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ATTORNEYS

THE SHIFTING NATURE OF INDEMNITY PROVISIONS IN TEXAS

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INTRODUCTION

Indemnity provisions in contracts are not unusual in Texas. It is also not unusual for at least one of the parties to not fully appreciate what the indemnity obligation means. Often, a party is forced into an agreement requiring indemnity because it simply does not have the bargaining power to negotiate other terms with a larger client and simply accepts the mandated contract terms. Understanding basic indemnification issues is critical for any service provider, contractor, or construction company that routinely faces indemnification issues. For the party receiving indemnity it is a shield that goes between you and paying damages for an event, while also giving you a sword to force another party to pay for your damages. For the party giving indemnity you are the shield taking on the risk and damages in protecting another party even for damages of their own making. Because indemnity provisions shift the risk of damages from one party to another, caution should be used before a party accepts the responsibility to indemnify another party. If an indemnity obligation is accepted, the indemnifying party should make certain that it has taken the steps to protect itself against the possibility that it will have to indemnify the other party for that party's own negligence.

The law regarding indemnification provisions in Texas continues to evolve, either through case law or by statute, and usually based on public policy concerns. The most recent major development in Texas indemnity law is the prohibition of indemnity provisions in non-residential construction contracts. With the Texas economy thriving at this time and construction projects increasing, this change in the law could affect how insurers and construction companies handle construction related claims going forward. This article explores the concept of indemnity and recent developments in Texas law regarding indemnification.

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WHAT IS INDEMNITY?

An indemnity clause is a promise to protect or hold another party harmless against either an existing or future loss or liability.[1] Indemnity provisions may include both the duty to indemnify and the duty to defend. Indemnity agreements may also be used to exculpate a person or entity from the consequences of its own actions such as when a party holds the other contracting party harmless even if the damage resulted from the negligence of the party being indemnified.[2] For example, Party A who has agreed to indemnify Party B may be forced to pay damages resulting from an event caused entirely by the negligence of Party B. The Texas Supreme Court recognized that risk shifting provisions that require a party to indemnify another party for that other party's own negligence are extra-ordinary contractual terms, and mandated fair notice requirements to govern the enforceability of such provisions.[3]

Fair Notice Requirements

Fair notice for indemnity provisions is comprised of two separate requirements: the express negligence doctrine and the conspicuousness requirement.[4] The express negligence doctrine provides that a party seeking indemnity from the consequences of that party's own negligence must express that intent in specific terms within the four corners of the contract.[5] The agreement must specifically state in express terms that indemnity is being provided to cover that party's own negligence. If an indemnity provision does not meet the requirements of the express negligence doctrine, the indemnitor will not be required to indemnify the indemnitee for any liability or damages resulting from the indemnitee's own negligence.[6]

The second component of the fair notice requirement, conspicuousness, requires that the indemnity provision be noticeable.[7] For indemnity provisions, the Texas Supreme Court adopted the conspicuousness standards of the Texas Uniform Commercial Code "UCC".[8] Conspicuousness under the Texas UCC requires that a provision be so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it.[9] This could include: 1) a heading in capitals equal to or greater in size than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same or lesser size; and 2) language in the body of a record or display in larger type than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same size, or set off from surrounding text of the same size by symbols or other marks that call attention to the language.[10] The provision must appear on the face of the contract to draw the attention of a reasonable person when he reviews the contract[11] so that the contracting party has fair notice that, under the agreement, he could still be liable for the damages, even if the loss or damages are not his fault.[12] For example, an indemnity provision on the back of a contract in the same font and color as the rest of the contract will not likely meet the conspicuous requirement; whereas an indemnity provision in

bold or in a different color or under a separate heading would likely meet the requirement.[13] Moreover, an indemnity provision set forth among unrelated terms and conditions on the back of a form and printed without distinguishing typeface will not likely meet the conspicuousness requirement.[14] Also, indemnity provisions are sometimes placed in purchase orders and sales documents, therefore, these types of documents should be reviewed regularly to determine the specific terms that the good or service is being provided.

Although the Texas Supreme Court developed the fair notice requirements for indemnification provisions that seek to exculpate a party for its own negligence, the Texas Supreme Court has also concluded that the fair notice requirements are not applicable when the indemnitee establishes that the indemnitor possessed actual notice or knowledge of the indemnity provision.[15] It is the indemnitee's burden to prove, and not the indemnitor's burden to disprove, that the indemnitee had actual notice or knowledge of the indemnification provision.[16]

INDEMNIFICATION PROHIBITIONS

In Texas, there are statutes that declare otherwise enforceable indemnification provisions void as against public policy in certain situations. This article discusses three of those statutes.[17] One is a long standing statute relating to oilfield contracts and prohibits only certain types of indemnification provisions. The other two relate to construction contracts. One is a relatively new statute enacted in 2011 that applies to non-residential construction agreements.

TEXAS OILFIELD ANTI-INDEMNITY ACT

The Texas Oilfield Anti-Indemnity Act (TOAIA) was enacted based on public policy concerns involving oil field contractors, and applies to agreements pertaining to an oil, gas, or water well, or mineral mine.[18] This includes any agreement to provide services to the well or mine, and any services or collateral acts such as furnishing transportation or rental equipment.[19] The TOAIA voids any provision

in an applicable agreement that purports to indemnify a person against the loss or liability for damage that is caused by or results from the sole or concurrent negligence of the indemnitee, his agent, or employee or even an individual contractor directly responsible to the indemnitee, arising from any loss, expense, or damage related to personal injury, death, or property damage.[20]

There are exceptions to the Act. First, the Act does not apply to joint operating agreements,[21] or indemnity agreements given to a surface estate owner for the production or

exploration of minerals on the owner's land.[22] Second, the Act does not apply to: 1) damages resulting from radioactivity; 2) property injury resulting from pollution including cleanup and control of the pollutant; 3) property injury that results from reservoir or underground damage, including the loss of oil, gas, water, mineral, or the well bore itself; 4) personal injury, death, or property damage that results from performing services to control a wild well; and 6) cost of control of a wild well, underground or above the surface.[23]

Finally, the TOAIA does not prohibit agreements that provide for indemnity if the parties agree in writing that the indemnity obligation will be supported by liability insurance coverage to be furnished by the indemnitor and subject to the certain limitations.[24] If the parties have mutual or reciprocal indemnity obligations, then the indemnity obligation is limited to the extent of the insurance coverage that each party has agreed to provide in equal amounts as the other party.[25] With respect to a unilateral indemnity obligation, the amount of insurance required may not exceed $500,000.[26]

CONSTRUCTION ANTI-INDEMNITY ACT

For many years, Texas has had a statutory prohibition against enforcement of indemnity provisions forcing a contractor to indemnify an architect or licensed engineer for the negligent acts of the architect or engineer.[27]

Specifically, the statute voids contractual indemnification provisions given by a contractor to architects and engineers for damage arising from personal injury, death, or property damage that are caused by or resulting from defects in plans, designs, or specifications prepared or used by the architect or engineer, or negligence of the architect or engineer in the rendition or conduct of professional duties called for or arising out of the construction contract including the plans, designs, and specifications.[28] Also prohibited are indemnity provisions provided by the architect or engineer in favor of the owner for any damage caused by the negligence of the owner in construction contracts not involving single family or multifamily residences.[29] However, this statute does not prohibit indemnity being provided by the contractor to the architect or engineer for the contractor's own negligence which caused the damages.[30]

In 2011, the Texas legislature took another step toward prohibiting indemnification in construction contracts. On January 1, 2012, the Texas Construction Anti-Indemnity Act (codified in Chapter 151 of the Texas Insurance Code) became effective and rendered void specific indemnity provisions in certain construction contracts entered into after January 1, 2012.[31] This Act has much broader application to construction contracts than the architect/engineer indemnity statute discussed above, as it applies to essentially any non-residential construction contract. Contracts to which this Act applies include

contracts, sub-contracts, or performance bonds, entered into or made by an owner, architect, engineer, contractor, construction manager, subcontractor, supplier, or material or equipment lessor for the design, construction, alteration, renovation, remodeling, repair, or maintenance of, or for the furnishing of material or equipment for, a building, structure, appurtenance, or other improvement to or on public or private real property, including moving, demolition, and excavation connected with the real property.[32] However, the Act does not apply to any construction contract pertaining to a single family house, townhouse, duplex, or land development directly related thereto, and any public works project of a municipality.[33]

This Act voids, as against public policy, any provision in a construction contract, or collateral agreement, to the extent that it requires an indemnitor (many times a subcontractor) to indemnify, hold harmless, or defend a party or third-party ("indemnitees"), against a claim caused by the negligence, breach of contract or statute, or any kind of fault of the indemnitees or third-parties under their control.[34] Any contractual provision that requires a party to provide additional insured coverage under the indemnitor's insurance policy are also void and unenforceable as to the negligence of the additional insured.[35] However, this does not apply to a consolidated insurance program where insurance is provided by one carrier to all contractors on the project. Also, the Act does not prohibit an employer from providing indemnification to others for any bodily injury or death of its employee.[36] Moreover, indemnification provisions that require the indemnifying party to indemnify another party for the consequences of its own negligence are still enforceable.[37]

There are many exclusions to this Act, some of which include: 1) consolidated insurance programs; 2) a cause of action for breach of contract or warranty that exists independently of an indemnity obligation; 3) loan and financing contracts; 4) surety agreements; 5) protections afforded under Texas' workers compensation laws; 6) protections of governmental immunity; and 7) agreements subject to the Oilfield Anti-IndemnityAct.[38] As can be seen, this new Construction Anti-Indemnity Act is broad in scope. Most construction contracts contain indemnity provisions, and are frequently called upon to provide protection to a general contractor or owner. These provisions are now rendered void in non-employee injury cases. This development is a continuation in the public policy shift involving construction claims to put the liability for damages on the party or parties who actually cause the damage. Essentially each party and its insurer bear only the responsibility for its own actions, not someone else's action. While these statutes void certain forms of indemnification, not all indemnification is prohibited. So there is still merit in including indemnification provisions in construction contracts.

HOW TO PROTECT YOUR COMPANY - INSURANCE

The first line of protection for any company that is required to indemnify another party is to procure comprehensive general liability (CGL) insurance coverage with specific coverages that may be needed for that company. Two special endorsements are especially helpful for any party who routinely agrees to indemnify other parties. First, a blanket additional insured endorsement is necessary. This endorsement typically provides that your insurance coverage is extended to cover as an additional insured any party that you have agreed in a written contract to name as an additional insured. Second, a contractual liability endorsement can provide coverage for bodily injury and property damage claims for certain indemnity agreements to which you have agreed. All insurance policies have exclusions and by their nature are limited in what they cover. But, insurance is necessary for most businesses that cannot afford to self insure. An in depth consultation with your attorney and insurance agent is worthwhile to analyze the common risks that your company may be exposed to and how best to protect against those risks. Depending upon price and coverage, insurance may not always be the solution to every risk, but CGL insurance, even with basic coverages and endorsements, is always the best starting point.

RECOMMENDATIONS

Indemnity provisions are extraordinary risk shifting provisions. Therefore, caution should be utilized when confronted with indemnity requested by another party or when indemnification provisions found in a purchase order. It is important to recognize that the enforceability of indemnity provisions varies from document to document and from state to state. A clause in one contract may be enforceable, while a clause in another may not be enforceable, depending upon the wording and location of the provision in the document or situated in the document as well as the laws of the state that will apply to the agreement. Companies should generally avoid entering into indemnity obligations, and only do so when there is a legitimate business interest to protect by so doing and only after the business has insured itself with appropriate protection.

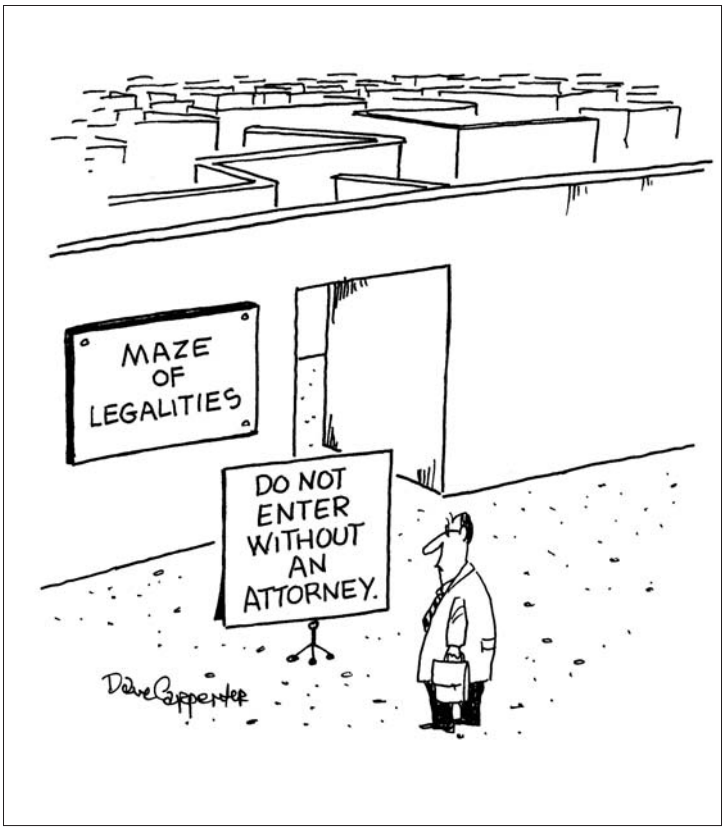
If your company relies on the use of indemnity provisions for protection, then the provisions should be reviewed occasionally by an attorney to make sure they are still enforceable. For additional insured contracts, a company should also obtain copies of all sub-contractor insurance policies and proof of coverage for your company. While indemnification provisions may appear fairly simple, businesses and insurers can eliminate their potential liability and exposure by consulting competent and knowledgeable counsel to draft and incorporate the appropriate indemnification or additional insured provisions into their contracts.

Company representatives should always do the following prior to entering into any contracts: 1) review contracts carefully before signing, especially any provisions requiring indemnification of another party for that other party's own negligence; 2) carefully consider the risks, potential liability and damages that the company could incur and ultimately be held responsible for due to the indemnification; 3) negotiate with the other party, if feasible, to reduce the company's liability and exposure under the contract; 4) identify all contracts that require the company to name as an additional insured any other party and make sure the company's insurance provides coverage for the additional insured; 5) verify coverage from all sub-contractors that are supposed to provide your company with insurance; 6) consult regularly with your insurance agent and attorney regarding the insurance coverages that are necessary to provide the company with affordable protection; 7) obtain umbrella insurance coverage; 8) keep all insurance polices active; and 9) keep a running historic list of all insurance policies that have provided coverage to the company, limits, and policy periods.

Insurance carriers faced with an indemnity request from a non-insured should consider: 1) whether the insurance policy provides coverage for the indemnity obligation; 2) whether the indemnity provision arises out of an oil or gas contract; 2) whether the indemnity provision arises out of a non-residential construction contract; 3) whether the proposed indemnity provision is conspicuous; and 4) whether the indemnity provision expressly states that indemnity is provided to the indemnitee covering the indemnitee's own negligence. If any of these situations are applicable, then additional analysis is warranted to determine if the indemnity provision is valid and what duties are owed.

NOTES

[1.] *Dresser Indus., Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505, 508 (Tex. 1993).
[2.] *Ohio Oil Co. v. Smith*, 365 S.W.2d 621,626 (Tex. 1963).
[3.] *Dresser Indus., Inc.,* 853 S.W.2d at 508. Fair notice requirements are also applicable to release provisions. *Id.*
[4.] *Enserch Corp. v. Parker*, 794 S.W.2d 2, 8 (Tex. 1990).
[5.] *Ethyl Corp. v. Daniel Constr. Co.*, 725 S.W.2d 705, 707-708 (Tex. 1987).
[6.] *Fisk Elec. v. Constructors & Assoc's*, 888 S.W.2d 813, 814-816 (Tex. 1994).
[7.] *Ethyl Corp.*, 725 S.W.2d at 707-08.
[8.] *Dresser Indus., Inc.*, 853 S.W.2d at 510 -511.
[9.] TEX. BUS. & COM. CODE ANN. § 1.201(10) (West 2009).
[10.] *Id.*
[11.] *Dresser Indus., Inc.*, 853 S.W.2d at 508.
[12.] *Spence & Howe Constr. Co. v. Gulf Oil Corp.*, 365 S.W.2d 631,634 (Tex. 1963).
[13.] *Dresser Indus., Inc.*, 853 S.W.2d at 510.
[14.] *U.S. Rentals, Inc. v. Mundy Service Corp.*, 901 S.W.2d 789, 793 (Tex. App. — Houston [14th Dist.] 1995, writ denied).
[15.] *Dresser Indus., Inc.*, 853 S.W.2d at 508 (Tex. 1993).
[16.] *U.S. Rentals, Inc.*, 901 S.W.2d at 793.
[17.] TEX. CIV. PRAC. & REM. CODE ANN. § 88.002 also provides that a health insurer may not enter into a contract with a physician, hospital or other healthcare provider or pharmaceutical company which includes an indemnification or hold harmless clause for the acts or conduct of the health insurer. This provision will be not be discussed in this article.
[18.] TEX. CIV. PRAC. & REM. CODE ANN. § 127.001 (West 2011).
[19.] *Id.*
[20.] *Id.* at §127.003.
[21.] *Id.* at § 127.002(c).
[22.] *Id.* at § 127.007.
[23.] *Id.* at § 127.004.
[24.] *Id.* at §127.005.
[25.] *Id.*
[26.] *Id.*
[27.] TEX. CIV. PRAC & REM. CODE ANN. § 130.002(a) (West 2011).
[28.] *Id.*
[29.] *Id.* at §130.002(b).
[30.] *Foster, Henry, Henry & Thorpe, Inc. v. J.T. Constr. Co.*, 808 S.W.2d 139, 141 (Tex. App. – El Paso 1991, writ denied).
[31.] TEX. INS. CODE ANN. §151.102 (West 2011).



[32] *Id.* at §151.101(5).
[33] *Id.* at §151.105(10).
[34] *Id.* at §151.102.
[35] *Id.* at §151.104(a).
[36] *Id.* at §151.103.
[37] *Id.*
[38] *Id.* at §151.105.

DIANE SWEEZER DAVIS IS A SENIOR ASSOCIATE AT THE HOUSTON CIVIL LITIGATION LAW FIRM OF FUNDERBURK FUNDERBURK COURTOIS, LLP. SHE MAY BE CONTACTED AT 713-620-7274 OR DDAVIS@FFLLP.COM.

MARK COURTOIS IS THE MANAGING PARTNER OF THE HOUSTON CIVIL LITIGATION LAW FIRM OF FUNDERBURK FUNDERBURK COURTOIS, LLP. HE MAY BE CONTACTED AT 713-620-7226 OR MJCOURTOIS@FFLLP.COM.

FUNDERBURK
FUNDERBURK
COURTOIS, LLP
ATTORNEYS

2777 ALLEN PARKWAY, SUITE 1000
HOUSTON, TEXAS 77019

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