Presented:
2012 CONSTRUCTION LAW

September 13-14, 2012
Dallas, Texas

The Impact of the New Statutory Anti-Indemnity/Insurance Limitations on Texas Construction Contracts

Cynthia A. Holub, Porter Hedges LLP

Cynthia A. Holub
Porter Hedges LLP
1000 Main Street, 36th Floor
Houston, Texas 77002
cholub@porterhedges.com
(713) 226-6607

TABLE OF CONTENTS

I. Introduction

Construction contracts are designed to allocate business risk between the parties. The language used in indemnity clauses, waivers of subrogation, insurance provisions (and more importantly, the insurance policies themselves), releases, limitation of liability and other exculpatory clauses can have significant financial impact on the parties. Careful drafting of these clauses on the front end of a project has the ability to save time and money on the back end. Prior to 2012, upstream parties on construction projects frequently used indemnity clauses to shift risk to downstream parties. However, in 2011, the Texas Legislature passed the new construction anti-indemnity act which dramatically reduces a party's ability to transfer risks. Basically, if the new anti-indemnity act applies to the construction contract, an upstream party, with one exception, is prohibited from requiring the downstream party to indemnify the upstream party for the upstream party's own negligence or other fault.[1] This paper discusses the new anti-indemnity legislation, its impact on various risk-shifting clauses, and drafting considerations.

II. Indemnity Clauses

A. Indemnity Overview

Almost all construction contracts contain some sort of indemnity provision. Black's Law Dictionary defines indemnity as **1.** A duty to make good any loss, damage, or liability incurred by another. **2.** The right of an injured party to claim reimbursement for its loss, damage, or liability from a person who has such a duty. **3.** Reimbursement or compensation for loss, damage, or liability in tort; esp., the right of a party who is secondarily liable to recover from the party who is primarily liable for reimbursement of expenditures paid to a third party for injuries resulting from a violation of a common-law duty. Black's Law Dictionary (9th ed. 2009)

Indemnity agreements are generally classified as either (1) limited form, (2) intermediate form, or (3) broad form. Limited form indemnity agreements require the indemnitor to indemnify only to the extent of the indemnitor's own negligence or other fault. An intermediate form indemnity requires the indemnitor to pay all damages incurred by the indemnitee, except those caused by the indemnitee's sole negligence or other fault. Under an intermediate form indemnitee agreement, if the indemnitee is 1% at fault and the indemnitor is 99% at fault, the indemnitor is still responsible for all of the indemnitee's damages. A broad form indemnity requires the indemnitor to pay all damages incurred by the indemnitee even if the indemnitor is not responsible for any portion of the damages, *i.e.,* even if the indemnitee is solely negligent or otherwise responsible. Enforceability of the various types of indemnity agreements turns on state law. In Texas, a valid intermediate or broad form indemnity provision must meet the fair notice requirements discussed in Section II.B.

Historically, indemnity agreements applied to third party claims. In other words, the indemnitor, or the person providing indemnity, would agree to indemnify the indemnitee, or the person receiving indemnification, from liabilities that the indemnitee owed to third parties. However, contracts today often include contractual claims between the indemnitor and indemnitee within the scope of the indemnity clause.

[1] The anti-indemnity statute actually speaks in terms of "indemnitor" and "indemnitee" and thus prohibits both upstream and downstream parties from obtaining indemnity for their own negligence or other fault.

The Texas Supreme Court has made it clear that an indemnity provision can be written in such a manner as to indemnify each party to an agreement against any and all contractual claims they have against each other. *See Ingersoll-Rand Co. v. Valero Energy Corp*., 997 S.W.2d 203, 208 (Tex. 1999). In *Ingersoll-Rand*, Valero sued M.W. Kellogg ("Kellogg") and Ingersoll-Rand for damages caused by malfunctioning equipment that Kellogg and Ingersoll-Rand installed during an expansion of Valero's oil refinery. 997 S.W.2d at 205. Kellogg was the general contractor and Ingersoll-Rand was the subcontractor. *Id.* Kellogg and Ingersoll-Rand claimed that the indemnification provision in the Valero-Kellogg contract applied to absolve them from liability to Valero. *Id.* The indemnity provision at issue provided, in part:

> OWNER shall release, defend, indemnify and hold harmless CONTRACTOR, its subcontractors and affiliates and their employees performing services under this Agreement against all claims, liabilities, loss or expense … arising out of or in connection with this Agreement or the Work to be performed hereunder, including losses attributable to CONTRACTOR'S negligence, to the extent CONTRACTOR is not compensated by insurance carried under this Article.

Valero Energy Corp. v. M.W. Kellogg Const. Co., 866 S.W.2d 252, (Tex. App.—Corpus Christi 1993, writ denied).

The trial court concluded that the indemnity provisions were enforceable and granted an interlocutory summary judgment for Kellogg and Ingersoll-Rand. *Ingersoll-Rand,* 997 S.W.2d at 205. Notably, there were no third party claims at issue.

After holding that the indemnity agreement between parties to a contract was enforceable to extinguish a claim for malfunctioning equipment supplied by one party to the contract, the trial court severed and abated the remaining issues so that Valero could appeal the summary judgment. *Id.* On appeal, Valero argued that the provision exculpating the contractors from liability was void because it was against public policy. *Id.* The Court of Appeals rejected this argument and affirmed the trial court's ruling. *Valero Energy Corp.,* 866 S.W.2d at 257. ("Valero and Kellogg are sophisticated entities, replete with learned counsel and a familiarity with the oil refinery industry … The waiver and indemnity provision absolving Kellogg of all liability sounding in products liability and gross negligence does not offend public policy.") After the trial court lifted the abatement, Kellogg and Ingersoll-Rand moved for summary judgment, seeking their attorney's fees under the indemnity provision.

The trial court denied Kellogg and Ingersoll-Rand's request for attorney's fees finding that the claims were compulsory counterclaims barred by *res judicata* and the statute of limitations. After the Court of Appeals affirmed, the Texas Supreme Court reversed and remanded the case finding that neither *res judicata* nor limitations barred the claims. In reaching its conclusion, the Texas Supreme Court confirmed the enforceability of indemnity provisions between parties to a contract:

> Valero's suit presented the rather anomalous situation of an indemnitor (Valero) acting concurrently as the plaintiff seeking damages from the indemnitee (Ingersoll-Rand). The more common scenario for an indemnification dispute involves three separate parties: plaintiff (party one), indemnitee (party two), and

Title search: The Impact of the New Statutory Anti-Indemnity/Insurance Limitations on Texas Construction Contracts

First appeared as part of the conference materials for the
2012 Construction Law session
"Drafting Risk Management Provisions in Construction Contracts — The Impact of Statutory Anti-Indemnity/Insurance Limitations and More"