; Mich. Stat. Ann. § 691.991; N.J. Rev. Stat. § 2A:40A-1; S.C. Code Ann. § 32-2-10; S.D. Codified Laws Ann. § 56-3-18; Tenn. Code Ann. § 62-6-123; Utah Code Ann. § 13-8-1; Va. Code Ann § 11-4.1; Wash Rev. Code § 4.24.115; W. Va. Code § 55-8-14.

barring indemnity for indemnitee's negligence (sole or contributory);[2] and (3) statutes barring indemnity of design professionals for liability arising from its professional services (statutes vary on sole or contributory negligence).[3]

II. The Attempted Work-Around: Insuring the Indemnity Obligation

Despite anti-indemnity legislation, many states recognize the important risk-shifting role of insurance in the construction industry. Thus, many states courts and statutes distinguish between a valid insurance purchase agreement ("insure-the-indemnity" clause) – requiring a subcontractor to purchase insurance for the benefit of others – and a potentially void indemnity clause. Courts have interpreted these insure-the-indemnity provisions differently, however.

With insure-the-indemnity clauses, the scope of the indemnity obligation defines the insurance coverage that the subcontractor must provide. The scope of the required insurance is co-extensive with the indemnity obligation regardless of whether the underlying indemnity obligation is itself enforceable. So potentially, a subcontractor could agree to indemnify another party for the other parties' sole negligence, which on its face may be invalid under the applicable state statute. But if the subcontractor also agrees to provide insurance to cover that indemnity

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[2] Colo. Rev. Stat. §§ 13-50.5-102(8) & 13-21-111.5; Conn. Gen. Stat. Ann. § 52-572k; Del. Code Ann. tit. 6, § 2704; Fla. Stat. Ann. § 725.06; Iowa Code Ann. § 537A.5; 740 Ill. Comp. Stat. 35/1; Kan. Stat. Ann. § 16-121(b); Ky. Rev. Stat. Ann. § 371.180; Mass. Gen. Laws Ann. Ch. 149, § 29C; Minn. Stat. Ann. § 337.02; Miss. Code Ann. § 31-5-41; Mont. Code Ann. §§ 28-2-2111 & 18-2-124; Mo. Stat. Ann. §434.100; Neb. Rev. Stat. § 25-21, 187; N.H. Rev. Stat. Ann. § 338-A:2; N.M. Stat. Ann. § 56-7-1; N.Y. Gen. Oblig. Law § 5-322.1; N.C. Gen. Stat. § 22B-1; Ohio Rev. Code Ann. § 2305.31; Or. Rev. Stat. § 30.140; R.I. Gen. Laws § 6-34-1; Tex. Insur. Code Ann. § 151.102.

[3] Ariz. Rev. Stat. § 32-1159; Cal Civ. Code § 2782; Del. Code Ann. tit. 6, § 2704; Fla. Stat. Ann. §§ 725.06 & 725.08 (limits indemnification by DP on public projects); Ind. Code Ann. § 26-2-5-1; La. Rev. Stat. Ann. §38:2216(G); Mo. Ann. Stat. § 434.100; N.H. Rev. Stat. Ann. § 338-A:1; N.J. Stat. Ann. § 2A:40A-2; N.M. Stat. Ann. § 56-7-1; N.Y. Gen. Oblig. Law § 5-324; N.C. Gen. Stat. § 22B-1; N.D. Cent. Code §9-08-02.1; Ohio Rev. Code Ann. § 2305.31; 68 Pa. Cons. Stat. Ann. § 491; R.I. Gen. Laws § 6-34-1; S.C. Code Ann. § 32-2-10; S.D. Codified Laws § 56-3-16; Tex. Insur. Code Ann. § 151.102; Va. Code Ann. § 11-4.4.

agreement, that insure-the-indemnity clause may be enforceable. *See Mathew v. William L. Crow Constr. Co.*, 632 N.Y.S.2d 181 (2d Dep't 1995) (an insure-the-indemnity provision requiring a subcontractor to purchase liability coverage for both its own and the general contractor's negligence did not violate New York's anti-indemnity law); *Holmes v. Watson-Forsberg Co.*, 488 N.W.2d 473, 475 (Minn. 1992) (insurance provision in subcontract agreement obligating subcontractor to obtain and maintain general liability insurance coverage is not an unenforceable indemnification agreement within meaning of Minn. Stat. § 337.02, but instead is a valid agreement to provide specific insurance coverage under Minn. Stat. § 337.05); *but cf., Walsh Constr. Co. v. Mut. of Enumclaw*, 76 P.3d 164 (Or. 2003) ("Whether the shifting allocation of risk is accomplished directly, e.g., by requiring the subcontractor itself to indemnify the contractor for damages caused by the contractor's own negligence, or indirectly, e.g., by requiring the subcontractor to purchase additional insurance covering the contractor for the contractor's own negligence, the ultimate – and statutorily forbidden – end is the same.")

The problem with mixing indemnity and insurance obligations is that a party can never obtain sufficient insurance to fully cover broad indemnity obligations. Available insurance is never comprehensive enough to fully cover a broad indemnity obligation. Insurance comes with exclusions, but those exclusions are not also excluded from the indemnity agreement. If a subcontractor fails to procure the right kind of insurance or enough insurance to cover the contractual indemnity obligation, the subcontractor may then be held liable for breach of contract. In that case, the subcontractor would, essentially, step into the shoes of the insurer.[4]

[4] *See, e.g.,* Minn. Stat. §337.05, subd. 2.

III. Legislative Efforts to Limit Insure-the-Indemnity Provisions

Subcontractors do not like insure-the-indemnity provisions that require them to purchase insurance that covers a third-party for that third-party's own acts. Instead, subcontractors seek to limit their liability to loss or damage resulting from the subcontractor's own actions. Subcontractors are concerned about the long-term effects of purchasing this insurance to cover another's negligence (sole or joint). If there is a claim and payment made for all or part of an event that is the responsibility of another, the subcontractor will most likely see an increase in future premiums for future insurance contracts, or may have trouble obtaining required insurance on future projects, resulting in a competitive disadvantage to the subcontractor. In response to this concern, several states have passed legislation to limit contractual requirements for insurance to cover indemnity obligations for a third-party's negligence.[5] Typically, under these statutes, a contractual requirement that one party purchase insurance for the benefit of another for anything other than the purchasing party's own acts is void as a matter of public policy.

Subcontractors may begin to lobby for more legislation nationally to limit insure-the-indemnity requirements. However, states should be careful in crafting this legislative limitation so as to prevent unintended consequences. For example, the Minnesota legislature recently considered a bill supported by the Minnesota Subcontractors Association. The bill proposed simply that "[a]n agreement or contract provision that requires a party to provide insurance coverage to another party or a third party for the negligence or intentional acts or omissions of another party or third party is against public policy and is void and unenforceable." As written,

[5] Cal. Civ. Code § 2782.05 (prohibiting a clause that requires insurance covering another's active negligence or willful misconduct); Colo. Rev. Stat. Ann. § 13-21-111.5 (limiting additional-insured requirements to the negligence of the person who was required to purchase insurance for another); Kan. Stat. Ann. § 16-121; La. Rev. Stat. § 9:2780.1; N.M. Stat. Ann. § 56-7.1(F).

this proposed legislation would potentially invalidate agreements to purchase and maintain workers' compensation insurance, builder's risk policies, OCIPs and CCIPs,[6] just to name a few examples. Fortunately, the statute ultimately passed by the Minnesota legislature carved out some exceptions to the broad statutory provision invalidating any contract clause requiring a party to purchase insurance to cover another's negligence or intentional acts or omissions to address some of these unintended consequences. *See* Minn. Stat. § 337.05, subd. 1(c) and (d).

IV. Advising Clients Faced with Insure-the-Indemnity Contract Clauses

Putting insure-the-indemnity clauses into practical application, contractors and subcontractors should be aware of several things:

1. Contractors should not rely on broad insure-the-indemnity clauses that simply require the subcontractor to insure the indemnity obligation without specifying what coverage will fulfill that requirement. If the subcontractor is left guessing what coverage will meet the requirement, the clause is not sufficiently specific and may be unenforceable due to ambiguity and vagueness.

2. The contract should identify the insurance required. For example, the clause could require the subcontractor to name the contractor as an additional insured on the subcontractor's CGL policy covering liability "arising out of"[7] the subcontractor's

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[6] Owner Controlled Insurance Program and Contractor Controlled Insurance Program, commonly referred to as "wrap-up" insurance policies, provide a way for one project party to purchase one policy covering everyone working on the job. These policies generally "wrap up" insurance, claims management, safety and risk control components on a project.

[7] Consideration should be given to the specific language used in the additional insured endorsement. An endorsement that provides coverage to the additional insured for damage "caused by the acts or omissions of" the subcontractor is more limited that an endorsement providing coverage for damages "arising out of" the subcontractor's acts or omissions. *See, e.g., Engineering & Constr. Innovations, Inc. v. L.H. Bolduc Co.*, 825 N.W.2d 695 (Minn. 2013) (where additional insured endorsement provided coverage to additional insured contractor for damage *caused by* the acts or omissions of the subcontractor, contractor qualified for additional insured coverage only if the contractor was vicariously liable, based on no fault of its own, but only the negligence of the subcontractor. Because a jury found the subcontractor not negligent, there was no additional insured coverage), *but cf., Peabody Energy Corp v. Roark*, 973 N.E.2d 636 (Ind. Ct. App. 2012) (where additional insured endorsement provided coverage to additional insured owner for damage *arising out of* the contractor's operations, owner qualified for additional insured coverage even for its own negligent acts).

ongoing operations and completed operations, with coverage equal to or greater than that provided by ISO Forms CG 20 10 04 13, CG 20 37 04 13 and CG 20 38 04 13.[8]

3. Subcontractors must take care to purchase the exact insurance specified in the construction contract. If there is a later coverage dispute, it will then be between the contractor and the insurer.

4. Subcontractors should review the contractual insurance requirements with both their attorney and insurance representative to determine the validity of the scope of the proposed contract clause and to determine whether the requested insurance is available in the marketplace. If the requested insurance is not available, the subcontractor should notify the contractor and endeavor to further negotiate the insurance clause.

In many states, contractors can still demand that a subcontractor provide insurance to cover broad indemnity obligations covering another party's actions. The landscape is slowly changing and more states are starting to limit this insure-the-indemnity requirement. In the meantime, subcontractors should carefully review and consider their obligations when agreeing to these provisions.

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[8] These new ISO forms contain modified language to respond to the new legislative trend of limiting contractual obligations to provide insurance. Specifically, there are 3 major changes to the additional insured forms:

1. "The insurance afforded to such additional insured only applies to the extent permitted by law;"
2. "If coverage provided to the additional insured is required by a contract or agreement, the insurance afforded to such additional insured will not be broader than that which you are required by the contract or agreement to provide for such additional insured;" and,
3. "If coverage provided to the additional insured is required by a contract or agreement, the most we will pay on behalf of the additional insured is the amount of insurance: (1) Required by the contract or agreement; or (2) Available under the applicable Limits of Insurance shown in the Declarations; whichever is less."