

Preconference Workshop 1

Monday, November 7, 9:00 a.m.–noon and 1:30–4:30 p.m.

INSURING SOLE AND PARTIAL INDEMNIFICATION AGREEMENTS

Presented by

**Donald S. Malecki, CPCU
Principal
Malecki Deimling Nielander & Associates, LLC**



Recently the coverage provided to additional insureds has been under attack from both the insurance industry and the legislative branch. The 2004 changes to standard additional insured endorsements dramatically restrict the scope of the additional insured's coverage, and many of the nonstandard endorsements currently in use are even more restrictive than the standard versions. At the same time, a number of state legislatures have introduced, and in some cases passed, legislation that makes it illegal to require insurance coverage that exceeds the scope of allowable indemnification under the anti-indemnity statute. In many instances, even the new standard additional insured endorsements would exceed the allowable scope of coverage. This workshop will provide a brief review of the evolution of the standard additional insured endorsements and present a panel of experts who will address a variety of concerns that standard and insurer endorsements present for owners and general contractors.

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Donald S. Malecki, CPCU
Principal
Malecki Deimling Nielander & Associates, LLC

Mr. Malecki is a panelist for Monday's Preconference Workshop 1, "The Changing Face of Additional Insured Coverage." He is a principal of Malecki Deimling Nielander & Associates, LLC, an insurance, risk, and management consulting firm in Kentucky. He also is president of Malecki Communications Company, publisher of *Malecki on Insurance*, a monthly newsletter on commercial insurance subjects.

He has been in the insurance and risk management business for more than 45 years as a broker, claim consultant, consultant, supervising underwriter, teacher, and writer.

Mr. Malecki is currently on the examination committee of the American Institute for Chartered Property Casualty Underwriters and the Consultants, Legal and Expert Witness Section Committee of the Society of CPCU, and he is an active member of the Society of Risk Management Consultants. He is past president of the Cincinnati Chapter of CPCU (1975) and past member of the Commercial Lines Industry Liaison Panel of the Insurance Services Office, Inc. He was given the Standard Setter Award of the Society of CPCU in 1998 and the Insurance Professional of the Year by various insurance groups in the Cincinnati, Ohio, area in 2004.

He is the author and coauthor of 10 books, including three textbooks used in the CPCU curriculum. In addition to *The Additional Insured Book* (1991), two of the books, *Insuring the Lease Exposure* (1981) and *The CGL Book* (1986), were Cincinnati Chapter research projects. His latest book is *The MCS-90 Endorsement: Truckers versus Insurers and the Government Makes Three*, published by IRMI in 2004.

Mr. Malecki is a graduate of Syracuse University, served 4 years with the U.S. Air Force, and holds the Korean Service Medal.

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Additional Insured

INSURING SOLE AND PARTIAL INDEMNIFICATION AGREEMENTS *Divergent Forces and Insurance Changes Creating the Need for Caution*

It appears that subcontractor associations and others who are lobbying state legislators for restrictions on indemnification agreements are producing some results. The process, however, is a very slow one and sometimes compromising, falling short of a clean sweep against sole and partial negligence assumptions.

There is some merit to the argument of subcontractors that they, as indemnitors, should not have to cover under their liability policies the financial consequences of indemnitees' liability in situations where in-

demnitors are not even named in the suits. These indemnitors also question the rationale for having to cover indemnitees under their liability policies on a primary basis. They express the concern that having to share their policy with others, be it contractual liability coverage or additional insured coverage, will result in a quicker reduction in limits than would otherwise be the case. This is a particularly important issue, because subcontractors cannot usually obtain high limits and this is one of the reasons for it. What indemnitors are willing to do is to change the rules of the past; that is, to protect, defend and indemnify indemnitees, but only those situations where the fault of injury or damage rests solely on the indemnitors. This task is a daunting one, given that sole fault is virtually nonexistent in today's world. Creative lawyers also make certain that at least one percent of fault will always rest with one side or the other.

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Donald S. Malecki, CPCU
Publisher/Writer

Norma Plotti
Production/Circulation Manager

Pete Ligeros, JD
Writer

Paul O. Dudey, CPCU
Editor

Donna L. Malecki
Associate Editor

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Indemnitees, on the other hand, have differing reasons for wanting to be protected first on the policies of indemnitors. Some, as a matter of principle, simply would rather rely on the policies of others first. To them, it makes good risk management sense to do so, and they usually have the bargaining power to make it happen.

Still other indemnitees, while somewhat less demanding, are nonetheless concerned that every time employees of indemnitors are seriously injured, they, the indemnitees, will be confronted with claims alleging that they were the primary cause. These indemnitees, of course, are likely to have their own liability insurance to rely on and with subrogation possibilities against exaggerated allegations. The problem is that it may take a long time to iron out who ultimately was responsible and possibly higher insurance costs in the interim, particularly when coverage is experience-rated.

Whatever the rationale may be, the demands of indemnitees seeking to transfer the financial consequences of their liability onto others are likely to persist until such time that the law precludes it. The danger here is that if the law does, in fact, permit broad assumptions of liability, insurance will be in place to cover them. Through 1987, most commercial general liability policies, and particularly those of the Insurance Services Office, automatically provided contractual liability coverage for the tort liability of indemnitees assumed, ranging from joint negligence to sole negligence of indemnitees.

Since 1988, however, some insurers have been endorsing their CGL policies to exclude coverage for the assumptions of indemnitees' tort liability. The ISO endorsement required to do this is Contractual Liability Limitation endorsement CG 21 39. The 2004 compromise of ISO to add coverage back for the tort liability assumed on a limited basis through the attachment of Amendment of Insured Contract Definition CG 24 26 may fall short of what indemnitors need to comply with insurance requirements.

From time-to-time, various publications will feature so-called "ball score" tallies on how the states view contractual assumptions of liability by indemnitors. Most of these publications, however, overlook the fact that the majority of states still permit indemnitors to assume the financial consequences of indemnitees' sole fault. This sentence is emphasized to serve as a red flag and warning that failing to understand the status of what a state permits could end up as something that, instead of being transferred to an insurer, has to be assumed!

What's the Score?

At the risk of over-simplification, the editors have divided the jurisdictional status of indemnification agreements into three broad groups as follows: (1) States with anti-indemnity statutes barring sole and/or partial fault of indemnitees; (2) States with no anti-indemnity statutes barring sole and/or partial fault of indemnitees; and (3) States barring sole and/or partial fault of

indemnitees, except when insurance is in place to cover it.

It is important to make clear here that the comments and observations are not intended to be legal opinions nor the practice of law. No action or inaction should be taken on the basis of these comments or observations without review of these statutes or proposed legislation or by appropriate legal counsel, since there are legal nuances that cannot be reflected on these pages. The exhibits also are limited to con-

tractors and not to design professionals and also do not take into consideration the anti-indemnity statutes addressing oil and gas production.

Exhibit I shows those states having anti-indemnity statutes that flatly bar sole and/or partial fault of indemnitees. The state of Oregon is the latest added to this category. It was because of *Walsh Construction v. Mutual of Emunclaw*, 189 OR. App. 400; 76 P.3d 164 2003. This state's statute also is being changed to clarify this intent.

Exhibit 1		
States With Anti-Indemnity Statutes and No Exceptions		
Arizona (1)	Bars sole and partial	Sec. 32-1159
Florida (2)	Bars sole and partial	F.S. 725.06
Idaho	Bars sole negligence	Sec. 29-114
Indiana	Bars sole negligence	Sec. 26-2-5-1
Massachusetts	Bars sole and partial	ALM GL Sec. 29C
Montana	Bars sole and partial	28-2-2111
New Mexico	Bars sole and partial	Sec. 56-7-1
Oregon	Bars sole and partial	Sec. 30.140
South Dakota	Bars sole negligence	Sec. 56-3-18
Tennessee	Bars sole negligence	Sec. 62-6-123
Utah	Bars sole negligence	Sec. 13-8-1
Washington	Bars sole and partial	Sec. 4.124.115

(1) The law currently applies solely to public projects. Senate Bill 1323 effective January 1, 2007, will prohibit indemnity agreements that insure or indemnify a promise for damages resulting in certain private construction contracts, including written or oral contracts with architects and engineers.

(2) Effective July 1, 2001, it applies to a construction contract for a public agency or in connection with a public agency's project. Except with respect to a construction project involving a public agency, other contracts requiring indemnification of the indemnitee in whole or in part are not void if the contract meets certain requirements set forth in F.S. 725.06(1).

Note that some states bar both sole and partial fault. Those states that preclude sole negligence, on the other hand, permit assumptions involving the joint fault of the indemnitee and indemnitor.

Exhibit 2 consists of those states having no anti-indemnity statutes, but where

courts enforce indemnification contracts when the intent of the contract to transfer the financial consequences of indemnitees is "clear and unequivocal." An exception is the "fair notice" doctrine applicable in the state of Texas, with the criteria being a contract (1) meeting the express-negligence test, and (2) being conspicuous.

Exhibit 2	
States With No Anti-Indemnity Statutes Voiding HH Provisions	
Alabama	Clear and unequivocal
Arkansas	Clear and unequivocal
Colorado	Clear and unequivocal
Iowa	Clear and unequivocal
Kansas	Clear and unequivocal
Maine	Clear and unequivocal
Missouri	Clear and unequivocal
Nevada	Clear and unequivocal
New Hampshire	338-A:1
Oklahoma	Clear and unequivocal
Texas (1)	Fair notice doctrine
Vermont	Clear and unequivocal
Wyoming	Clear and unequivocal

(1) Senate Bill 445, effective September 1, 2005, would create a new section of Chapter 502, defining "construction contract"; making void and unenforceable sole or partial negligence of the indemnitee, and any insurance required, including coverage for an indemnitee as an additional insured that exceeds the limitations and indemnity obligations of Chapter 502 or requires an endorsement for a waiver of subrogation. But this Chapter would not affect the validity and enforceability of any insurance contract or protection under the workers compensation law.

Note that if the sponsor of the Texas bill is successful, both sole and partial fault indemnifications will still be permitted so long as insurance is in place for them. This bill,

therefore, is not significant and undoubtedly falls short of what subcontractors might have hoped for. It would be significant had the insurance exception not been added.

The Commonwealth of Kentucky was in this category until 2005. It now appears in **Exhibit 3**. The state of New Hampshire is one of those few states that has no statute precluding indemnification agreements, except for design professionals (which is not being addressed for purposes of this discussion) and apparently does not even require that a contract be clear and unequivocal to be enforceable.

Exhibit 3, the third category, includes those states that hold certain indemnification agreements to be void and unenforceable, unless insurance or insurance with certain insurers be in place.

This could be viewed by indemnitees as being the same as a state without any restrictions. While this may be true, it is not without its source of argument. Note the reference to some states requiring as an exception insurance from an admitted insurer. The fact that a state requires that it be an admitted insurer means that insurance from a nonadmitted insurer would be viewed as an unacceptable exception. Whether an authorized insurer would also include both admitted and nonadmitted insurers will depend on how the statute defines those terms. The same applies to those states making exceptions for authorized insurers.

Exhibit 3			
States Where Sole Or Partial Fault Is Void, Except When Insurance Applies			
<u>States</u>	<u>Reason Void</u>	<u>Any Exception</u>	<u>Statute</u>
Alaska	Sole negligence	Admitted insurer	Sec. 45.45.900; AS 21
California (1)	Sole negligence	Admitted insurer	Civil code Sec. 2782
Connecticut	Sole negligence	Licensed insurer	Sec. 52-572k
Delaware	Sole or Partial	Authorized insurer	Title 6 Sec. 2704
Georgia	Sole negligence	Admitted insurer	Code Ann.Sec. 13-8-2
Hawaii	Sole negligence	Admitted insurer	Sec. 431:10-222
Illinois (2)	Sole negligence	Insurance	Ch.740, Para.35/3
Kentucky	Sole negligence	Insurance	KRS Chapter 371
Louisiana	Sole negligence	Insurance	R.S.38:2216 G.
Maryland	Sole negligence	Insurance	Cts. and Jud.Proc. Code Sec. 5-401
Minnesota	Sole or partial	Insurance	Ann. Sec. 337.04
Mississippi	Sole negligence	Insurance	Ann.Sec. 31-5-41
Nebraska	Sole negligence	Insurance	Rev. Stat. 25-21,187
New Jersey	Sole negligence	Authorized insurer	Ann. Sec. 2A:40A-1
New York	Sole or Partial	Admitted insurer	Sec. 5-322.1
North Carolina	Sole or Partial	Insurance	Sec. 22B-1
Ohio	Sole negligence	Authorized in OH	Rev. Code 2305.31
Pennsylvania	Sole negligence	Admitted insurer	Sec. 11-4.4
Rhode Island	Sole negligence	An Insurer	Sec. 6-34-1
South Carolina	Sole negligence	Insurance	Sec. 32-2-10
Virginia	Sole negligence	Admitted insurer	Sec. 11-4.1
West Virginia	Sole negligence	Insurance	Sec. 55-8-14
Wisconsin	Sole or partial	Insurance	Sec. 895.49

(1) Assembly Bill AB 573. An act to repeal Section 2782 so that hold harmless and indemnification liability in whole or in part will be void and with no insurance exception as is the case currently.

(2) House Bill HB0704. Proposes to amend the Construction Contract Indemnification for Negligence Act to make all sole negligence assumptions void and without any insurance exception.

What is important here to note is that reference to insurance is not likely to encompass those agreements where indemnitors are self-insureds. Much depends on how the courts view insurance versus self-insurance. Also of concern is the use of fronting arrangements and large deductible issues not addressed by the laws in many states on this topic. An interesting case on point, which is discussed in the September 1995 issue of *Malecki on Insurance*, is *USX Corporation v. Liberty Mutual Insurance Company and Turner Construction Company*, 645 N.E. 2d 396 (App. Ct. Ill. 1994).

Briefly, USX was to act as a subcontractor and Turner a the general contractor. Turner submitted a standard form agreement obligating USX to provide insurance to name Turner as an additional insured. USX responded by stating that it was providing certificates attesting to its authority to act as a self-insurer in the state of Illinois. Confronted with a third party action by a USX employee, Turner sought indemnity based on the underlying contractual obligation of USX who, in turn, insisted it had no obligation to indemnify Turner since the cause of the loss was the sole fault of Turner.

The Illinois statute, at the time of this case,

was subject to an insurance exception, allowing the indemnitor (USX) to insure against the sole fault of the indemnitee (Turner). The problem for Turner and USX, alike, was that the self-insurance of USX was not considered to be insurance and therefore did not fulfill that state's statute regarding an insurance exception.

The importance of this ruling and others like it cannot be overstated. Because a true insurance policy can cover the sole fault of the indemnitee, whether added as an additional insured by endorsement or automatically for liability assumed by the named insured by contract, the failure for self-insurance to apply will leave the indemnitor in breach of its promise. The indemnitee, likewise, will find itself in a precarious situation. Having relied on the indemnitor's promise of indemnity, the loss of that protection could have an adverse financial impact on the indemnitee as well.

Note, finally, that the bills pending in both California and Illinois, if approved, would be considered significant victories for subcontractors, particularly since both states generate a lot of litigation and case law over third party over actions, contractual liability and additional insured coverage; precisely what subcontractors would like to see eliminated.

Conclusion

This entire exercise of featuring the current status of anti-indemnity statutes and developing a score-card is important for a number of reasons. One is that, while there are some conditions precedent, a clear majority of states still permit indemnitors to assume the sole and/or partial negligence of indemnitees. The question is whether indemnitees will try to capitalize on this fact or be more reasonable in what is to be assumed. The important point here is that, insofar as insurance is concerned, it is a new ball game. Many commercial liability policies no longer include contractual liability coverage, even when specifications prescribe sole or partial indemnification and it is permitted by state law.

If the law puts a stop to assumptions of liability, indemnitors pushing for these laws may find that the litigation will continue in many instances, but without the benefit of insurance. The reason is that both indemnitors and indemnitees are likely to become embroiled in disputes to determine their respective percentages of fault. When that happens, insurers will argue they have no obligation to defend, because neither contractual liability nor additional insured coverage will be provided under the new laws and indemnification agreements being advocated. Each side will then find that it bears its own litigation costs and possibly even some indemnity obligations they may otherwise have avoided had the new rules not been in force. Ironically, the best that can be hoped for in many of these situations will be precisely what the legislation

being advocated is intended to eliminate; namely, contribution from the subcontractors' insurers. In the end, as always, the beneficiaries of these attorney right-to-work bills will be the attorneys themselves.

It therefore would behoove both indemnitors and indemnitees to be careful, and to take steps making certain that insurance is in place for indemnification agreements, particularly since some additional insured endorsements provide no broader coverage than what is provided by contractual liability coverage. An insurable contract that is not considered to be properly covered can be damaging to the indemnitor who cannot transfer the risk of assumption to an insurer and is confronted with an allegation of breach for having failed to procure the proper coverage. Such a situation can also adversely affect the indemnitee who, in the short run may be required to assume that risk, until the matter is resolved against the indemnitor by the court, if at all. Finally, the movement by some states to different categories is likely to be encouraging to subcontractor groups. Passage of the proposed laws in California and Illinois, not only would be viewed as an enormous victory, but also would undoubtedly kindle an even greater push toward change. The question remains, however, whether the changes the subcontractors hope for will benefit them or make matters worse. Careful thought must go into dispute resolution wording, statutes and contracts, especially when good intentions may backfire once they become laws that will be scrutinized by the courts, in relation to varying fact patterns.

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