Prosecuting and Defending Risk Transfer Agreements and Related Provisions

By Ewing E. Sikes and Robert L. Guerra, Jr.

When faced with any type of commercial litigation, you owe it to your client to investigate fully the existence, the applicability, and the enforceability of these provisions as soon as you are retained.

Most commercial transactions for goods and services now contemplate and account for some level of risk transfer between the parties. How risk is dealt with usually depends upon the relationship between the parties and the law in your particular jurisdiction. Most commonly, risk is handled through contractual provisions that attempt to apportion and to shift liability. However, these agreements can be buried or obscured by their font or placement or both within a contract, and many times, the parties themselves forget that they are there. Additionally, not all risk transfer avenues are contractual in nature. Many jurisdictions have created statutory or common law causes of action or both that permit various types of risk transfer.

Generally speaking, the purpose of a risk-shifting provision is to mitigate or apportion liability or both in a subsequent tort action or commercial claim brought by a third party. These provisions are important because they can change the outcome of a case. Indeed, nothing gives an experienced litigator a sigh of relief like a valid risk transfer agreement when his or her client is the targeted defendant in a liability case. Such a clause can swing the entire evaluation of a case. Likewise, finding out that your client is the target of a risk transfer agreement in a liability case can cause headaches if you don't know how to deal with it. Consequently, you need to be prepared to use a risk transfer agreement and the law to your favor. This means being able to use the applicable mechanism as both a sword and a shield, especially if your client is the beneficiary of one of these agreements. Thus, understanding these mechanisms and specifically, how to prosecute and defend against them is critical to dealing with both tort and contract claims. This is especially true given the extraordi-

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nary consequences these provisions and laws have in terms of shifting the parties' respective liabilities since courts and legislatures have sometimes limited them or created hurdles that parties to these agreements must overcome to enforce them.

What follows is a discussion of the various ways that risk is sometimes shifted and strategies for coping with the shifts in a litigation setting.

Contractual Agreements

It is now common to see risk transfer agreements in virtually all contracts, master service agreements, purchase orders, franchise agreements, and lease agreements. These usually appear in the form of contractual indemnity and additional insured clauses. However, there are various types of contractual indemnity, and as such, understanding what your indemnity clause purports to do is critical to the analysis.

Contractual Indemnity

Black's Law Dictionary defines an indemnity agreement as "A collateral contract or assurance, by which one person engages to secure another against an anticipated loss or to prevent him from being damnified by the legal consequences of an act or forbearance on the part of one of the parties or of some third person." *See Dresser Industries, Inc. v. Page Petroleum, Inc.,* 853 S.W. 2d 505, (Tex. 1993) (quoting *Black's Law Dictionary* 692 (5th ed. 1979)).

This type of contract generally creates what is known as a contractual indemnity agreement. The parties to this agreement are known as the indemnitor and indemnitee. In this context, the party being indemnified is the "indemnitee," and the party guaranteeing the indemnity is the "indemnitor." Thus, in layman's terms, the indemnitor—typically the party with the least bargaining power—is responsible for indemnifying or securing the indemnitee's future liability.

As discussed above, risk transfer agreements purport to shift prospective future liability from the indemnitee to the indemnitor. Thus, by nature these agreements are extraordinary in terms of what they intend to do. Consequently, there are limits to contractual risk transfer agreements. As a result, it is important to ascertain quickly the existence of a risk transfer agreement, if any, in your case and the type of agreement at play to determine its scope and validity. For example, some agreements seek to indemnify the indemnitee for the negligence of the indemnitee only. Others seek to indemnify the indemnitee only for the indemnitor's own negligence. Still others attempt to strike a balance in between the two. Different jurisdictions treat these clauses differently.

Indemnity for the Indemnitee's Negligence

The first step to take when analyzing an indemnity clause is to review the referenced agreement itself to determine whether or not it satisfies the requirements in your jurisdiction to make such a clause enforceable. Most jurisdictions require that the indemnitor receive "fair notice" of the extent of the risk transfer granted under the agreement.

The most frequently used fair notice requirement throughout the United States is based upon the "clear and unequivocal" doctrine. According to this doctrine, contracts to indemnify a party against the consequences of the party's own negligence, to be enforceable, must demonstrate that the intent to indemnify is "clear and unequivocal" within the body of the agreement. *See Cumberbatch v. Board of Trustees,* 382 A.2d 1383, 1386 (Del. Super. Ct. 1978). Jurisdictions adopting the "clear and unequivocal" doctrine have held that ambiguous clauses attempting to invoke indemnity "against all liabilities whatsoever" are not clear and unequivocal, and the subject clause must contain an "explicit reference to the indemnitee's negligence." *See Gulf Oil Corp. v. Atlantic C.L.R. Co.,* 196 So.2d 456, 459 (Fla. App.2d 1967). *See generally Washington Elementary Sch. Dist. No. 6 v. Baglino Corp.,* 817 P.2d 3 (Ariz. 1991); *Arkansas Kraft corp. v. Boyed Sanders Constr.,* 764 S.W.2d 452 (Ark. 1989); *Royal Ins. Co. v. Whitaker Contr. Corp.,* 824 So.2d 747 (Ala. 2002).

Though not adhering to the "clear and unequivocal" doctrine, Texas also requires that the invoked clause upon which a party seeks to establish indemnity must specify the acts that the clause covers. The fair notice requirement in Texas generally encompasses both the "express negligence doctrine and a conspicuousness requirement. *See Gilbane Bldg. Co. v. Keystone Structural Concrete, Ltd.* 263 S.W. 3d 291, 296 (Tex. App. 2007) *citing to Storage and Processors, Inc. v. Reyes*, 134 S.W.3d 190, 192 (Tex. 2004). The express negligence test applies to indemnity provisions seeking to indemnify the indemnitee for the negligence of the indemnitee alone. *See Ethyl Corp. v. Daniel Construction Co.,* 725 S.W.2d 705 (Tex. 1987). As explained by the Supreme Court of Texas, "[u]nder the doctrine of express negligence, the intent of the parties must be specifically stated within the four corners of the contract." *Ethyl* at 708.

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In other words, an agreement must specifically state that indemnity is owed regardless of the negligence of the indemnitee.

Likewise, Texas also requires that the agreement be conspicuous within the document. And "[t]he conspicuous requirement mandates 'that something must appear on the face of the [contract] to attract the attention of a reasonable person when he looks at it.'" *See Dresser Industries, Inc. v. Page Petroleum, Inc.,* 853 S.W.2d 505, 511 (Tex. 1993) (quoting *Ling &Co. v. Trinity Sav. & Loan Ass'n*, 482 S.W.2d 841, 843 (Tex. 1972)). The court in Dresser went on to state that

> [a] term or clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it. A printed heading in capitals (as: NON-NEGOTIABLE BILL OF LADING) is conspicuous. Language in the body of a form is "conspicuous" if it is in larger or other contrasting type of color.

See Dresser Industries, 853 S.W.2d 505 at 511 (*quoting* Texas Bus. Comm. Code Ann §1.201(10) (Tex. UCC), and adopting the

standards for conspicuousness set out in the Texas Uniform Commercial Code).

However, fair notice requirements do not apply when "the indemnitee establishes that the indemnitor possessed actual notice or knowledge of the indemnity agreement." *See Dresser Industries,* 853 S.W.2d 505, 508 n. 2 (citing *Cate v. Dover Corp.*, 790 S.W.2d 559, 561 (Tex. 1990)).

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In still other jurisdictions the full intent of indemnification of one party to another need only be implied, rather than explicitly stated. In New York, "a party is entitled to full contractual indemnification provided that the intention to indemnify can be clearly *implied* from the language and purpose of the entire agreement and surrounding facts and circumstances." *See Campos v. 68 E. 86th St. Owners Corp.,* 117 A.D.3d 593 (N.Y. App. Div. 2014) (citing *Drzewinksi v. Atlantic Scaffold & Ladder Co.,* 515 N.E.2d 902 (N.Y. 1987)). Thus, contrary to the fair notice requirements maintained in other jurisdictions, courts in New York require that a party seeking to determine the extent and enforceability of an indemnification clause look beyond that which is contained in the actual contract agreement.

Contractual Comparative Indemnity

Another type of indemnity clause is known as a contractual comparative indemnity provision. This type of clause in essence operates to establish what is commonly referred to as "contractual contribution." Contractual contribution seeks to establish indemnity for an indemnitor's negligence, as opposed to the indemnitee's negligence. Thus, this is a handy provision to use if the contract at issue doesn't meet the fair notice requirement required by your jurisdiction.

For example, the Texas Supreme Court has stated that the "express negligence test" does not apply to indemnity provisions that provide indemnity for the negligence of the indemnitor (the party providing indemnity). *See Gulf Insurance Company v. Burns Motors, Inc.,* 22 S.W. 3d 419 (Tex. 2000). In *Gulf Insurance,* the court noted that the agreement at issue provided

> that the agent is, under certain circumstances, indemnified 'except to the extent Agent has caused, contributed to or compounded such error.'… The Agency–Company Agreement does not contemplate indemnifying the indemnitee from the consequences of his own negligence. Thus, the express negligence doctrine does not apply here.

See id. at 424 (quoting from the agreement at issue in the case).

Thus the intent of the indemnity provision in this case was for the indemnifying party to protect the "indemnitee" for the "indemnitor's" negligence, not for the "indemnitee's" negligence. Consequently, the comparative indemnity provisions, at least in Texas, are their own creatures and do not have to meet the express negligence test.

Additional Insured Clauses

Typically, most commercial contracts require a contracting party to procure insurance for the protection of the hiring party as a condition of doing business. This is typically seen in a general contractor and subcontractor relationship: the subcontractor is required to obtain insurance listing the general contractor as an additional named insured on its policy. This is commonly referred to as "AI" coverage. However, as with contractual indemnity provisions, there are numerous pitfalls when encountering these clauses.

Statutory Indemnification

Some jurisdictions also create statutory indemnification obligations, particularly in areas of great need or for the protection of the public. In those situations, legislative bodies will remove the ability of certain parties to contract for indemnity and instead, devise statutory indemnification schemes to protect certain classes of individuals. Product liability is one such area where legislative bodies have done this frequently. For example, Texas requires a manufacturer to indemnify a seller "except for any loss caused by the seller's negligence, intentional misconduct or other act or omissions such as negligently modifying or altering the product for which the seller is independently liable." *See* Texas Civil Practices and Remedies Code Section 82.002(a). Likewise, states such as Arizona and Mississippi also have statutory indemnification limitations. For example, statutory protections extended to sellers in Arizona and Mississippi, among other states, do not apply if the seller possessed knowledge of the potential defect in the product. *See* Ariz. Rev. Stat. Ann. §12-684; Miss. Code Ann. 11-1-63.

Common Law

Along with contractual and statutory mechanisms that could transfer risk, many states allow common law indemnity in various situations. For example, a number of jurisdictions have extended common law protections for sellers. *See Frazer v. A.F. Munsterman, Inc.,* 527 N.E.2d 1248, 1251 (Ill. 1988); *Promaulayko v. Johns Manville Sales Corp.,* 562 A.2d 202, 207-08 (N.J.

Practice Point: Dealing with Statutory Indemnification

It is important to determine the breadth of the statutory indemnification protections afforded by a statute if one exists in your jurisdiction. Additionally, assuming that such a statute does exist in your jurisdiction, you should find out how the state courts have interpreted the statue. For example, the Supreme Court of Texas has interpreted Chapter 82 of the Texas Civil Practices and Remedies Code as not excluding items that may later become a part of a greater whole. Likewise, a "seller" has been interpreted to "include those who sell both products and services, so that person who contracts to provide and install a single product may be considered a seller of the product." *See Fresh Coat, Inc. v. K-2, Inc.,* 318 S.W. 3d 893 (Tex. 2010). The *Fresh Coat* case has been held to apply the statutory indemnification requirements against manufacturers of construction systems with respect to claims brought by contractors.

1989). Texas extends common law indemnity in limited situations, along with the statutory provisions referenced above, for innocent product retailers, under theories of vicarious liability such as *respondeat superior. See Aviation Office of America, Inc., v. Alexander & Alexander, Inc.,* 751 S.W.2d 179, 180 (Tex.1988). As a general rule, you should check the case law in the jurisdiction where your matter will be resolved to find out whether or not common law protections could become an issue in your case.

Ripeness and Timing

Another factor to consider is whether your claim is ripe. An indemnity claim generally does not accrue until a court issues a settlement order or a judgment that would then implicate the indemnity provision in question. However, courts in some jurisdictions have required a plaintiff to assert a claim based on an indemnity provision in the underlying action. For example, in New Jersey, the state supreme court has consistently has held that the interests of judicial economy require contribution claims to be brought in the underlying action, despite their not having accrued, and have extended the same requirement to indemnity cross-claims. *See Buck v. MacDonald,* 642 A.2d 108, 110 (N.J. 1997).

In contrast, Texas allows an indemnitee to choose when to bring the indemnity claim. Specifically, in *Ingersoll-Rand v. Valero Energy,* 997 SW 2d 203 (Tex. 1999), the Texas Supreme Court held that indemnity claims may in fact be brought before the actual indemnity claim accrues, stating

> we have held that an indemnitee may bring a claim against an indemnitor before the judgment is assigned against the indemnitee.… We allow such claims to be brought in the interest of judicial economy, as an exception of the accrual rule for indemnity claims. Such claims are contingent on accrual. But we have never held that an indemnity must state such claims in the initial suit to preserve them.

See Ingersoll, 997 S.W.2d at 209 (discussing *Getty Oil v. Insurance Company of North America*, 845 S.W.2d 794 (Tex. 1992)).

Discussing the *Getty* decision further in a footnote, the *Ingersoll* decision noted that "forcing the indemnity suit to wait for judgment in the liability suit 'would contravene the policies of the courts to encourage settlements and minimize litigation.'" *See id.* at footnote 29 (quoting *Getty*). Thus, in Texas, as in many other jurisdictions, the indemnity claims do not have to wait until an underlying judgment is taken against it, with many courts citing the interests of "judicial economy" as allowing these claims to be brought with the underling action.

Consequently, if you have the choice of bringing your indemnity claim in the main lawsuit or in a subsequent one, you will have to weigh several factors, including the venue, the judge, and the current scheduling order. Indeed, should you choose to bring your claim in the same action, you will likely have to do so in the form of a third-party complaint or petition. Depending on the law in your particular jurisdiction, you may have to seek leave of the court before being able to do so. Further, a party seeking indemnity needs to consider whether the claim for indemnity is valid, and if not, the implications of bringing in a third-party defendant that may to choose to ally itself with the plaintiff.

Assuming that you decide to proceed with a third-party action for indemnity, careful consideration must be given to how you will conduct discovery against the opposing parties in question. Specifically tailored and artfully drawn discovery requests, rather than those as part of a standard boilerplate set, should be propounded on the parties from whom indemnity is sought. The discovery should be tailored to aid you in proving that an indemnity agreement exists and that a breach has occurred. This will assist you in carrying your burden of proof as the party seeking affirmative relief. Conversely, if you are defending a third-party action for indemnity, make sure to assert all affirmative defenses to the claim at the outset and file timely motions for summary judgment if applicable. A summary judgment motion should question the validity of the purported indemnity clause raising any and all standard contract formation defenses available in the case.

Dealing with Contractual Indemnity and AI Issues

Perhaps the best line of attack or defense in a risk transfer case is one developed from the terms contract or the master service agreement itself delineating the responsibilities of the parties. The contract will typically delineate the responsibilities of each party including the expertise that each will bring to the agreement. In some cases the agreement will even discuss the extent to which each party will rely upon that expertise. This clarifying language is vitally important because it will clear up any ambiguities about the respective roles of the parties well in advance of, and often preventing, a trial.

Contractual contribution seeks to establish indemnity for an indemnitor's negligence, as opposed to the indemnitee's negligence.

Exploring the delineation of responsibilities in the contract is important for another reason, too: many jurors may not understand the differences or relationships between the parties in a large multi-party dispute. Others may have a preconceived notion of the responsibilities of the parties. This is especially true in large construction cases or complex commercial cases involving numerous parties with different disci-

Practice Points: Contractual Indemnity and AI Issues

- Explore the contractual language delineating the responsibilities of the parties to the contract.
- Exploit the favorable language in the contract with deposition witnesses and during witness trial examinations.
- Verify what types of fair notice requirements, if any, exist in your jurisdiction.
- Ascertain whether there are any barriers to indemnity in your jurisdiction, such as anti-indemnity statutes.
- Find out if the parties complied with the contractual requirements calling for "AI" coverage.
- Determine if the policy itself contains the requisite language to create AI coverage.

plines or areas of responsibilities. That the contracts that govern these agreements typically define the parties and their various roles can assist you greatly. By exploring the language in these contracts well in advance of depositions you can exploit the favorable language with every witness.

For example, many jurors believe that the general contractor in a construction case is solely responsible to the owner for the acts or omissions of the subcontractors. However, taking construction contracts as an example, most if not all construction contracts between a general contractor and subcontractors require that the subcontractors acknowledge at least some of the following:

- they possess a level of expertise that the general contractor does not have;
- That they are responsible for the means and methods of the services they are providing;
- That the subcontractors are responsible for supervision, coordination and sequencing of their own work;
- That they are knowledgeable about their trade and/or services;
- That they are responsible for reporting non-conforming work of others and covering non-conforming work of others;
- That they agree to incorporate the general contractor's contract with the owner into their sub-contract; and
- That they agree to be bound to the owner to the same extent as the general contractor

Consequently, if you have the choice of bringing your indemnity claim in the main lawsuit or in a subsequent one, you will have to weigh several factors, including the venue, the judge, and the current scheduling order.

Most jurors generally do not know anything about these provisions, and a result, an attorney presenting such a contractual clause at trial must make sure to emphasize it and the effect that it had of essentially extending the contractual obligations to a third party not part of the original contract. It is imperative that counsel for the general contractor stress the various provisions that were agreed to in the subcontract at all stages of the trial, including voir dire, opening statement, and witness examinations, demonstrating the effect that the clause had on the relationship between the parties and ultimately, the determination of liability among the parties.

After exploring the contractual language, you should next determine the types of fair notice requirements, if any, that exist in your jurisdiction. Keep in mind that if you are prosecuting an indemnity clause you may have to obtain affidavits or take depositions or do both to establish that the indemnitor had knowledge of this clause. Conversely, you may need to use the discovery process to develop evidence demonstrating lack of knowledge of the relevant provisions if you are defending against an indemnity clause.

Third, you should ascertain whether there are any barriers to indemnity in your jurisdiction. For example, many states have anti-indemnity statutes dealing with various industries. One such area is the construction industry. In this regard, over two-thirds of the states have some degree of statutory prohibition on risk and liability transfer on additional insured claims found in construction contracts. In many jurisdictions, these statutory limitations have been codified and have been in effect for some time. For example, section 6-34-1 of the General Regulatory Provisions of Rhode Island was enacted in 1976, and holds, in part, that agreements

> [p]urporting to indemnify the promisee, the promisee's independent contractors, agents, or employees or indemnitees against liability for damages arising out of bodily injury to persons or damage to property proximately caused by or resulting from the negligence of the promisee, the promisee's independent contractors, agents, employees or indemnitees, is against public policy and is void.

See R.I. Gen. Laws §6-34-1.

Likewise, Texas, a long-standing outlier in this regard, recently passed the Construction Anti-Indemnity Act in 2012. The Texas Construction Anti-Indemnity Act not only precludes certain contractual indemnity clauses, but also precludes certain additional insured provisions. *See* The Texas Insurance Code Sections 151.102 and 151.104(a). This is a relatively new law so it is unclear how it will be interpreted by the courts. Please note, however, that there are several statutory exceptions, including but not limited to exceptions for claims made by employees of the indemnitor for bodily injury or death, and indemnity provisions relating to construction of single family houses, townhouses, duplexes and land development strictly related to them or for public work projects for a municipality. *See* Texas Insurance Code Section 151.103 and 151.105(10) (A) and (B).

All told, the Texas Construction Anti-Indemnity Act and other similar statutes are important given that construction litigation is growing in many parts of the country and thus, will have an effect on risk transfer associated with it. For instance, it is not uncommon to see building owners sue only the general contractor in a construction case. This is especially true when the general contractor has insufficient assets or insurance or both to satisfy a judgment. However, subcontractors are really necessary parties to the litigation. Thus, many times it is incumbent upon the general contractor to sue all of the subcontractors. This is typically done through contribution or indemnity claims, which may not have the same statute of limitation problems as other potential causes of action. However, with the proliferation of anti-construction indemnity statutes, building owners may choose to sue general contractors solely in contract in an effort to isolate the general contractor and to prevent the inclusion of the subcontractors under a contribution theory. Nevertheless, keep in mind that if you find yourself in this predicament you may still be able to assert a claim for comparative indemnity (contractual contribution). Specifically, the Texas Construction Anti-Indemnity Act as worded would not prevent a party to a comparative indemnity provision from enforcing it. Moreover, most indemnity provisions qualify as

a comparative indemnity provision and as such, counsel for general contractors would be well advised to use these types of provisions to make sure that all necessary parties are included in a suit.

Assuming that there are no legal barriers, you should next check to find out if the parties complied with the contractual requirements calling for "AI" coverage. In other words, did the indemnitor actually obtain the coverage in question? Simply requiring additional insured status is not sufficient protection for the indemnitee or the general contractor. Specifically calling for additional insured status and actually obtaining AI coverage are two different matters. This is particularly important if the indemnifying party is not financially solvent or large enough on its own to meet its indemnification obligations. Thus, obtaining a copy of the indemnifying party's applicable insurance policy should be a priority from the outset. In an effort to do this, counsel should ensure that fully executed certificates of insurance exist and are valid because it is not uncommon in large commercial transactions with numerous subcontractors for there to be a problem with at least one of the subcontractor's certificates.

Likewise, counsel should determine if the policy itself contains the requisite language to create AI coverage. If the coverage was not obtained, then the prosecuting party should explore the possibility of a breach of contract claim against the breaching party. Further, keep in mind that in an "additional insured" claim, the party providing a defense and making any indemnity payments is a third-party insurance company. A claim against the insurance company will likely have to be the subject of a separate action.

Finally, counsel for a subcontractor should explore the applicability of any anti-indemnity or additional insured provisions that may apply.

Conclusion

In most commercial transactions, the relationships between the parties involved are generally well defined. However, given the sophisticated business environment in which most commercial transactions occur, the existence of some sort of indemnity protection—be it contractual, statutory, or common law—could alter the relationship between the parties, which, in turn, could have a significant effect on how you represent your client. Indemnity provisions may also change the way that you and your client receive and respond to the pending lawsuit.

Most defense lawyers are unaccustomed to acting as plaintiffs' lawyers in prosecuting a cause of action. Doing so constitutes a change in the prevailing mindset of your case—switching form a defensive posture to one where you put pressure on a party to provide indemnity. To do this effectively, you must make sure that the necessary documents meet the legal requirements in admissible form and take depositions, if necessary, before proceeding to trial. A client will have to defend his or her services, and in the alternative, blame someone else for the work or services or both that someone else has alleged that your client performed deficiently or inadequately or both. Also, this could result in your client alleging claims or denying claims against a party with which he or she may have a longstanding personal or professional relationship. All in all, this requires a deft balancing act on the part of the attorney, and that is exactly what you must do if you want to assert or deny an indemnity claim.

The overall importance of these risk transfer agreements cannot be overstated. When faced with any type of commercial litigation, you owe it to your client to investigate fully the existence, the applicability, and the enforceability of these provisions as soon as you are retained. Doing this will shape the way that you prosecute a lawsuit on behalf of a client or defend a client facing a lawsuit, allowing you to inform your client about the possible strategies that you could use in the litigation. While the ultimate outcome of a litigation may not be in your client's favor, understanding the effect of applicable risk transfer agreements could save you and your client a great deal of time, money, and aggravation. FD