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Anti-Indemnity Statutes' Impact on Construction Defect Claims

Construction contracts routinely contain indemnity agreements. These agreements are essentially a promise by which one party (the indemnitor) to defend, indemnify, or hold harmless another party (the indemnitee) for acts or omissions relating to the construction project. Prior to the enactment of anti-indemnity statutes, the general contractor (indemnitee) would routinely require the subcontractor (indemnitor) to add the general contractor as an additional insured on its commercial general liability (CGL) policies and promise indemnity even for the indemnitee's own negligence if the subcontractor wanted to work for the general contractor. In addition to the inequities created, most southern state legislatures have declared that certain types of indemnities not based on fault are against public policy and invalid. Several southern states have also determined that providing additional insured coverage for the general contractor's own negligence is also against public policy.

I. Indemnity Agreements

A. Forms of Indemnity Clauses

Generally, there are three forms of indemnity clauses. Under "broad form indemnity," the indemnitor agrees to indemnify the indemnitee for all liability regardless of who is at fault. The "intermediate form" of indemnity requires the indemnitor to indemnify the indemnitee for all liability, even if the damage arises as a result of the indemnitee's contributory negligence; however, there is no indemnity owed if the indemnitee is solely negligent. For "limited form" indemnity, the indemnitor agrees to indemnify the indemnitee only to the extent of the indemnitor's own negligence, not for any of the indemnitee's negligence.

B. Types of Anti-Indemnity Provisions

States treat indemnity agreements in one of the three following ways: (1) the state does not have an anti-indemnity statute; (2) the state has an anti-indemnity statute

that prohibits an indemnitor from indemnifying an indemnitee for the indemnitee's sole negligence; or (3) the state prohibits an indemnitor from indemnifying an indemnitee for any of the indemnitee's own negligence, sole or partial. All the southern states have anti-indemnity statutes.

II. Anti-Indemnity Statutes in the South

A. Effective Dates

Anti-indemnity statutes do not apply unless the contract was entered into after the enactment of the state statute. For example, in Texas, the statute's effective date was January 1, 2012. Therefore, the anti-indemnity statute provisions cannot apply if the prime contract between the owner and general contractor was entered into before that date. In Texas, the date of the prime contract controls, not the date of a subcontract between the general contractor and a subcontractor even if the subcontractor or subcontractor's carrier is evaluating potential additional insured or indemnity exposure for the general contractor.

B. Construction Contract

The construction anti-indemnity statutes apply only if the contract is a "construction contract" as that term is defined. Most of the southern jurisdictions broadly define the term "construction contract." For example, the New Mexico legislature defined "construction contract" to mean:

> "[C]construction contract" means a public, private, foreign, or domestic contract or agreement relating to construction, alteration, repair, or maintenance of any real property in New Mexico and includes agreements for architectural services, demolition, design services, development, engineering services, excavation, or other improvement to real property, including buildings, shafts, wells, and structures, whether on, above or under real property.

NMSA 1978, § 56–7–1(E) (2005).

C. Scope of Indemnity Permitted

Fifteen states have enacted legislation for construction contracts that prohibits broad form indemnity agreements – i.e., indemnity agreements that purport to indemnify a person against their sole negligence. In other words, if the indemnitee is 100% at fault, an indemnification agreement purporting to indemnify the indemnitee will be held invalid. However, such an indemnification agreement in a construction contract

is valid so long as the indemnitor is at fault to any degree, even 1%. Arkansas falls within this group.

Twenty-eight states have enacted legislation that applies to both sole and partial negligence. In these states the indemnitor cannot be held liable for the indemnitee's negligence, no matter what the degree. Louisiana, Oklahoma, New Mexico, and Texas fall within this group. These states have determined that it is against public policy to require a non-negligent party to be responsible for an act or omission for which it was not at fault because an indemnitee who knows that another party is ultimately responsible for the indemnitee's negligent acts (or omissions) may not act as carefully as it otherwise might if it knows it will be responsible for its own acts.

The Louisiana anti-indemnity statute contains the following two exceptions tying indemnity provisions to insurance paid by the indemnitee:

> (1) Any clause in a construction contract containing the indemnitor's promise to indemnify, defend, or hold harmless the indemnitee or an agent or employee of the indemnitee if the contract also requires the indemnitor to obtain insurance to insure the obligation to indemnify, defend, or hold harmless and there is evidence that the indemnitor recovered the cost of the required insurance in the contract price. However, the indemnitor's liability under such clause shall be limited to the amount of the proceeds that were payable under the insurance policy or policies that the indemnitor was required to obtain.
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> (2) Any clause in a construction contract that requires the indemnitor to procure insurance or name the indemnitee as an additional insured on the indemnitor's policy of insurance, but only to the extent that such additional insurance coverage provides coverage for liability due to an obligation to indemnify, defend, or hold harmless authorized pursuant to Paragraph (1) of this Subsection, provided that such insurance coverage is provided only when the indemnitor is at least partially at fault or otherwise liable for damages ex delicto or quasi ex delicto.

L.R.S. 9:2780.1. (2012).

D. Additional Insured

Parties to a construction contract can also transfer risk by agreeing that one party (usually the subcontractor) will name the other (typically the general contractor) as an additional insured on its CGL policy. Additional insured status provides rights to the

general contractor under the subcontractor's insurance coverage. General contractors operating in states that prohibit one party from indemnifying another party for that party's negligence may try to circumvent the prohibition on indemnification for one's own negligence by requiring the subcontractor to name the general contractor as an additional insured on the subcontractor's insurance policy. This strategy is based on the concept that additional insured coverage is different from indemnity and that agreements to procure insurance will not be subject to limitations otherwise applicable to indemnity agreements.

While Arkansas is one of the states that precludes only broad form indemnity provisions, Arkansas's statute expressly provides that an agreement within a construction contract to name a party as an additional insured does not violate the statute.

In addition, of the twenty-eight states that prohibit indemnity for sole and partial negligence, eighteen of them include an insurance "savings" clause, establishing which types of insurance contracts are saved or not affected by the anti-indemnity statute. New Mexico, Oklahoma, and Texas fall within this group. Of these eighteen, ten states have express restrictions in their anti-indemnity statutes on clauses requiring a party to provide coverage for the additional insured's negligence. New Mexico, Oklahoma, and Texas also fall within this group.

Oklahoma and New Mexico have anti-indemnity statute exceptions relating to project-specific insurance. The Oklahoma statute states: "This section [anti-indemnity statute] shall not apply to construction bonds nor to contract clauses which require an entity to purchase a project-specific insurance policy, including owners' and contractors' protective liability insurance, project management protective liability insurance, or builder's risk insurance." Okla. Stat. Ann. tit. 15, § 221(D); *see also Bitco Gen. Ins. Corp. v. Wynn Constr. Co.*, No. 17–462, 2017 WL 3470584, at *2 (W.D. Okla. Aug. 11, 2017) (finding that the exception in Section 221(D) did not apply where "the insurance policies at issue [we]re not project-specific policies" and where "the construction contracts do not require Wynn [the construction company/indemnitor] to purchase a project-specific insurance policy."). The New Mexico provision (N.M. Stat. Ann. § 56-7-1(B)) provides:

> B. A construction contract may contain a provision that, or shall be enforced only to the extent that, it:
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> (2) requires a party to the contract to purchase a project-specific insurance policy, including an owner's or contractor's protective insurance, project management protective liability insurance or builder's risk insurance.

See also First Mercury Ins. Co. v. Cincinnati Ins. Co., 882 F.3d 1289, 1300 (10th Cir. 2018) ("Because the Subcontract Agreement's provisions requiring High Desert to name

Bingham as an additional insured fall within the exception listed in § 56-7-1(B)(2) as a construction contract requiring a party to purchase a project-specific insurance policy, the provisions are valid under New Mexico law.").

E. Other Outstanding Issues

1. Duty to Defend.

Another issue that arises with anti-indemnity statues is how the statutes impact a party's and insurer's duty to defend. A few statutes specifically provide that an agreement to indemnify or defend another for its own negligence will be declared unenforceable as against public policy. However, other statutes do not specifically address the obligation to defend as part of an agreement to indemnify.

The duty to defend is separate and distinct from the duty to indemnify, with the duty to defend being broader. The duty to defend is broader than the duty to indemnify in three ways: (1) the duty to defend generally extends to every claim that arguably falls within the scope of coverage; (2) the duty to defend one claim usually creates a duty to defend all claims; and (3) the duty to defend typically exists regardless of the merits of the underlying claims.

Because the duty to defend is distinct from an indemnification obligation, it is possible that the duty to defend can survive even when an indemnity agreement is struck down as violating an anti-indemnity statute. However, depending upon the language of the specific statute, there may be a valid argument that the subcontractor or subcontractor carrier has no duty to defend the general contractor when the general contractor is being sued for its own negligence because this would be in violation of the statute's prohibition of no defense of the general contractor's own negligence.

2. Waiver of Act

In order to avoid the act's application, the contracting parties may attempt to waive the applicability of the anti-indemnity statutes by inserting a choice-of-law provision that selects a state without an anti-indemnity statute. However, some southern state statutes, including the Texas anti-indemnity statute, specifically state that the statute cannot be waived.

3. Common Law Requirements May Still Apply

If a construction contract is valid under a state's anti-indemnity statute or falls within a statutory exception (e.g., employee injury in Texas), the construction contract may still not be enforceable if the indemnity provision does not meet common law requirements. For example, prior to the Texas anti-indemnity statute, a contractual

indemnity clause providing for broad or intermediate form indemnity must satisfy the two subparts of the Fair Notice Doctrine: the express negligence rule and the conspicuousness test. The intent of the Fair Notice Doctrine is that the indemnitor is put on notice that it is agreeing to indemnify the indemnitee for its own negligence.

The express negligence rule provides that parties seeking to indemnify the indemnitee from the consequences of its own negligence must express that intent in specific terms. *Ethyl Corp. v. Daniel Constr. Co.*, 725 S.W.2d 705, 708 (Tex. 1987). The intent of the parties must be stated within the four corners of the contract. *Id.* Examples of indemnity clauses that have satisfied the express negligence rule are:

> "Contractor agrees to protect, defend, and indemnify, and save operator . . . from and against all claims, demands, and causes of action . . . without regard to the cause or causes thereof or the negligence of any party or parties . . .." *Adams Resources Exploration Corp. v. Resource Drilling Inc.*, 761 S.W.2d 63, 64 (Tex. App.—Houston [14th Dist.] 1988, no writ) (emphasis added).

> "Subcontractor shall fully protect, indemnify, and defend contractor . . . against any . . . causes of action . . . regardless of cause or of any fault or negligence of contractor." *B-F-W Construction Co. v. Garza*, 748 S.W.2d 611, 613 (Tex. App.—Fort Worth 1988, no writ) (emphasis added).

The courts interpreted both provisions to put the indemnitor on notice that it must indemnify the indemnitee for the indemnitee's own negligence. The key language in the above clauses that allowed them to meet the express negligence rule is emphasized.

The conspicuousness test mandates that the indemnity clause appear on the face of the contract so that it attracts the attention of a reasonable person when viewed. *Dresser Indus., Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505, 508 (Tex. 1993). This requirement can be met by a heading being printed in capital letters or by text printed in larger or other contrasting type (e.g., bold print). *Id.* at 511.

III. Steps for Reviewing New Construction Claim Seeking Defense and Indemnity

Subcontractors routinely submit new construction claims to their carriers in response to a general contractor's request for defense and indemnity pursuant to the parties' construction contract. When a new claim comes in, the claim professional should engage in the following analysis. First, the professional should determine which state law applies to the contract and policy (possibly different states). Next, the professional should evaluate if the contractual provision is valid under the applicable state's common law. For instance, if the provision is not conspicuous, then there should be no indemnity

obligation owed for the general contractor's own negligence (intermediate or broad form indemnity) under Texas law. Next, the professional should determine if the state's anti-indemnity statute is applicable, i.e., whether the contract was entered into after the statute's effective date. Then, the professional should determine the validity of the indemnity provisions under the state's anti-indemnity statute, including the applicability of any exceptions/exclusions (e.g., single-family homes in Texas) and severability. After that, the professional should assess the existence, scope, and validity of the contract's additional insured provision (including primary/non-contributory language). Finally, the professional should assess the availability and scope of the additional insured coverage under the policy's terms to determine the carrier's exposure.