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**PERSPECTIVES ON THE EVOLUTION OF INDEMNITY
FOR CONSTRUCTION PROFESSIONALS**

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Contractual indemnity and issues involving additional insureds each come with their own nuances and potential pitfalls for construction professionals. While it is true that indemnity clauses are simply risk transfer provisions, the way that indemnity clauses are used and the way those clauses are interpreted by the courts is constantly changing. This paper offers perspectives regarding indemnity, including a look at how some specific states have treated indemnity provisions, anti-indemnity statutes, and the ramifications of that treatment in the construction industry.

The Basics of Indemnity

Indemnity clauses are used as a risk transfer provision. Such provisions seek to transfer risk from one party to another party, whereby an “Indemnitor” agrees to reimburse the “Indemnitee” for losses resulting from a claim or claims brought by a third party. As an example, an owner typically agrees with a general contractor for an indemnity provision to be included in the construction contract that would look to the general contractor to reimburse the owner for any amounts that the owner has to pay to a third party as a result of the owner being sued after an accident occurred at the construction site. An indemnification clause in the contract between the owner and general contractor may require the general contractor to indemnify, hold harmless, and defend the owner against claims, damages and allegations. As a general contractor, if there is an agreement to indemnify an owner for anything other than damages arising out of your negligence and the performance of services, you will be contractually liable for damages that you would not have been liable for under common law. In other words, the courts would not impose liability on you since you did not violate any

standard of care. However, due to the contractual provision that was agreed upon in the written contract, you would still be held to be contractually liable *regardless* of whether you were negligent, because this is what you agreed to with the owner via the indemnification clause.

Indemnity clauses can contain obligations to indemnify, defend, and hold harmless. To indemnify means that an Indemnitee will be reimbursed after a loss by the Indemnitor. To defend means that the Indemnitee's legal expenses will be paid for as it defends itself against a third party claim. To hold harmless means the Indemnitor has agreed to protect the Indemnitor from suits by either third parties or the Indemnitor.

Generally speaking, there are three types of indemnity clauses: broad form indemnity, intermediate form indemnity, and narrow form indemnity. Broad form indemnity agreements can be (and usually are) problematic. Such agreements can cause a construction professional to become responsible for almost *any* problem that arises during a project, regardless of the actual negligence of the construction professional. A typical broad form indemnity provision would be the following: "Company A agrees to hold harmless and indemnify Company B from any and all liability, including costs of defense, arising out of performance of the services described herein." A sweeping and broad indemnification clause such as this would create enormous and mostly uninsurable liabilities for a construction professional. This clause does not have any limitation as to the liability that would result as a consequence of the negligent acts, errors, or omissions. As expected, many states have made broad form indemnification illegal via court decisions or anti-indemnity statutes.

Intermediate form indemnity provisions provide that a construction professional will cover another's risk whenever the construction professional shares *some* of the liability due to negligence. A typical intermediate form indemnity agreement would read as follows: "Company A agrees to defend, hold harmless and indemnify Company B from any and all liability arising out of Company A's performance, except for the sole negligence or willfulness misconduct of Company B." As expected, a professional liability policy of insurance would not cover this loss, as such a policy covers a construction professional for *its own* negligent acts, errors and omissions, but does not cover a construction professional for the negligence of others that the construction professional assumes contractually. In such a scenario with an intermediate form indemnity clause, so long as the construction professional is just 1% at fault, the construction professional would pick up 100% of the tab, even if 99% of the fault could be attributed to the other party.

A limited form indemnity clause reflects more accurately what the common law requires. A typical limited form indemnity clause would read as follows: "Company A agreed to hold harmless and indemnify Company B from and against liability arising out of Company A's negligent performance of services." This type of indemnity provision would trigger coverage under most professional liability policies. Such limited form indemnities are often used to refer to performance or intentional acts, and they do not typically pertain to *negligent* acts, errors or omissions. Such indemnification provisions also often require a company to not only be indemnified, but also to be defended. As will be discussed in more detail in this paper, a California Supreme Court case,

Crawford (Kirk), et al. v. Weather Shield Mfg., Inc.,¹ held that the obligation to defend was separate from the obligation to indemnify in such a clause. The *Crawford* case held that the Indemnitor could be responsible for the indemnity defense costs, even if it was ultimately determined that the Indemnitor was without fault.

As a result of the various issues that construction professionals have encountered with indemnity provisions, many states enacted anti-indemnity statutes to serve as a guide to construction professionals. Over forty states have enacted anti-indemnification statutes. These statutes restrict or invalidate indemnification agreements in construction contracts. Anti-indemnity statutes do those things in various ways. For example, twenty seven states prohibit a contracting party from indemnifying another party for its sole or partial fault. Thirteen states prohibit a contracting party from indemnifying another party for its sole fault.

Indemnity and Additional Insured Coverage

Clearly, learning how to successfully navigate around anti-indemnification statutes in your particular jurisdiction is an increasingly complex dilemma for construction professionals. Indemnity agreements are not “insurance”. Indemnity agreements, rather, are simply an “assurance” by one party to another that they agree to step up to bat if certain predetermined elements are met by a situation at a construction project. Indemnity agreements, therefore, are only as good as the Indemnitors ability to satisfy the obligations it agreed to under the indemnity agreement. As a result, indemnity clauses are often intertwined with additional insured clauses,

¹ *Crawford (Kirk), et al. v. Weather Shield Mfg., Inc.*, 44 CAL.4th 541, 187 P.3d 424 (2008).

which require a contractor to amend its liability policy, making another party, such as an owner or general contractor, an insured under the policy.

Although such additional insured clauses are often interwoven with indemnity clauses, they do constitute a legally separate and distinct contractual clause. For example, a subcontractor at a construction project may be required by its contract with the general contractor to purchase a policy of insurance naming the general contractor and owner as “additional insureds”. An additional insured endorsement to the insurance policy of this subcontractor would usually then be required. This additional insured endorsement adds the general contractor and the owner as an insured under that policy of insurance covering the subcontractor. It therefore extends the benefits of the policy to the additional insureds and obligates the subcontractor’s insurance carrier to insure it.

Some states that limit indemnification agreements in construction contracts also limit contractual requirements for insurance coverage that would apply under an additional insured situation. Most anti-indemnity statutes apply exclusively to construction contracts. However, that is changing as well. In some states such as Kansas, the anti-indemnity statute limits statutory indemnity to contractually required insurance, as well. The end result of the changes to anti-indemnity statutes in many states with regards to indemnity is that additional insured coverage becomes extremely limited.

There are ways for construction professionals to avoid running afoul of the anti-indemnification statute in their respective state. First, it is imperative for construction professionals to carefully read the anti-indemnification statute applicable to their state

before the process begins of drafting the construction contract. In addition, drafting language that excludes a construction client's sole negligence and, if necessary, partial negligence, is imperative. In addition, ensuring that there is adequate commercial general liability and workers' compensation insurance coverage is critical. If a loss occurs, there must be the appropriate levels of coverage to ensure that construction professionals are adequately covered.

Often times, attorneys in the construction industry are involved in the drafting of indemnification provisions and are responsible for ensuring that their clients are adequately protected pursuant to such provisions. Understandably, attorney must also work to enforce indemnity agreements. When a catastrophic loss occurs at a construction project, and there are adequate and enforceable indemnity agreements, it becomes the attorney's responsibility to force those indemnity agreements to come to fruition. As a result, it is imperative for the tender of indemnification and defense to be made as early as possible upon notice of such a loss.

It may be necessary to tender more than once, due to failure to receive a response. Additionally, a letter tendering the indemnification and defense should be sent directly to an additional insured carrier, as well as the entity that agreed to indemnify. The tender letter sent to an additional insured carrier should also emphasize that the tender letter requests indemnification, to hold harmless, and to defend. This forces the additional insured carrier to assess all of his obligations and play defense if it determines that the indemnification provision did not pertain to all three. Even once tender letters are issued, it will be necessary to follow up on such tenders and to ensure that carriers are keeping these tender letters on their radar and responding in a timely

fashion. If an additional insured carrier fails to respond, parties must be prepared to litigate these types of indemnification agreements in court. In addition, a tactic that sometimes works is to send the additional insured carriers pleadings and/or correspondence in the case as if they are already involved. This also provides a factual context to the additional insured carrier beyond what is included within your tender letter, and would most certainly be necessary information in a complex or catastrophic loss.

Case Note: A Specific Look at How Indemnification Became Unenforceable for a General Contractor

Examining the various, specific ways indemnification agreements can affect construction professionals is useful. Commercial general contractors clearly have specific needs when it comes to indemnity agreements in its contracts, as to both owners and subcontractors. First, from a commercial general contractor's perspective that does business in multiple jurisdictions, it is necessary for that general contractor to have knowledge of the way that indemnification and anti-indemnity statutes exist in the jurisdictions where it works. A general contractor wants the broadest indemnity permitted by law. It is commonplace for a general contractor to assume indemnity obligations as to an owner, and therefore, the general contractor clearly wants to pass those responsibilities down to subcontractors and other construction professionals that perform work at the project.

Indemnity provisions within a contract involving a general contractor may often need to get specific. For example, issues such as the indemnity agreements pertaining

to third party claims arising from rework need to be considered. Another example to be considered is governmental fines and/or penalties from adjacent public/private partnership projects. From a perspective of a general contractor, tailoring an indemnification agreement to address such future claims is imperative in limiting and controlling risk.

An interesting case involving a general contractor and the ways an indemnity agreement drastically affected its bottom line for risk was decided in November 2016 by the Supreme Court of Virginia. In that case, *Hensel Phelps Constr. Co. v. Thompson Masonry Contr., Inc.*², general contractor, Hensel Phelps Construction Company, (hereafter “Hensel”) brought an action against subcontractors and sureties. The case culminated in an appeal addressing whether the subcontractors had waived the applicable statute of limitations through reference to the prime contract between the general contractor and a commonwealth agency that was not subject to the statute of limitations, or, if the statute of limitations was not waived, whether it had expired.

In that case, Hensel had contracted with a number of different subcontractors pursuant to a project occurring at Virginia Polytechnic Institute and State University (“Virginia Tech”). Hensel won a contract with Virginia Tech which would be considered the prime contract worth over \$15 million for construction work to occur at the local student health and fitness center. Ultimately, Hensel, as prime contractor, entered into agreements with various subcontractors to complete portions of the project. United States Fidelity and Guaranty Company acted as a surety to some of the subcontractors. The prime contract entered into between Virginia Tech and Hensel included a

² *Hensel Phelps Constr. Co. v. Thompson Masonry Contr., Inc.*, 292 VA 695, 791 S.E.2d 734 (2016)

paragraph titled “warranty of materials and workmanship”. That provision stated that all materials shall be in a first class condition, that workmanship shall be of the highest quality, and that work not conforming to those warranties shall be considered defective. There were also provisions related to final inspection and final payment. Additionally, there was a provision entitled “guarantee of work”, stating that all work shall be guaranteed by the contractor against defects resulting from the use of inferior materials, equipment or workmanship for one year from the date of final acceptance of the entire project by Virginia Tech in writing. The provision went on to note that nothing in that section shall be construed to establish a period of limitations with respect to any other obligation which the contractor might have under the contract documents, including liability for defective work under the warranty provisions. In the case, the parties all agreed that there would be no applicable statute of limitations period to apply, because Virginia Tech was a Commonwealth agency.

Construction at Virginia Tech ultimately was completed under the prime contract in 1998. Hensel received final payment by Virginia Tech in 1999 and ultimately final payment was made to Hensel’s subcontractors. One of the subcontractors ultimately returned to fix an identified problem covered by their warranty and concluded all such work by 2000. Later, however, Virginia Tech discovered defective workmanship in construction at the project. It ultimately elected to remove, replace or repair these defects.

In 2012, owner Virginia Tech asserted a claim against general contractor Hensel under the prime contract, seeking over \$7 million in compensation for the cost of remedying defective workmanship at the project. In turn, Hensel then demanded that

the subcontractors pay the costs of Virginia Tech attributable to their alleged defective workmanship. As expected, the subcontractors failed to do so. Hensel paid Virginia Tech \$3 million to settle the claim and then filed an action alleging breach of contract and common law indemnity claims against the subcontractors, and breach of contract claims against the sureties. Ultimately, the subcontractors and sureties both argued that the statute of limitations barred the breach of contract claims and the subcontractors also demurred to the common law indemnity claims.

The Court granted the pleas of the subcontractor to bar the breach of contract claims and dismissed the case in its entirety. General contractor Hensel argued there were specific phrases in the subcontract agreements that unambiguously demonstrated the intent of all to waive the statute of limitations. Specifically, Hensel argued that the warranty period for the subcontractors would be equal to the warranty period provided to Hensel relative to the responsibilities of Hensel to the owner under the contract documents. The Court disagreed, finding that the various phrases pointed to within the contractual agreements with the subcontractors *did not* demonstrate the sufficient intent to incorporate a waiver of the statute of limitations.

The Court also noted that the statute of limitations as between Virginia Tech and Hensel was waived pursuant to a specific provision within Virginia's legislative code indicating that no statute of limitations shall apply to the Commonwealth and be a bar to any such proceeding. Hensel then argued that the claims asserted in this suit did not accrue until the date of the settlement of the indemnification claim in 2014, rendering the suit timely. Again, the Supreme Court of Virginia disagreed. Hensel argued that there was a second accrual of the statute of limitations on the contract which was

triggered by a breach of the indemnification provision. Specifically, the breach of the indemnification provision by the subcontractor constituted a separate and independent breach from the original failure to perform. This resulted in the second accrual of the statute of limitations on the contract. The Court noted that the subcontracts each contained numbered paragraphs titled “indemnification”. The Court noted that within those paragraphs, the indemnification provisions provided for indemnification against Hensel’s own negligence.

However, in 2010, in the case of *Uniwest v. Amtech Elevator Services, Inc.*, the Supreme Court of Virginia held that an indemnification provision provided for indemnity to the Plaintiff from claims arising from Plaintiff’s own negligence was void for violating public policy.³ Because the *Uniwest* holding rendered the indemnification provision within the subcontracts with Hensel unenforceable, Hensel could not seek enforcement of those indemnification paragraphs in the subcontracts. Instead, it attempted to repurpose other provisions of the contract and consider them to be “indemnification” provisions. The Court admitted that some of those paragraphs did include indemnification-type language. However, the Court simply would not agree that other provisions scattered throughout the contract were contemplated by the parties to act as indemnification provisions, particularly when there was an independent paragraph dedicated solely to indemnification.

Importantly, the Court indicated in its holding that as the general contractor, Hensel had the ability to address inferior work performed pursuant to its contract with Virginia Tech, and could have required subcontractors to fix any faulty or inferior work

³ *Uniwest v. Amtech Elevator Services, Inc.*, 280 Va. 428, 699 S.E.2d 223 (2010).

for five years following their breach in performance. They failed to do that and did not claim to sustain any damages until 2014 when Hensel settled its claim with Virginal Tech.

The Court also found that the parties did not intend to have the obligations of the subcontractors continue to be an ongoing obligation. Instead, the parties agreed to warranty work as being acceptable and not defective, but this was a finite obligation completed upon performance and guarantee. The Court also noted that Hensel as the general contractor or the owner could have required ongoing periodic inspections after completion of performance, but failed to do so. In response to the argument of Hensel that the ruling would place all government contractors in a position of unending liability with no opportunity for recourse against their subcontractors, the Court indicated that contractors that enter into contracts with the Commonwealth can draft or amend their subcontracts so as to comply with the *Uniwest* holding.

Case Note: A Specific Look at California, and It's Treatment (or Mistreatment) of Indemnity

It is clear from decisions in many jurisdictions including the *Hensel* decision that it is necessary for construction professionals to consider revisions to subcontracts when the courts in those jurisdictions alter or render as unenforceable indemnification provisions written before changes in the law. As exemplified in the above case, indemnity agreements are often assessed by the courts and jurisdictions, and the law may change to the benefit or detriment of an Indemnitor and/or Indemnitee. Therefore, an ongoing analysis must continuously be made of the treatment of indemnification

provisions in whatever jurisdiction construction clients are involved in to ensure that pre-decision provisions would continue to be upheld.

Another interesting perspective with regards to anti-indemnity has occurred in the State of California. Before some historic decisions were made with regards to indemnity, indemnity in California was mandated by the California Civil Code.⁴ The Code was to apply unless a contrary intention appeared. Then, in 1967, the Civil Code was amended via Section 2782 which barred indemnity for a party's sole negligence. In 2008, the California Legislature then added Section 2782(d), suggesting that indemnity clauses would be found to be unenforceable if the claims arose out of or related to the negligence of a builder or contractor in construction defect claims.

In 2008, the California Supreme Court decided *Crawford (Kirk), et al. v. Weather Shield Mfg., Inc.*⁵ In *Crawford*, the Court determined that even though the Defendant did nothing wrong, and therefore, it had no obligation to indemnify, Defendant Weather Shield was *still* responsible for 100% of Crawford's legal fees. Essentially, the duty to defend was found to be a separate obligation from the duty to indemnify. The Court went even further than that, however, in ruling that there did not have to be an express provision requiring defense. Rather, the duty to defend was inherent in the duty to indemnify. If a party agreed to indemnify another party, they also agree to defend that party. In order to ensure that a party is not held responsible for funding another party's legal fees when they have done nothing wrong, it would be necessary for that party to amend any indemnity agreements to include an express disclaimer of the duty to

⁴ Section 2778 enacted in 1882 of the California Civil Code.

⁵ *Crawford (Kirk), et al. v. Weather Shield Mfg., Inc.*, 44 CAL.4th 541, 187 P.3d 424 (2008)

defend. The *Crawford* court remarked that the subcontract failed to limit or exclude Weather Shield's duty to defend, as otherwise provided by the Civil Code.

In 2010, the Sixth Appellate District in California then decided *UDC-Universal Development, LP v. CH2M Hill*,⁶ which was the first decision since *Crawford* to define and address the issue of indemnity obligations. There, the Court found that an indemnitor is obligated to defend and indemnitee in the absence of a showing of negligence. In the *UDC* case, the Court of Appeals for California held that a defense obligation pursuant to a contract between the parties arose when harm was alleged, as resulting from deficient work. Therefore, when the developer involved in the case requested that the duty to defend be satisfied, the consultant's duty was triggered. The Court held that the defense obligation pursuant to the duty to defend did not require that an underlined claim of negligence be specifically alleged.

Other changes followed legislatively in California. In 2011, Senate Bill 484 passed, effective for contracts entered into as of January 1, 2013. Senate Bill 484 expanded protections to subcontractors which were enumerated in Civil Code Section 2782 to non-residential (commercial) construction contracts. The bill added language that a subcontractor owes no defense or indemnity obligation until there is a written tender, with that tender needing to include information relating to the work performed by the subcontractor and how the reasonable allocated share of fees and costs was determined. Also under the bill, a subcontractor can defend a claim with their choice of counsel, or a subcontractor can pay no more than a reasonable allocated share of the Indemnitor's fees/costs, subject to the process of reallocation upon final resolution. As

⁶ *UDC-Universal Development, LP v. CH2M Hill*, 181 Cal. App.4th 10, 103 Cal. Rptr.3d 684 (6th Dist. 2010).

a result of all of the changes that California indemnification went through, many homebuilders in California began to utilize wrap up policies of insurance to eliminate the issues created by *Crawford* related to indemnity.

Other changes have also taken place in California related to specialized areas, such as Senate Bill 496 which was signed into law on April 28, 2017. This bill provides for contracts signed on or after January 1, 2018, and amends Section 2782.8 of the Civil Code as it pertains to a design professional's obligation to defend an upstream party. This law limits the costs to defend an upstream party to the design professional's proportionate percentage of fault. As a result of the enactment of Senate Bill 496, there still is some uncertainty as to the results in California with regards to the duty to defend. Specifically, although the immediate duty to defend is not specifically eliminated in the bill, it does appear that the immediate obligation to defend an upstream party is eliminated. If an insurer ultimately denies a duty to defend, they can use Senate Bill 496 as its reasoning.

Conclusion

Regardless of the role of the construction professional at issue, most certainly, clients request and demand that contracts be written such that they are protected from lawsuits arising from the construction project. Challenges abound with regards to indemnity provisions and contracts given the changing treatment of indemnity across the country via anti-indemnification statutes. Indemnification provisions, the use of additional insured provisions, and the various duties to defend and indemnify all must be carefully considered when advising construction clients. As this area is rapidly

changing, it is advisable to always consult the current status of your jurisdiction's laws and treatment of the laws before offering legal advice relative to indemnification.