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ADDITIONAL INSURED AND CONTRACTUAL LIABILITY COVERAGE
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ADDITIONAL INSURED AND CONTRACTUAL LIABILITY COVERAGE:
What You Need to Know

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Section I: Additional Insured Coverage

A. INTRODUCTION

In many industries, but especially the construction industry, a general contractor will often require a subcontractor to provide the general contractor coverage under the subcontractor's liability policy. The general contractor has overall responsibility for the project and activities at the construction site, but it most likely has little, if any, actual involvement in the subcontractor's work. The purpose behind securing both additional insured coverage and contractual liability coverage in the construction context is to pass the cost, and risk of loss, to the subcontractor that has direct control over its own operations and employees.

In theory, the general contractor and subcontractor negotiate this risk transfer to the subcontractor in the contract between them. In many cases, however, the subcontractor has little say in the matter, generally having to accept the risk transfer for little or no increase in contract price. The general contractor may require that the subcontractor procure not only contractual liability coverage to secure the indemnity obligations, but also add the general contractor as an additional insured to the subcontractor's general liability policy – a "belt and suspenders" approach to risk allocation. Problems arise when determining the scope of the additional insured coverage, which is provided by a myriad of forms. The most commonly used forms are discussed below.

B. ENDORSEMENTS

An additional insured does not have the same coverage as the named insured. Any term, condition or exclusion referring to "you" or "your" applies only to the named insured. For instance, a typical CGL policy contains a property damage exclusion that applies to property owned, rented, occupied by or loaned to "you," the named insured. Damage to property owned by the additional insured is not excluded. In contrast, damage to personal property in the care, custody or control of either the named insured or an additional insured is typically excluded. Other differences in the coverage afforded to the additional insured versus the named insured include:

- The products-completed operation hazard is generally not applicable to additional insureds (but you must review the specific language of the additional insured endorsement).
- Only the named insured's employees, executive officers and directors are insureds.
- The additional insured typically does not face the same occurrence reporting requirements.

Also, in situations where the named insured intentionally causes injury, an additional insured can have coverage where the named insured does not. Courts usually address this coverage issue in a different context, however, such as where an employer is being held liable for the intentional torts of its employee under a negligent hiring or supervision theory. *See, e.g., King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185, 191-92 (Tex. 2002) (holding that the actor's intent is not imputed to the insured in determining whether there was an "occurrence"); *U.S. Fid. &*

Guar. Co. v. Open Sesame Child Care Center, 819 F. Supp. 756, 760-61 (N.D. Ill. 1993) (applying Illinois law) (broadly construing insuring agreement and concluding that a negligent hiring claim related to and interdependent on employee's alleged child molestation still constituted an "occurrence"); *but see Companion Prop. & Cas. Ins. Co. v. Airborne Express, Inc.*, 631 S.E.2d 915, 918 (S.C. Ct. App. 2006) (applying Georgia law) (holding that negligence claims against employer did not constitute an "occurrence" because claimant's injuries resulting from employee's sexual assault and murder were not alleged to have been caused by an accident).

1. Additional Insured Endorsement – No Qualifications

The following is the broadest form of additional insured endorsement:

WHO IS AN INSURED (Section II) is amended to include as an insured the person or organization shown in the schedule as an insured.

This endorsement does not attempt to limit coverage. A general contractor insured under this type of endorsement is covered for its sole negligence, its own activities and any joint and several liability it may be assessed. Additional insured coverage under this endorsement is not restricted or limited to a particular construction project or related to the work of the named insured subcontractor.

2. Additional Insured Endorsement – Qualified

The 1993 ISO 20 10 endorsement reflects ISO's initial efforts to narrow the coverage afforded to an additional insured by qualifying or limiting coverage to the named insured's "ongoing operations." The 1993 ISO 20 10 provides:

WHO IS AN INSURED is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of your ongoing operations performed for that insured.

At one time, this endorsement was one of the most widely used in general liability policies issued to subcontractors, especially in the construction industry. The "ongoing" language was added to the more recent versions of the endorsement to clarify the intent of insurers to cover a general contractor (additional insured) only while the subcontractor (named insured) is working on the project. In other words, once the subcontractor's work is complete, the general contractor no longer has coverage under the policy. *See Pardee Constr. Co. v. Insurance Co. of the West*, 92 Cal. Rptr. 2d 443, 456-57 (Ct. App. 2000) (discussing ISO's change in the endorsement from "your work" to "ongoing operations" and concluding the change demonstrates that "ongoing operations" does not include completed operations). Remember that "you" and "your" refer only to the named insured, not the additional insured.

This and similar endorsements have generally given rise to two related issues: (1) whether the endorsement requires that the additional insured's liability arise out of the named insured's *negligence*; and (2) what standard of causation is required by the language "arising out

of your ongoing operations.” These issues have been the subject of much debate in construction-related insurance cases across the country.

1. *Whether Liability Must Arise Out Of The Named Insured’s Negligence*

In construing the phrase “liability arising out of your ongoing operations,” most courts hold that liability need not have been caused by the named insured’s acts. Liability can arise out of the named insured’s ongoing operations without any *negligence* by the named insured having caused the injury or damage. As one appellate court remarked,

The majority view of these cases is that for liability to “arise out of operations” of a named insured it is not necessary for the named insured’s acts to have “caused” the accident; rather, it is sufficient that the named insured’s employee was injured while present at the scene in connection with performing the named insured’s business, even if the cause of the injury was the negligence of the additional insured.

Admiral Ins. Co. v. Trident NGL, Inc., 988 S.W.2d 451, 454 (Tex. App. – Houston[1st Dist.] 1999, pet denied); *see also Merchants Ins. Co., Inc. v. U.S. Fidelity & Guar. Co.*, 143 F.3d 5, 10 (1st Cir.1998) (applying Massachusetts law) (general contractor was an additional insured under subcontractor’s policy for general contractor’s own negligence; subcontractor’s employee was injured “in the course of, and contemporaneously with,” the subcontractor’s work for the general contractor); *McIntosh v. Scottsdale Ins. Co.*, 992 F.2d 251, 255 (10th Cir.1993) (city, stipulating that it was 100% negligent for injuries to patron at city festival, was an additional insured under festival company’s general liability insurance policy).

A few courts, however, have taken the view that “liability arising out of your ongoing operations” means that the liability must arise, at least in part, out of the named insured’s *negligent acts or omissions*. *See, e.g., G.E. Tignall & Co., Inc. v. Reliance Nat’l Ins. Co.*, 102 F. Supp.2d 300, 306 (D. Md. 2000) (concluding that lead abatement subcontractor’s policy limiting additional insured coverage to liability arising out of its ongoing operations did not extend additional insured coverage to school renovation contractor for its own negligence); *cf. St. Paul Fire & Marine Ins. Co. v. American Dynasty Surplus Lines Ins. Co.*, 124 Cal. Rptr. 2d 818, 834 (Ct. App. 2002) (holding that electrical subcontractor’s additional insured endorsement was ambiguous and, when read in light of its subcontract with construction contractor, provided coverage only for liability arising, at least in part, out of subcontractor’s own “acts or omissions” in the performance of its subcontract). Some courts have commented that additional insured provisions are generally intended to protect the additional insured against *vicarious* liability for the acts of the named insured. *See Maryland Cas. Co. v. Nationwide Ins. Co.*, 76 Cal. Rptr.2d 113, 119 (Ct. App. 1998); *Harbor Ins. Co. v. Lewis*, 562 F. Supp. 800, 803 (E.D. Penn. 1983). As discussed above, however, most courts reject this idea, with at least one court noting that this limitation may make additional insured coverage illusory, since the additional insured would have an indemnity claim against the wrongdoer. *Marathon Ashland Pipe Line, LLC v. Maryland Cas. Co.*, 243 F.3d 1232, 1240 n.5 (10th Cir. 2001) (citing Douglas R. Richmond & Darren S. Black, *Expanding Liability Coverage: Insured Contracts and Additional Insureds*, 44 DRAKE L. REV. 781, 806 (1996)).

2. *What Standard of Causation Is Required?*

Courts have also had to address the degree to which the named insured's work must be involved in the liability facts to determine whether liability arises out of the named insured's ongoing operations. This typically becomes an issue where a subcontractor's employee is injured while merely being on the jobsite but is not, at the time, doing the subcontractor's work for the general contractor. The facts of *McCarthy Bros. Co. v. Continental Lloyds Ins. Co.* are illustrative. 7 S.W.3d 725 (Tex. App.–Austin 1999, no pet.). In *McCarthy Bros.*, an electrical subcontractor's employee working on Motorola's premises was injured when he slipped and fell on an incline to the equipment trailer on the worksite. The court held that since the employee was walking down the incline to get tools to perform his job, the activity was an integral part of the subcontractor's work for Motorola. *Id.* It is difficult to read this case to stand for anything other than that if the employee is on the premises to do the subcontractor's work, even if not performing that work at the time of the injury, his presence on the premises is enough for additional insured coverage.

Most jurisdictions consider the “arising out of” language to be broad enough to grant additional insured coverage in similar situations. *See, e.g., Mikula v. Miller Brewing Co.*, 701 N.W.2d 613, 616-21 (Wis. Ct. App. 2005) (employee of window installer subcontractor who was injured when cargo elevator doors crushed his hand was “in the course of his work” for subcontractor, which was hired by window-installer general contractor to perform certain tasks as part of the contractor's ongoing operations for premises owner; thus, premises owner was an additional insured under window contractor's liability policy); *Marathon Ashland Pipe Line*, 243 F.3d at 1238-40 (applying Wyoming law) (concluding that injury to pipeline operator's temporary worker arose out of building erection company's ongoing operations for pipeline operator because temporary worker's presence at operator's site was the natural and probable consequence of building erection company's hiring him and paying his salary while releasing him to pipeline operator's complete direction and control); *Mid-Continent Cas. Co. v. Swift Energy Co.*, 206 F.3d 487, 498 (5th Cir. 2000) (applying Texas law) (holding that so long as the insured worker was on the site to perform the subcontractor's business, his injuries on the general contractor's site are covered); *see also Evanston Ins. Co. v. ATOFINA Petrochems., Inc.*, 256 S.W.3d 660, 670 (Tex. 2008) (“In cases in which the premises condition caused a personal injury, the injury respects an operation if the operation brings the person to the premises for purposes of that operation.”); *cf. Liberty Mut. Fire Ins. Co. v. E.E. Cruz & Co., Inc., et al.*, 475 F. Supp.2d 400, 408-11 (S.D.N.Y. 2007) (city was an additional insured under subcontractor's general liability policy since subcontractor's equipment and installed and uninstalled electrical components at the job site were part of subcontractor's performance of its contractual obligation to provide and install electrical systems and components for the project, “and therefore integral to [subcontractor's] ‘ongoing operations performed for [the City].’”) (construing 2004 ISO 20 10 form, below); *Vitton Constr. Co. v. Pacific Ins. Co.*, 2 Cal. Rptr. 3d 1, 5-6 (Ct. App. 2003) (holding that causal connection was sufficient for a general contractor to receive coverage under a subcontractor's policy when another subcontractor's employee was injured by the first subcontractor's work even though the first subcontractor had completed its work and had left the premises).

But just being on the premises to perform work is not sufficient for all courts to find additional insured coverage. Some courts have required the subcontractor's operations to be more than a mere “but for” cause of the injury or damage for the general contractor or premises

owner to be an additional insured. *See, e.g., Pro Con Constr., Inc. v. Acadia Ins. Co.*, 794 A.2d 108, 110 (N.H. 2002) (holding that general contractor was not an additional insured under subcontractor's general liability policy, where subcontractor's employee was allegedly injured when he slipped and fell on an icy sidewalk while on his way from his work area to a coffee truck parked on the site's lot); *see also Cincinnati Ins. Co. v. Dawes Rigging & Crane Rental, Inc.*, 321 F. Supp.2d 975, 981-82 (C.D. Ill. 2004) (applying Illinois law) (agreeing that although "arising out of" connotes "but for" causation, simple connection of injured construction worker's employment with named insured was not by itself sufficient for crane lessor to have additional insured coverage under construction company's liability policy).

These courts' opinions notwithstanding, this endorsement is being broadly interpreted in most jurisdictions, resulting in a likely finding of additional insured coverage for general contractors if the underlying injuries have any connection at all to the subcontractor's operations. In the past, these endorsements were given away to insureds for very little cost, to allow subcontractor insureds to get the coverage necessary to get onto the worksites. The need for this coverage will not change. But given the typically broad construction of these endorsements, it should come as no surprise that liability insurers have begun revising form 20 10 to try to minimize their risk.

In 2001, ISO again amended the 20 10 endorsement, further attempting to restrict the coverage available to an additional insured, by adding exclusionary language to the coverage afforded:

- A. **Section II -- Who Is An Insured is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of your ongoing operations performed for that insured.**
- B. **With respect to the insurance afforded to these additional insureds, the following exclusion is added:**

- 1. **Exclusions**

This insurance does not apply to "bodily injury" or "property damage" occurring after:

- a. **All work, including materials, parts or equipment furnished in connections with such work, on the project (other than service, maintenance or repairs) to be performed by or on behalf of the additional insured(s) at the site of the covered operations has been completed; or**
- b. **That portion of "your work" out of which the injury or damage arises has been put to its intended use by any person or**

organization other than another contractor or subcontractor engaged in performing operations for a principal as a part of the same project.

Finally, the 2004 ISO 20 10 endorsement reflects ISO's continuing effort to further restrict coverage available to an additional insured. This endorsement provides in relevant part:

A. Section II. Who Is An Insured is amended to include as an additional insured the person(s) or organization(s) shown in the Schedule, but only with respect to "bodily injury", "property damage", or "personal and advertising injury" caused in whole or in part, by:

- 1. Your acts or omissions; or**
- 2. The acts or omissions of those acting on your behalf;**

in the performance of your ongoing operations for the additional insured(s) at the location(s) designated above.

B. With respect to the insurance afforded to these additional insureds, the following additional exclusions apply:

This insurance does not apply to "bodily injury" or "property damage" occurring after:

- 1. All work, including materials, parts or equipment furnished in connections with such work, on the project (other than service, maintenance or repairs) to be performed by or on behalf of the additional insured(s) at the location of the covered operations has been completed; or**
- 2. That portion of "your work" out of which the injury or damage arises has been put to its intended use by any person or organization other than another contractor or subcontractor engaged in performing operations for a principal as a part of the same project.**

The 2004 revision of ISO 20 10 specifically requires that the *acts or omissions* of the named insured (or someone acting on its behalf) actually caused the injury or damage, at least in part, for additional insured coverage to exist. As this revision becomes included in more liability

policies, we may start to see fewer courts finding additional insured coverage where the named insured is not negligent.

3. Additional Insured Endorsement – Supervision

This additional insured endorsement limits the scope of coverage to ongoing operations or acts or omissions of the additional insured in connection with its general supervision of the operations:

WHO IS AN INSURED (Section II) is amended to include as an insured the person or organization (called, "additional insured") shown in the Schedule but only with respect to liability arising out of:

- A. Your ongoing operations performed for the additional insured(s) at the location designated above; or**
- B. Acts or omissions of the additional insured(s) in connection with their general supervision of such operations.**

There is limited case law interpreting the general supervision language, but most courts have interpreted it broadly, finding general supervision in most instances. *See St. Paul Ins. Co. v. Texas Dept. of Transp.*, 999 S.W.2d 881 (Tex. App.–Austin 1999, pet. denied) (holding that an endorsement providing additional insured coverage for injury that “resulted from” the subcontractor’s work for TxDOT or TxDOT’s general supervision of that work, provided coverage to TxDOT in a situation in which the petition could be read to allege that the subcontractor mistakenly constructed the beltway, TxDOT supervised that construction and both the subcontractor and TxDOT’s acts or omissions caused the injury to the plaintiff); *Chesapeake & Potomac Tel. Co. of MD v. Allegheny Constr. Co.*, 340 F.Supp. 734 (D. Md. 1972) (owner's failure to warn the contractor's employees of the condition of a telephone pole which collapsed constituted general supervision); *Southwestern Bell Tel. Co. v. Western Cas. & Sur. Co.*, 269 F.Supp. 315 (E.D. Mo. 1967), *aff'd*, 396 F.2d 51 (8th Cir. 1968) (owner's failure to provide adequate safety plats and warnings of the existence of a buried electrical conduit fell within the scope of general supervision coverage). Although there are certainly fact situations that will not constitute "general supervision," in most instances an injured worker will plead some allegation of negligent supervision to, at a minimum, trigger a duty to defend.

4. Miscellaneous Additional Insured Endorsements

There are many more limited additional insured endorsements that may be added to further restrict coverage. The following are two such clauses:

1. Designated Premises

WHO IS AN INSURED (Section II) is amended to include as an insured the person or organization shown in the Schedule as an insured but only with respect to liability arising out of the following locations:

2. Contractual Indemnity Only

WHO IS AN INSURED (Section II) is amended to include as an insured, any person, organization, trustee, or estate with respect to which you are obligated by virtue of a written contract to provide insurance such as is afforded by this policy, but only to the extent of such obligations.

C. **RELATIONSHIP BETWEEN INDEMNITY AGREEMENT AND SCOPE OF ADDITIONAL INSURED COVERAGE**

When additional insured coverage is limited to the terms of a written “insured contract” between the general contractor and subcontractor, a review of the underlying indemnity agreement is crucial to determining the scope of coverage. Courts have struggled with the relationship between an indemnity agreement and the scope of additional insured coverage. The question is whether the additional insured coverage is part of the indemnity agreement, or a separate, independent obligation.

In *Getty Oil Co. v. Insurance Co. of North America*, the insurance and indemnity provisions fell within the same contractual clause of a purchase agreement. 845 S.W.2d 794, 796-97 (Tex. 1992), *cert. denied*, 510 U.S. 76 (1993). The insurance provision required the seller to carry liability insurance to protect the purchaser and the indemnity provision required the seller to indemnify the purchaser from claims “arising out of or incident to the performance or the terms of this order...” *Id.* at 796-97. The indemnity provision in *Getty* contained an internal provision for insurance to support it, while the agreement to procure additional insured coverage required the extension of coverage “whether or not required [by the other provisions of the contract].” *Id.* at 804. Based on this distinction, the Texas Supreme Court held the additional insured insurance provision did not support the indemnity provision, but was instead a free-standing obligation. *Id.* at 804-06. The result is that the court declined to extend the express negligence doctrine to additional insured agreements, and the scope of that coverage was not tempered by the scope of the indemnity agreement. *Id.*; *cf. ATOFINA Petrochems.*, 256 S.W.3d at 670 (contractor’s agreement to extend direct insured status to premises owner as an additional insured was separate and independent from service contract’s admittedly unenforceable indemnity provision); *Coastal Transp. Co. v. Crown Cent. Petroleum Corp.*, 20 S.W.3d 119 (Tex. App.–Houston [14th Dist.] 2000, *pet. denied*) (holding that the provision requiring Coastal to provide additional insured coverage was a separate obligation from the indemnification provision, and therefore was enforceable even when indemnity obligation held invalid). Other courts have reached similar conclusions. *See, e.g., American Cas. Co. of Reading, PA v. Gen. Star Indem. Co.*, 24 Cal. Rptr.3d 34, 47 (Ct. App. 2005) (“[A]n “additional insured” endorsement creates a contractual obligation that is entirely separate and apart from any indemnification obligation that may exist in an underlying construction contract.”); *W.E. O’Neil Constr. Co. v. Gen. Cas. Co. of Ill.*, 748 N.E.2d 667, 672-73 (Ill. App. Ct. 2001) (provision in subcontract requiring subcontractor’s insurance to cover the indemnity agreement and add general contractor as an additional insured to subcontractor’s CGL policy was separate and apart from, and not tied inextricably to, the indemnity agreement); *Krastanov v. K. Hovnanian/Shore Acquisitions, LLC*, 2008 WL 2986475 (N.J. Super. Ct. App. Div.) (fair reading of the subcontractor’s agreement did not make the insurance coverage dependent on the applicability of the indemnity clause;

unequivocal language of the 20 10 endorsement controlled the coverage afforded to the general contractor); *cf. Breaux v. Halliburton Energy Servs.*, 2009 WL 581140 (5th Cir.) (applying Louisiana law) (where agreement expressly provided that the indemnity and insurance obligations are separate and distinct, it would be contrary to the plain terms of the agreement to incorporate the additional insured obligation in the insurance provision into the indemnity obligation).

An insurer desiring to clarify the scope of coverage should include policy language limiting additional insured status to the extent that the named insured has assumed the additional insured's liability in a written "insured contract." By doing so, the insurer essentially provides no greater coverage than is afforded through contractual liability coverage for the named insured's indemnity obligations.

D. PROBLEMS TO WATCH FOR

1. Certificate of Insurance - Potential Pitfalls

Generally speaking, courts will enforce the policy terms over a certificate of insurance when they conflict especially when using an ACORD form with its limiting language. The obvious areas of conflict include errors in the name of the additional insured, failure to list an exclusion on the certificate, and the limits of coverage. As a precautionary matter, the general contractor should request a copy of the policy, not just a certificate, whenever possible to insure that: (1) the coverage provided is as represented; and (2) the additional insured endorsement was *actually issued*. For carriers, careful attention to certificates that their agents issue is imperative. While a certificate of insurance usually cannot create additional insured coverage if such coverage does not already exist under the policy terms, carriers must beware of potential liability for any misrepresentation in certificates issued by their agents. *See, e.g., Sumitomo Marine & Fire Ins. Co. of Am. v. So. Guar. Ins. Co. of Ga.*, 337 F. Supp.2d 1339, 1355 (N.D. Ga. 2004) (applying Georgia law) (holding that insurer was estopped from asserting no additional insured coverage to housing development owner where certificate of insurance issued by agent reflected owner as additional insured). Agents should also confirm that representations of additional insured status on certificates of insurance comport with the policies listed, since insurance agents can incur liability to the insured *and the insurer* for their representations. *See, e.g., Hollis v. Charlew Constr. Co., Inc.*, 754 N.Y.S.2d 756, 758 (N.Y. App. Div. 2003).

2. Insurance Lapses for Failure to Pay Premium

The additional insured should require in its contract with the named insured that the insurance company notify the additional insured of a policy cancellation and should ensure that the policy includes an endorsement requiring such notification.

3. Priority of Coverage

Both the general contractor and the subcontractor will usually each have two policies – one primary and one excess. The priority of coverage among these insurers often depends upon the existence of a valid and enforceable indemnity provision that is covered under the subcontractor's insurance policy. If the subcontract contains a valid and enforceable indemnity agreement that is covered as an insured contract under the subcontractor's policies, the subcontractor's primary insurer is entirely responsible for all amounts incurred by the general

contractor in defending against a covered lawsuit, and may not look to the general contractor's primary insurer for contribution. *See, e.g., American Indem. Lloyds v. Travelers Prop. & Cas. Ins. Co.*, 335 F.3d 429 (5th Cir. 2003). With respect to whether the subcontractor's excess or the general contractor's primary must pay next, the majority rule appears to be that the indemnity agreement controls this, too. *See St. Paul Fire & Marine Ins. Co. v. Am. Internat'l Specialty Lines Ins. Co.*, 365 F.3d 263, 277 (4th Cir. 2004) (holding that indemnitor's line of insurance must pay loss without contribution from indemnitee's own insurance); *Wal-Mart Stores, Inc. v. RLI Ins. Co.*, 292 F.3d 583, 590-92 (8th Cir. 2002) (same). California takes the opposite view, *i.e.* that the indemnitee's primary carrier must exhaust before the indemnitor's excess carrier is obligated to pay. *See JPI Westcoast Constr., L.P. v. RJS & Assocs., Inc.*, 68 Cal.Rptr.3d 91, 103-04 (Cal. App. 1st Dist. 2007) (holding that indemnitor's excess insurer allowed to subrogate against indemnitee's primary insurer); *Reliance Nat'l Indem. Co. v. General Star Indem. Co.*, 85 Cal. Rptr.2d 627, 639 (Cal. App. 2d Dist. 1999) (refusing to apply the indemnity exception to hold the indemnitor's excess insurer liable before the indemnitee's primary insurer, because to do so would allow the indemnitee's primary insurer to "shift the loss to an excess carrier which charged a lower premium").

Where there is no indemnity agreement, the insurers' respective obligations should be determined by their policies' "other insurance" clauses. Notably, ISO changed its CGL form's "other insurance" clause in 1998 to specifically address additional insured coverage. Form CG 00 01 now provides:

This insurance is excess over:

* * *

Any other primary insurance available to you covering liability for damages arising out of the premises or operations, or the products and completed operations, for which you have been added as an additional insured by attachment of an endorsement.

Section II: Contractual Liability Coverage

A. INTRODUCTION

In the context of risk allocation, no single issue may be of more significance than contractual liability coverage. An indemnity agreement is the foundation of contractual liability coverage and can potentially saddle an insured with tremendous additional exposure that was not contemplated at the time the policy was issued and premium dollars were accepted. Conversely, under the proper circumstances, an indemnity agreement can shift away losses that would otherwise be borne by the insured, and, ultimately, its insurance carrier. Even a valid indemnity agreement, however, may be of little practical benefit if contractual liability insurance does not support the indemnity obligation.

The purpose of this paper is to provide the reader with a fundamental understanding of both indemnity agreements and contractual liability coverage. It provides a framework to assist in determining whether a valid indemnity agreement exists, and also highlights coverage questions that are often associated with contractual liability insurance.

Because these issues frequently arise in the context of an owner/contractor or general contractor/subcontractor relationship, these coverage issues are discussed in the context of a commercial general liability policy.

B. THE BASIC INSURANCE PROVISIONS

In a standard ISO form commercial general liability policy, contractual liability coverage is normally provided through an exception to an exclusion. The exclusion in the pre-1996 ISO form (the changes in the 1996, 1998 and 2001 forms are discussed later in this paper) provides as follows:

This insurance does not apply to:

“Bodily injury” or “property damage” for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:

- (1) Assumed in a contract or agreement that is an “insured contract”, provided the “bodily injury” or “property damage” occurs subsequent to the execution of the contract or agreement; or**
- (2) That the insured would have in the absence of the contract or agreement.**

The term “insured contract” has several components under the standard ISO¹ commercial liability coverage form, including contracts for lease of premises, sidetrack agreements, and elevator maintenance agreements. In the context of an owner/contractor or general contractor/subcontractor relationship, the relevant portion of the definition is as follows:

¹ Insurance Services Office, Inc.

That part of any other contract or agreement pertaining to your business (including an indemnification of a municipality in connection with work performed for a municipality) under which you assume the tort liability of another party to pay for “bodily injury” or “property damage” to a third person or organization. Tort liability means a liability that would be imposed by law in the absence of the contract or agreement.

The most important aspect of contractual liability coverage is whether the party seeking indemnity (the “indemnitee”) has contractually required the other party (the “indemnitor”) to “assume the tort liability” of the indemnitee to pay for bodily injury or property damage to a third party; if not, no contractual liability coverage is afforded. In order to make a determination of this issue, an examination of the contractual arrangement between the indemnitor and indemnitee is required.

C. INDEMNITY AGREEMENTS

In most states, the shifting of risks through an indemnity agreement has generally been frowned upon. The vast majority of jurisdictions require an interpretation of indemnity language that is stricter than the standard applied to general contract language. Most states have adopted a “strict” or “clear and unequivocal” approach to interpreting contractual indemnity agreements. A handful of others engage in case-by-case analysis, while others apply the general “reasonable construction” or “plain language” contract analysis.

Applicability of the Contract

In evaluating the enforceability of an indemnity agreement, the threshold question is whether the contract between the indemnitor and the indemnitee applies to the claim or loss involved. Obviously, if the loss or claim is outside of the scope of the contract, the indemnity provision will not apply and no indemnity obligation exists. Determining whether the injury for which indemnity is claimed falls within the scope of the contract depends in large part on the jurisdiction in which the claim is brought and the language of the specific indemnity provision.

In determining whether the contract applies, courts have focused on whether the indemnitee's liability arose out of the work the indemnitor contracted to perform. This limitation is typically reflected in the contract language. If there is no causal connection between the indemnitee's liability and the work the indemnitor agreed to perform, the indemnity agreement should not apply. For instance, in *Joe Adams & Son v. McCann Constr. Co.*, 475 S.W.2d 721, 722 (Tex. 1971), the general contractor, McCann, sought indemnity from the subcontractor, Joe Adams & Son. Joe Adams was a concrete subcontractor for McCann. McCann had erected wooden forms extending above ground level, and Joe Adams' employees were pouring concrete into these forms. While the concrete was being poured, the forms collapsed, injuring three of Joe Adams' employees. The injured workers recovered against McCann, and McCann then sought indemnity from Joe Adams under an indemnity clause which required Joe Adams to provide indemnity for damage or injuries “through or on account of any act or in connection with the work of [Joe Adams].” McCann contended that the injuries occurred while the concrete was being poured and that the filling of the forms was the immediate cause of the collapse; consequently, the indemnity provision was applicable. The Texas Supreme Court disagreed, holding that McCann's liability arose from an accident “that was proximately caused by its own want of care, and there is no suggestion that Adams or anyone under its supervision or control was at fault in any way.” The court explained that indemnity provisions within a contract “are

usually primarily to protect a general contractor against loss or liability resulting from operations or physical conditions over which he has no control and which are under the control of the subcontractor.” Since Adams had no control or authority over the concrete forms, the supreme court found that indemnity was inappropriate.²

Similarly, in *Martin Wright Elec. Co. v. W.R. Grimshaw Co.*, 419 F.2d 1381 (5th Cir. 1969), the Fifth Circuit held that indemnity was not owed under a subcontract for payments made by a general contractor to the estate of a subcontractor's employee, who sustained fatal injuries. At the time of the accident, the employee had just finished storing tools, and, while leaving the area, tripped and fell over a dowel. The Fifth Circuit first rejected an argument that the indemnity agreement applied because the employee was in the scope of his employment at the time of his injury. The court found this fact did not necessarily answer the question of whether the employee's injuries arose in the performance of work within the contemplation of the indemnity clause. After examining the other facts, the court concluded that no indemnity was owed and explained as follows:

The injury to [the subcontractor's employee] in the instant case was caused by the negligence of Grimshaw [the indemnitee], and the lighting in the basement area, the wire mesh, the metal dowel nor Grimshaw's omissions in regard to them causing the injuries had any relation to, connection or involvement with the performance by Wright [the indemnitor] of the work covered by the subcontract, and Wright is not liable to Grimshaw under the indemnification provisions of the subcontract.

Courts in other jurisdictions have answered this kind of question more broadly, and more often find indemnity is owed. For example, in *Vitty v. D.C.P. Corp.*, 633 A.2d 1040 (N.J. Super. App. Div. 1993), the court found that D.C.P., who operated a tow truck service, was bound by an indemnity agreement to defend and indemnify the New Jersey Highway Association. A D.C.P. truck driver was killed on the job, when a drunk driver struck another car on the highway, jumped a median, became airborne, and landed on the tow truck that was legally parked at a U-turn post. D.C.P. argued that the driver, although on duty, was not engaged in towing or wrecking activities when the accident occurred, therefore the indemnity agreement of the contract for towing and wrecking services did not apply. The court rejected this argument, looking to the language of the agreement, which provided indemnity for claims “arising out of” the contract:

[W]e reject the contention that the phrase “arising out of” requires that the injury or property damage sustained must be the direct and proximate result of the performance of towing services in order for the indemnification clause to be triggered. Specifically, the license does not require that the claim of the injured party be directly and proximately caused by the operation of a tow truck in transit. Instead, the words “arising out of” should be construed in accordance with their common and ordinary meaning as referring to a claim “growing out of” or having its “origin in” the subject matter of the towing agreement. . . . So interpreted, there

² In *Joe Adams*, the court also adopted the “clear and unequivocal” test for establishing the validity of indemnity agreements. This test was overruled by the Texas Supreme Court in *Ethyl Corp. v. Daniel Constr. Co.*, 725 S.W.2d 705, 708 (Tex. 1987), in which the court adopted the “express negligence” test. *Ethyl Corp.* did not, however, discuss the “causal connection” issue and thus, that standard remains intact.

need be shown only a *substantial nexus* between the property damage or injury alleged in the claim and the activities encompassed in the towing contract.

Id. at 1012-43 (citations omitted) (emphasis added). The New Jersey court found that merely being engaged in activities related to those specifically contracted for at the time of the accident was sufficient to make the indemnity clause applicable to the claim.

Muirhead v. Transworld Drilling Co., 469 So.2d 474 (La. App. 3 Cir. 1985) offers an even more severe example of broad indemnity application. Aminoil and Transworld entered into a drilling contract under which Transworld would furnish a portable drilling unit and platform tender and have certain personnel on the rig. Aminoil was required to furnish the shore base where Transworld employees would park their cars, then board helicopters or boats to transport them offshore. Muirhead, a Transworld employee, was injured when he fell while walking across the shore base from the helicopter to his car. Muirhead sued Transworld and Aminoil, and Aminoil sought indemnity from Transworld under the contract. The indemnity agreement at issue applied to any and all claims “occurring, growing out of, incident to, or resulting directly or indirectly from” Transworld’s work. Transworld argued that Muirhead was not working when he fell, and further, the shore base on which he fell was explicitly Aminoil’s responsibility. The court disagreed and found that Muirhead was required to walk across the shore base as part of his work for Transworld. Specifically rejecting the narrower construction of indemnity agreements in Texas, the court found that the injury was caused, “directly or indirectly,” from Muirhead’s work with Transworld; therefore, the indemnity agreement was applicable to his claim.

In a more recent case from Alaska, the court found an indemnity agreement applied, even though the contract specifically excluded the work which allegedly caused the injury. In *Hoffman Const. Co. of Alaska v. U.S. Fabrication & Erection, Inc.*, 32 P.3d 346 (Alaska 2001), Providence Hospital contracted with Hoffman Construction for new construction and renovation on the Providence Hospital campus. The parties removed asbestos abatement responsibilities from the contract, although Hoffman retained the duty to coordinate its work and the work of its subcontractors on the asbestos abatement. One of the Hoffman subcontractors was U.S. Fabrication & Erection (USFE), who performed steel erection work on the South Tower simultaneous with asbestos abatement being performed on the same tower. Four USFE employees brought suit alleging they had been exposed to asbestos while working on the south tower. Providence sought indemnity in the suit, based on its contract with Hoffman providing indemnity for any claim “arising out of . . . the performance of this Construction Contract, regardless of whether or not it is caused in part by a party indemnified hereunder.”

The court found that the plaintiffs’ claims were within the scope of the indemnity clause, since Alaska has “interpreted similar indemnity clauses very broadly in the past and found that an employee’s claims ‘arise out of’ an indemnitor’s performance if the injury occurs when the employee is on the job that is the subject of the indemnification agreement.” Because the plaintiffs were USFE employees working under the Hoffman subcontract, their claims arose out of Hoffman’s performance on the Providence contract. Accordingly, the Hoffman-Providence indemnity provision applied to their claims.

Parties wanting indemnification often attempt to draft provisions requiring indemnity in certain scenarios (such as injuries of the indemnitee’s employees), regardless of whether a causal connection exists between the indemnitee’s exposure and the indemnitor’s work. In most instances, however, whether the indemnity agreement applies will depend on the law of the state

applicable to the contract and may require a fact-intensive inquiry, by a judge or even a jury. If the facts of a particular case indicate that the indemnitee's liability is unrelated to the work the indemnitor has contracted to perform or outside the scope of work for which indemnity exists, the indemnitor may be able to successfully argue that no indemnity is owed.

The "Clear and Unequivocal" Interpretation

Once the indemnity provision is found to potentially apply to the claim or loss, a court must determine whether the provision is valid and enforceable. Jurisdictions have adopted varying methods to make this determination, but by far the most common is the "clear and unequivocal" approach. In jurisdictions adopting this approach, also referred to as "strict construction," the primary concern involves situations in which the indemnitor would be liable for the indemnitee's sole negligence. The courts recognize that indemnity agreements are an intentional assignment or shifting of risk by parties to a contract. The issue that arises is whether the indemnitor should be required to indemnify the indemnitee for its sole negligence when the indemnitor might not have intended this result. Accordingly, many courts have decided that an indemnification agreement must clearly and unequivocally state that the parties contemplated and agreed to indemnify the specific situation in which indemnity is sought, including instances in which the indemnitee is solely responsible.

Courts in states adopting this rule have reached different methodologies for how it should be applied—some require a consideration of the bargaining power or sophistication of the parties, while others will only allow indemnity agreements in certain situations, like construction. But the common element is that courts will not enforce an indemnity agreement unless the language is unequivocally clear that the parties intended for the indemnitor to be responsible for the indemnitee's sole negligence.

Construction Contracts

Contractual indemnity agreements are common in contracts for construction work, and most states use a form of the "clear and unequivocal" approach to determine whether an indemnity agreement is valid in a construction situation. This standard has been sanctioned by the U.S. Supreme Court, and applied in a construction context, in *U.S. v. Seckinger*, 397 U.S. 203 (1970). In that case, an employee of a plumbing contractor was injured while working on a U.S. government project. Because the injury was allegedly due to the government's negligence, the employee sued the United States, and the government sought indemnity from the plumbing contractor based on the following clause: "[h]e (the contractor) shall be responsible for all damages to persons or property that occur as a result of his fault or negligence in connection with the prosecution of the work."

The Court rejected the government's argument that the contractor was required to provide indemnification for the government's sole negligence. The Court stated that where the parties intend that the indemnitee be indemnified for its sole negligence, such intent must be "clearly and unequivocally indicated." The Court found that the language before it did not contain such a clear and unequivocal intention, noting that the indemnity clause required the contractor to indemnify the government only to the extent of the contractor's negligence.

Since *Seckinger*, many cases have applied the "clear and unequivocal" test to determine an indemnity agreement's validity. Several recent cases are described below:

The Fifth Circuit applied Louisiana’s “clear and unequivocal” approach in *Dowling v. Georgia-Pacific Corp.*, 302 Fed.App. 283, (5th Cir. 2008). KBR contracted with owner Georgia-Pacific to perform work at one of Georgia-Pacific’s facilities. Dowling, a KBR employee, was injured while working pursuant to the contract:

Dowling filed suit against Georgia-Pacific, alleging her injuries were the result of Georgia-Pacific’s negligence. Georgia-Pacific filed a Third-Party Complaint against KBR and Pacific Employees Insurance Company, KBR’s insurer, alleging KBR was required to defend and indemnify Georgia-Pacific against Dowling’s claims. KBR filed a counterclaim against Georgia-Pacific alleging Georgia-Pacific’s negligence was the cause of Dowling’s injuries and that under the terms of the contract, Georgia-Pacific was required to reimburse KBR for the costs related to its defense of Dowling’s claims. In April 2007, Georgia-Pacific settled Dowling’s claims. KBR did not participate in the settlement. The settlement did not make any allocation of fault as between Georgia-Pacific and KBR.

Dowling at 284 (footnote omitted). The court looked to the language of the indemnity agreement to determine if it was sufficiently “clear and unequivocal” to allow full indemnity of Georgia-Pacific. The specific indemnity clause stated: “[t]o the extent the Loss is caused, in part, by the joint, concurrent or contributory negligence of G-P, its agent or employees, Contractor shall provide said indemnification *to the extent or degree Contractor is the cause of or liable for the Loss.*” *Id.* at 286 (emphasis in original). The court determined that the agreement limited KBR’s indemnity obligation to the degree of its own fault, therefore the language did not clearly and unequivocally allow Georgia-Pacific’s indemnity for its sole negligence.

In *Boulder Plaza Residential, LLC v. Summit Flooring, LLC*, 198 P.3d 1217, (Colo.App. 2008), the court applied a commonly cited corollary of the “clear and unequivocal” rule, stating that the indemnity agreement does not necessarily have to include the word “negligence” to be considered clear and unequivocal. In *Boulder Plaza*, the construction managers, BPR, hired McCrerey as a general contractor to build several residential condo units. McCrerey subcontracted installation of hardwood floors to Summit. The floors were installed improperly, at great cost to the project, and largely could not be repaired. BPR sued McCrerey and Summit, who filed numerous counter and cross-claims against BPR and one another. One of the claims between the parties was that Summit was required to indemnify McCrerey pursuant to an indemnity agreement in the subcontract. BPR settled with McCrerey, McCrerey assigned BPR its rights against Summit, and the case between BPR and Summit went to trial. The trial judge determined that a finding of Summit’s fault was required as an element of contractual indemnity. The jury failed to find Summit was negligent, and, therefore, returned a verdict against BPR on the contractual indemnity claim.

On appeal, BPR argued that the indemnity provision did not require a showing of Summit’s negligence, and that Summit had an obligation to indemnify even if it was not negligent. Citing Colorado’s strict construction of indemnity agreements, the court considered the language requiring Summit to indemnify McCrerey “against all claims for damage to persons and property *growing out of the execution of the work . . .*” *Id.* at 1221-22 (emphasis in original). While acknowledging Colorado’s rule that the indemnity provision need not include the word “negligence” to be enforceable, the language in the subject contract specifically limited the indemnity obligation to claims growing out of Summit’s own work. Therefore, the provision

was not sufficiently broad to require Summit to indemnify BPR absent a showing that Summit was at least partially negligent.

Because of rigid standards used by most courts in applying the “clear and unequivocal” test, there are far more published cases in which an indemnity agreement was held to be unenforceable than cases in which the agreement was upheld. In a recent Missouri case, however, the court enforced an indemnity agreement, finding that the language was sufficiently broad to clearly and unequivocally apply to a contractor’s sole negligence. In *Utility Service and Maintenance, Inc. v. Noranda Aluminum, Inc.*, 163 S.W.3d 910 (Mo. 2005), Utility contracted with Noranda to do industrial painting at a new Noranda manufacturing facility. As part of the contract, Utility agreed to Noranda’s standard terms and conditions, which included an indemnity agreement stating:

Seller [Utility] shall indemnify and save Purchaser [Noranda] free and harmless from and against any and all claims, damages, liabilities or obligations of whatsoever kind, including, but not limited to, damage or destruction of property and injury or death of persons resulting from or connected with Seller’s performance hereunder or any default by Seller or breach of its obligations hereunder.

Id. at 911-12. A Utility employee was severely injured while working under the Utility-Noranda contract, and sued Noranda, alleging its negligence caused his injuries. Citing the indemnity provision, Noranda requested defense and indemnity from Utility, who passed the claim on to its insurer, TIG. TIG assumed the defense and settled on Noranda’s behalf, then sought a declaratory judgment that the indemnity agreement was unenforceable.

The Missouri Supreme Court decided that the indemnity language clearly and unambiguously applied to claims “including, but not limited to,” Utility’s performance. The court found there was nothing ambiguous about a requirement that one party indemnify the other for “any and all claims” in a commercial contract. Claims for Noranda’s negligence were within the phrase “any and all claims.”

Other Contracts

While indemnity provisions are very common in construction-related contracts, they can be, and often are, included in other types of agreements. *E.g.* *Azurak v. Corporate Property Investors*, 790 A.2d 956 (N.J. Super. App. Div. 2002) (contract between mall and janitorial company for janitorial services); *Vitty v. D.C.P. Corp.*, 633 A.2d 1040 (N.J. Super. App. Div. 1993) (contract between state highway authority and tow truck company for towing and wrecking services); *Duty Free Shoppers Group Ltd. V. State*, 777 P.2d 649 (Alaska 1989) (lease contract between state and shop at airport). State courts will generally apply the same interpretation rules to construction and non-construction contracts, though a few states have statutes limiting the type of contract in which an indemnity provision may be included. These statutes are discussed in more detail below.

Texas's Approach to Validity of the Indemnity Agreement

Under Texas law, parties may contract to redistribute future liability unless the agreement is unconstitutional, violates statutory law or is against public policy. See *Valero Energy Corp. v. M.W. Kellogg Const. Co.*, 866 S.W.2d 252 (Tex. App. – Corpus Christi 1993, writ denied). Texas strictly construes the language of the agreement, but has also adopted two “fair notice” requirements for determining whether the agreement is valid—this two-step test is stricter than most other states. See *Ethyl Corp. v. Daniel Constr. Co.*, 725 S.W.2d 705, 708 (Tex. 1987); *Dresser Industries, Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505, 508 (Tex. 1993). An indemnity agreement is valid and enforceable only if the indemnity agreement satisfies both the “express negligence” test and “conspicuousness” requirements. *U.S. Rentals, Inc. v. Mundy Serv. Corp.*, 901 S.W.2d 789, 791 (Tex. App. – Houston [14th Dist.] 1995, writ denied). In an opinion that recently reaffirmed the “fair notice” requirements, the Texas Supreme Court noted that these requirements exist and are enforced because of the “extraordinary risk-shifting” that is inherent in indemnity agreements. *Storage & Processors, Inc. v. Reyes*, 134 S.W.3d 190, 193 (Tex. 2004). The Texas Supreme Court underscored the necessity for the “fair notice” requirements in indemnity agreements because of the possibility of the indemnitee avoiding liability for its sole negligence. The Court specifically reserved the two-part test for agreements involving an “extraordinary” degree of risk.

The Express Negligence Test

In the landmark decision, *Ethyl Corp. v. Daniel Constr. Co.*, the Supreme Court of Texas adopted the “express negligence” test for cases involving contractual indemnity. 725 S.W.2d 705. Under this test, a party seeking to be indemnified for the consequences of its own negligence must express that intent in specific terms. The indemnity provision in question in *Ethyl* stated as follows:

Contractor shall indemnify and hold owner harmless against any loss or damage to persons or property as a result of operations growing out of the performance of this contract and caused by the negligence or carelessness of Contractor, Contractor's employees, Subcontractors, and agents or licensees.

Applying the “express negligence” test, the court found that this indemnity language did not expressly provide that the indemnitee (the owner) was to be indemnified for its own negligence. Therefore, the court concluded that the indemnity agreement was not enforceable against the indemnitor (the contractor).

Under *Ethyl*, courts also held that indemnity would be limited to the extent of liability assumed – in other words, assumption of concurrent or comparative negligence will not extend to sole negligence. See, e.g., *Amoco Oil v. Romaco, Inc.*, 810 S.W.2d 228, 229 (Tex. App.–Houston [14th Dist.] 1999, no writ); *Jobs Bldg. Serv., Inc. v. Rom, Inc.*, 846 S.W.2d 867, 870 (Tex. App.–Houston [1st Dist.] 1992, writ denied). In another important decision, the Texas Supreme Court concluded that it is not necessary for an indemnitee to differentiate among the various degrees of negligent conduct (sole, joint, concurrent, etc.) in order to be entitled to indemnity for the consequences of its own negligence. *Atlantic Richfield Co. v. Petroleum Personnel, Inc.*, 768 S.W.2d 724 (Tex. 1989). In *Atlantic Richfield*, the court found that the contractual language “including, but not limited to, any negligent act or omission of [the indemnitee]” met the express negligence standard

Since the *Ethyl* decision, the Texas Supreme Court and various Texas Courts of Appeals have rendered numerous opinions interpreting whether specific indemnity provisions complied with the “express negligence” standard. Most courts have applied the “express negligence” standard broadly, holding that if any doubt exists as to whether the indemnity provision expressly provides that the indemnitee is to be indemnified for its own negligence, the indemnity agreement is not valid under Texas law.³

The “Conspicuousness” Test

To be enforceable under Texas law, in most instances, an indemnity agreement must also pass the “conspicuousness” requirement. Although this test had been discussed in prior opinions, in the case of *Dresser Ind., Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505 (Tex. 1993), the Texas Supreme Court incorporated this test and the “express negligence” test into the “fair notice” requirements.

In *Dresser*, the court adopted the standard for conspicuousness of documents contained in the Uniform Commercial Code for warranty agreements. Under this standard, an indemnity clause or release agreement is considered conspicuous “. . . when a reasonable person against whom the clause is to operate ought to have noticed it.” Applying this standard, the *Dresser* court held that a release agreement contained in Dresser Industries’ contract did not meet the conspicuousness standard because it was located on the back of the contract in a series of eighteen numbered paragraphs without headings or contrasting type. The court concluded that the release paragraphs were not conspicuous, and therefore, were unenforceable under Texas law. See also *U.S. Rentals, Inc. v. Mundy Service Corp.*, 901 S.W.2d 789, 792 (Tex. App.—Houston [14th Dist.] 1995; writ denied) (finding that an indemnity agreement did not meet the “conspicuousness” requirement; the provision was the seventh of fifteen unrelated provisions set forth on the back of a written contract, and the heading and text of all fifteen provisions were printed in the same respective sizes and types). The *Dresser* court noted that a printed heading in capitals is considered conspicuous and language in the body of a form is conspicuous if it is in larger type or other contrasting type or color.

Notably, the *Dresser* court recognized an exception to the “conspicuousness” requirement, if the indemnitee establishes that the indemnitor possessed actual notice or knowledge of the indemnity agreement. *Dresser*, 853 S.W.2d at 508, fn. 2. Therefore, if the indemnitor is aware of the indemnity agreement at the time it executes the pertinent contract, the “conspicuousness” test is not applicable. See, e.g., *McGehee v. Certainteed Corp.*, 101 F.3d 1078 (5th Cir. 1996) (holding that indemnity provision in contract did not comply with “conspicuousness” standard; however, fact question existed as to whether indemnitor had actual knowledge of indemnity agreement, precluding summary judgment in favor of indemnitor).

³ Unfortunately, however, there is no “bright-line” test for determining whether the language of an indemnity agreement complies with the “express negligence” test, and, in fact, the results reached by a few courts on this issue seem somewhat inconsistent. E.g. *Banner Sign & Barricade, Inc. v. Price Construction, Inc.*, 94 S.W.3d 692, 694 – 97 (Tex. App. – San Antonio 2002, pet denied); *Banzhaf v. ADT Sec. Sys. S.W., Inc.*, 28 S.W.3d 180 (Tex. App.—Eastland 2000, review denied); *Tri-State Ins. Co. v. Rogers-O’Brien Constr. Co.*, 1997 WL 211534 (Tex. App.—Dallas, April 30, 1997); *Glendale Constr. v. Accurate Air Sys.*, 902 S.W.2d 536, 539 (Tex. App.—Houston [1st Dist.] 1995, writ denied); *Enserch Corp. v. Parker*, 794 S.W.2d 2 (Tex. 1990); *Amoco Oil Co. v. Romaco, Inc.*, 810 S.W.2d 228 (Tex. App.—Houston [14th Dist.] 1989, no writ).

The *Dresser* court, and many opinions since *Dresser*, also referred to definition of “conspicuous” found in the Uniform Commercial Code and TEX. BUS. & COM. CODE ANN. § 1.201(10):

(10) "Conspicuous," with reference to a term, means so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it. Whether a term is "conspicuous" or not is a decision for the court. Conspicuous terms include the following:

(A) 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

(B) 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.

This statute provides a general idea of what should be considered “conspicuous,” but ultimately leaves the decision to the court’s discretion. This allows courts to consider the specific and perhaps unique facts of a case before them, and weigh certain factors accordingly.

Anti-Indemnity Statutes

As discussed above, common law generally allows contracting parties to allocate the legal consequences of either party’s negligence between them. While such transfers were at one time looked upon with skepticism and regarded as being against public policy, such considerations have, for the most part, been limited or abandoned completely. Many states have passed laws, however, that define the extent to which such risk transfers can be incorporated into a contract. These so-called “anti-indemnity” statutes pertain for the most part to construction contracts, because it is thought that participants in a hazardous activity like construction should be held to a high degree of accountability for their own negligent behavior. In states in which oil and gas production is prominent, similar statutes restrict the scope of permissible indemnification in oil and gas production contracts.

Construction Anti-Indemnity Statutes

States that restrict indemnity agreements in contracts for construction-related activities permit either (1) indemnification to the extent of the indemnitor’s negligence or (2) indemnification for the concurrent negligence of the indemnitor and the indemnitee. These statutes prohibit indemnification for the indemnitee’s sole negligence. In addition to the type of indemnity the statutes allow, they may also distinguish between public and private construction contracts.

Alaska, Arizona, Arkansas, California, Georgia, Hawaii, Idaho, Indiana, Maryland, Massachusetts, Michigan, New Jersey, Pennsylvania, South Carolina, South Dakota, Tennessee,

Utah, Virginia, Washington, and West Virginia have statutes allowing indemnity for concurrent negligence of indemnitor and indemnitee.

As an example, the Arkansas statute pertaining to all construction contracts reads in relevant part:

- (b) A clause in a construction agreement or construction contract entered into after July 31, 2007 is unenforceable as against public policy to the extent that a party to the construction contract or construction agreement is required to indemnify, defend, or hold harmless another party against:
 - (1) Damage from death or bodily injury to a person arising out of the sole negligence or fault of the indemnitee, its agent, representative, subcontractor, or supplier; or
 - (2) Damage to property arising out of the sole negligence or fault of the indemnitee, its agent, representative, subcontractor, or supplier.
- (c) A provision or understanding in a construction agreement or construction contract that attempts to circumvent this section by making the construction agreement or construction contract subject to the laws of another state is unenforceable as against public policy.
- (d) A clause described under subsections (b) and (c) of this section is severable from the construction agreement or construction contract and shall not cause the entire construction agreement or construction contract to become unenforceable.

A.C.A § 4-56-104.

Other states will allow indemnification only to the extent the indemnitor is negligent. These states include Arizona, California, Colorado, Connecticut, Delaware, Florida, Illinois, Kansas, Kentucky, Louisiana, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, and Texas.

For example, the Colorado statute applying to all construction contracts provides in relevant part:

- (1) In an action brought as a result of a death or an injury to person or property, no defendant shall be liable for an amount greater than that represented by the degree or percentage of the negligence or fault attributable to such defendant that produced the claimed injury, death, damage, or loss, except as provided in subsection (4) of this section.

Colo. Rev. Stat. § 13-21-111.5

Arizona and California, like many states, have different statutes for different types of construction contracts. Several states have separate statutes for public and private construction

(California distinguishes residential, rather than public/private, construction contracts). Most states place the same restrictions on public and private indemnity contracts. However, Arizona permits indemnity of the indemnitor's negligence in public contracts and concurrent negligence in private contracts. California statutes allow indemnity for the indemnitor's negligence in residential construction, but allow indemnity for concurrent negligence in all other construction contracts.⁴

Oil Field Anti-Indemnity Statutes

Wyoming, New Mexico, Louisiana, and Texas have laws restricting indemnification agreements as part of oil field and mining contracts. The Wyoming and New Mexico statutes invalidate most oilfield indemnity agreements. The Louisiana statute restricts certain applications of indemnity agreements, and the Texas statute prohibits indemnity agreements which are not backed by insurance coverage.

The requirements for a valid oil field indemnity agreement are more strict in Texas than in any other state, because the agreement must comply with the statutory requirements and the "fair notice" requirements, as discussed above. As a result, many contracting parties now formulate indemnity agreements in compliance with Texas law, even if little or no work will be performed in Texas.

D. COVERAGE ISSUES

In attempting to determine whether contractual coverage is available, it is important to keep in mind that: (1) the coverage is provided to the named insured, and not the indemnitee, and (2) virtually all of the limitations and conditions to coverage that apply to a direct claim for insurance by the insured also apply in the context of contractual liability insurance. The claim must involve "bodily injury" or "property damage" caused by an "occurrence" and meet the other requirements of the insuring agreement to Coverage A of the policy. Also, most of the exclusions in a liability policy, with the general exception of the "employer's liability" exclusion, apply to the contractual liability coverage. For example, if an indemnitee is seeking indemnity from an insured for liability that clearly involves bodily injury or property damage arising out of pollution, the policy's "pollution exclusion" may bar coverage. Of course, these types of coverage issues should be analyzed for any claim or suit involving an insured.

Because of the tripartite relationship among the insurer, the insured, and the third-party indemnitee, several unique coverage issues may arise. The remainder of this paper will focus on these issues.

The Indemnitee's Defense Costs

Several years ago a major issue concerning contractual liability insurance was whether coverage is afforded for defense costs incurred by the indemnitee. The 1996 commercial general liability coverage form (CG 00 01 96) issued by ISO clarifies this issue to some degree. (For

⁴ At the time this paper was written, the Texas legislature was considering bills that would make indemnity provisions in construction contracts void and unenforceable, except for a claim arising from the bodily injury or death of any employee of the indemnitor. The SB 555 passed in the Texas Senate, and is HB 818 currently under consideration in the House committee. The statute would apply to any construction contract for property in Texas, irrespective of choice-of-law in the contract.

policies with ISO forms preceding the 1996 form this issue is unresolved.) The 1996 ISO form (carried through to the 1998 and 2001 ISO forms) added language intended to clarify the issue of whether defense costs are covered. The ISO form provides the following relevant provision in regard to contractual liability coverage:

(1) This insurance does not apply to:

“bodily injury” or “property damage” for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:

*** * ***

(2) Assumed in a contract or agreement that is an “insured contract”, provided the “bodily injury” or “property damage” occurs subsequent to the execution of the contract or agreement. Solely for the purposes of liability assumed in an “insured contract”; reasonable attorney fees and necessary litigation expenses incurred by or for a party other than an insured are deemed to be damages because of “bodily injury” or “property damage”; provided

- (a) Liability to such party for, or for the cost of, that party’s defense has also been assumed in the “insured contract”; and**
- (b) Such attorney fees and litigation expenses are for defense of that party against a civil or alternative dispute resolution proceeding in which damages to which this insurance applies are alleged.**

Under these provisions, defense costs incurred by an indemnitee are covered by a CGL policy if: (1) the indemnity agreement between the insured and the indemnitee requires the insured to indemnify defense costs; and (2) the defense costs are incurred in a civil or alternative dispute resolution proceeding in which the damages (bodily injury or property damage) is otherwise covered by the policy. Thus, if the indemnity agreement does not specifically indicate that indemnification of defense costs is required or if the underlying damages are not covered by the policy, the indemnitee’s defense costs are not covered by the policy.

Indemnitee’s Defense Costs - “Expense” or “Loss” Item

Assuming the indemnitee’s defense costs are covered or that the insurer merely agrees to pay those defense costs, an issue arises as to whether those costs are treated as an “expense” item and fall under the “supplementary payments” part of the policy or whether the costs are a “loss” item and reduce the policy limits.

The pre-1996 ISO forms did not address this issue. The 1996 and subsequent ISO forms include language in the “supplementary payments” section of the policy, explaining when an indemnitee’s defense costs will be considered a “supplementary payment” or “expense” item and will not reduce the limits:

SUPPLEMENTARY PAYMENTS – COVERAGES A AND B

*** * ***

- 2. If we defend an insured against a “suit” and an indemnitee of the insured is also named as a party to the “suit”, we will defend that indemnitee if all of the following conditions are met:**

- a. The “suit” against the indemnitee seeks damages for which the insured has assumed the liability of the indemnitee in a contract or agreement that is an “insured contract”;
- b. This insurance applies to such liability assumed by the insured;
- c. The obligation to defend, or the cost of the defense of, that indemnitee, has also been assumed by the insured in the same “insured contract”;
- d. The allegations in the “suit” and the information we know about the “occurrence” are such that no conflict appears to exist between the interests of the insured and the interests of the indemnitee;
- e. The indemnitee and the insured ask us to conduct and control the defense of that indemnitee against such “suit” and agree that we can assign the same counsel to defend the insured and the indemnitee; and
- f. The indemnitee:
 - (1) Agrees in writing to:
 - (a) Cooperate with us in the investigation, settlement, or defense of the “suit”;
 - (b) Immediately sends us copies of any demands, notices, summonses or legal papers received in connection with the “suit”;
 - (c) Notify any other insurer whose coverage is available to the indemnitee; and
 - (d) Cooperate with us with respect to coordinating other applicable insurance available to the indemnitee; and
 - (2) Provides us with written authorization to:
 - (a) Obtain records and other information related to the “suit”; and
 - (b) Conduct and control the defense of the indemnitee in such “suit”.

So long as the above conditions are met, attorneys’ fees incurred by us in the defense of that indemnitee, necessary litigation expenses incurred by us and necessary litigation expenses incurred by the indemnitee at our request will be paid as Supplementary Payments. Notwithstanding the provisions of Paragraph 2.b.(2) of Section I – Coverage A – Bodily Injury And Property Damage Liability, such payments will not be deemed to be damages for “bodily injury” and “property damage” and will not reduce the limits of insurance.

Our obligation to defend and insured’s indemnitee and to pay for attorneys’ fees and necessary litigation expenses as Supplementary Payments ends when:

- a. We have used up the applicable limit of insurance in the payment of judgments or settlements; or

b. The conditions set forth above, or the terms of the agreement described in Paragraph f. above, are no longer met.

Although this change to the policy appears to be significant, given the extent of the conditions and requirements, its impact has generally been minimal.

Possibly the greatest hurdle to overcome is set forth in the very first paragraph, requiring both the insured and the indemnitee be defendants in the same lawsuit. Often, the insured is not a party to the lawsuit because the insured's employee is the claimant bringing the suit, and a state's workers compensation laws will prohibit a direct suit against the employer. In this instance, the provisions would not apply, and the defense costs would be considered a "loss" item, reducing the limits.

Another major obstacle is that the provisions require that "no conflict appears to exist between the interest of the insured and the interest of the indemnitee," and the indemnitee and the insured agree that the insurer can assign the same counsel to defend both parties. In a case in which both the insured and the indemnitee are defendants in the suit, which would usually involve a claim by a party not employed by the insured, conflicts of interest certainly can, and often do, exist. For instance, if the indemnitee is entitled to indemnity for damages caused by its concurrent negligence, but not its sole negligence, the indemnitee will almost certainly attempt to place a portion of the responsibility on some other party—possibly the insured/indemnitor. Under this scenario, a conflict would exist and separate counsel would be required for each party. Again, the indemnitee would be unable to comply with this condition and defense cost incurred by the indemnitee would reduce the policy limits.

Possibly the most problematic aspect of the revision is the requirement that the indemnitee notify any "other insurer whose coverage is available to the indemnitee" and cooperate with the insurer with respect to "coordinating other applicable insurance available to the indemnitee." The drafters of the provision may have intended that the indemnitee notify only the insurers of other indemnitors (such as other contractors that may have indemnity agreements with the indemnitee) and cooperate with the insurer in coordinating coverage under those policies. Certainly, however, it appears that the intent of the provision is to include insurance coverage that is directly available to the indemnitee. Few, if any, indemnitees are likely to agree with this condition since the entire purpose of an indemnity agreement is to shift the risk involved to the indemnitor or the indemnitor's insurers. Further, as explained below, contribution by the indemnitee's own insurer completely ignores the fact that the indemnitee, or its insurer, is not ordinarily subject to the "other insurance" provision of the indemnitor's CGL policy.

Other Insurance

Typically, a commercial liability policy includes an "Other Insurance" clause with the following introductory language:

If other valid and collectible insurance is available to *the insured*, for a loss recovered under Coverages A or B of this Coverage Part, our obligations are limited as follows

(Emphasis added).

The policy indicates that the term “insured” means any person or organization qualifying as such under the “Who is an Insured” section of the policy. An indemnitee does not qualify under this section and, therefore, is not an insured. Thus, the “other insurance” provisions of the policy do not apply in the context of contractual liability coverage, and the insurer of the indemnitor generally has no right of contribution from the indemnitee’s insurer.

Occasionally, a dispute may arise over the allocation of defense costs and indemnity when the indemnitee under an enforceable indemnity agreement also qualifies as an additional insured under the indemnitor’s policy. In that circumstance, the indemnitor’s insurer may argue that, because of the additional coverage, it is entitled to seek contribution from the indemnitee’s insurer under the “other insurance” clause, irrespective of the valid indemnity agreement. The Fifth Circuit, however, interpreting Texas law, held that the indemnitor’s insurer does not have a claim for contribution in this context. *See American Indem. Lloyds v. Travelers Prop. & Cas. Ins. Co.*, 335 F.3d 429, 436 (5th Cir. 2003). The court agreed with the rationale of other jurisdictions addressing the issue, concluding that the indemnity agreement should control. *Id.* If the “other insurance” provisions were to be determinative, the parties’ indemnity agreement would be negated and impose liability on the indemnitee’s insurer when the indemnitee had specifically bargained to avoid that result as part of the consideration in its contract.

E. CONCLUSION

While this paper is by no means an exhaustive analysis of all the issues involving contractual liability coverage and indemnity agreements, it has attempted to provide the reader with a basic understanding of how this coverage operates. Hopefully, the information will provide a useful tool in evaluating risk transfer and will be of assistance in attempting to shift risk to another party or in attempting to restrict the shifting of risk to an insured, depending upon the goal desired.

As is evident from the paper, however, contractual liability coverage generally involves complicated issues, not only from the standpoint of determining whether the indemnity agreement is valid, but in evaluating whether coverage is afforded under the policy. The answers to many of the questions are fact-intensive, and often there are no easy answers. Many of the cases cited above evidence this uncertainty, as even the courts have difficulty assessing these issues and have often reached inconsistent conclusions. Therefore, although this paper may prove helpful, each claim should be evaluated under its own facts, and if questions arise, a legal opinion should be obtained.

Section III: Other Insurance

A. INTRODUCTION

When an insured has more than one policy that provides coverage for a claim, courts generally examine the “other insurance” clause in the policies to determine the order in which two or more policies must respond. When the “other insurance” clause in the policies are not deemed mutually repugnant, courts generally apply the clauses as written.

The minority approach is that all “other insurance” clauses regardless of their nature are mutually repugnant. The minority approach stems from the decision in *Lamb-Westin, Inc. v. Oregon Auto. Ins. Co.*, 219 Or. 110, 341 P.2d 110, *modified and rehearing denied*, 219 Or. 129, 346 P.2d 643 (1959). In *Lamb-Weston*, the court was confronted with two co-insuring primary policies, one which contained an excess clause and the other a pro-rata clause. The court found that “whether one policy uses one clause or another, when any come in conflict with the other insurance clause of another insurer, regardless of the nature of the clause, they are in fact repugnant and each should be rejected *in toto*.” *Id.* at 119. Several courts have followed the minority rule. *See e.g., State Farm Mut. Auto Ins. Co. v. United States Fid. & Guar. Co.*, 490 F.2d 407 (4th Cir. 1974) (West Va. law); *Crown Center Redev. Corp. v. Oxidental Fire & Cas. Co.*, 716 S.W.2d 348, 361 (Mo. Ct. App. 1986); *Westhoff v. American Interins Exch.*, 250 N.W.2d 404 (Ia. 1977). Under the minority rule, the policies are treated as co-insurers and the loss is pro-rated between the insurers.

B. TYPES OF OTHER INSURANCE CLAUSES

There are numerous types of “other insurance” clauses, but they are generally classified as pro-rata, excess, or escape clauses. *See Hardware Dealers Mut. Fire Ins. Co. v. Farmers Ins. Exch.*, 444 S.W.2d 583, 586 (Tex. 1969).

Pro-Rata

A pro-rata clause usually provides that if there is other applicable insurance, the insurer's liability is limited to its pro-rata share of the loss which typically is apportioned according to the amount the insurer's policy limit bears to the aggregate limit of all other valid and collectible insurance. This is referred to as the “contract limits” method. *See, e.g., American Cas. Co. of Reading, Pa. v. PHICO Ins. Co.*, 549 Pa. 682, 702 A.2d 1050, 1053 (1997). However, some pro-rata other insurance clauses provide for contribution by equal shares. Under the “equal shares” arrangement, each insurer contributes the same amount, dollar-for-dollar, until the liability limit of one is exhausted. *Id.* The remaining insurer or insurers then pays the balance of the claim until the loss is paid or the policy limit is exhausted. A typical pro-rata clause provides:

If the insured has other insurance against liability or loss covered by this policy, the company shall not be liable for a greater proportion of such liability or loss than the applicable limit of liability bears to the total applicable limit of liability of all collectible insurance against such liability or loss.

The more common method for apportioning pro rata shares is “contract limits,” although several states apply the “equal shares” method. Many recent commercial liability policies include a “method of sharing” provision, which outlines the pro rata method the policy contemplates. An example of such a clause reads:

If all of the other insurance permits contribution by equal shares, we will follow this method also. Under this approach each insurer contributes equal amounts until it has paid its applicable limit of insurance or none of the loss remains, whichever comes first.

If any of the other insurance does not permit contribution by equal shares, we will contribute by limits. Under this method, each insurer’s share is based on the ratio of its applicable limit of insurance to the total applicable limits of insurance of all insurers.

See, e.g., American Indem. Lloyds v. Travelers Prop. & Cas. Ins. Co., 335 F.3d 429 (5th Cir. 2003) (applying Texas law); *Employers Ins. of Wausau v. American Intern. Specialty Lines Ins. Co.*, 2005 WL 1220945 (N.D. Cal. 2005) (applying California law). Courts seem to be divided on the issue of whether to apply a “method of sharing” clause, if one policy contains such a clause but the other policy does not. *See, e.g., Allstate Ins. Co. v. TIG Ins. Co.*, 711 So.2d 84 (Fla. Dist. Ct. App. 1st Dist. 1998) (each of two policies contained “other insurance” clauses, one contained “method of sharing” clause but the other was silent; court disregarded “method of sharing” clause and applied state’s “contract limits” approach instead); *Universal Underwriters Ins. Co. v. CAN Ins. Co.*, 308 N.J. Super. 415, 706 A.2d 217 (App. Div. 1998) (court applied “contract limits” approach when one policy had “method of sharing” clause that provided for that approach and other policy was silent).

Excess

By contrast, an excess clause usually provides that an insurer's liability is limited to the amount the loss exceeds the coverage provided by any other valid and collectible insurance. A typical excess clause provides:

This policy shall be excess over any other insurance whether prior or subsequent hereto, and by whomsoever effected, directly or indirectly covering loss or damage insured hereunder, and this Company shall be liable only for the excess of such loss or damage beyond the amount due from any other valid and collectible insurance, however, not exceeding the limits as set forth in the Declarations.

Escape

An escape clause attempts to avoid all liability for a loss covered by other valid and collectible insurance. A typical escape clause provides:

If any other Insured included in this insurance is covered by valid and collectible insurance against a claim also covered by this Policy, he shall not be entitled to protection under this Policy.

There are three generally recognized types of escape clauses: simple, super, and excess. An example of a simple escape clause is the one cited above. In contrast, a super escape clause may provide:

This insurance does not apply to any liability for such loss as is covered on a primary, contributory, excess, or any other basis by insurance in another insurance company.

The excess escape clause is more complicated; it typically provides that the insurer is liable for only the amount of loss that exceeds the limits of other available insurance, but the insurer is not liable when the other available insurance equals or exceeds its own limits. An example excess escape clause reads:

If other valid insurance exists protecting the insured from liability for such bodily injury, this policy shall be null and void with respect to such specific hazard otherwise covered, whether the insured is specifically named in such other policy or not; provided, however, that if the applicable limit of liability of this policy exceeds the applicable limit of liability of such other valid insurance, then this policy shall apply as excess insurance against such hazard in an amount equal to the applicable limit of liability of this policy minus the applicable limit of liability of such other valid insurance.

There are numerous variations to the three general types of other insurance clauses and many “other insurance” clauses cannot be categorized as pure pro-rata, excess or escape clauses. There is some disparity in the approach courts take to conflicting other insurance clauses, but many courts analyze the language of the policies in light of the circumstances of each contracting party in an attempt to determine the intention of each contract within the design of a consistent overall insurance scheme. *See Allstate Ins. Co. v. Employers Liab. Assur. Corp.*, 445 F.2d 1278, 1283 (5th Cir. 1971). Often, contracting parties will custom create an “other insurance” clause to suit their specific intent. Although this may meet the needs of the parties, the clause is more likely to conflict with the “other insurance” clauses in other policies, in which case a court might not enforce the custom clause as written. *See, e.g., McDonald v. Country Mut. Ins. Co.*, 133 Ill. App. 3d 89, 101 Ill. Dec. 53, 478 N.E.2d 571 (3d Dist. 1985).

When two policies provide coverage at the same level, *i.e.*, two primary policies or two excess policies, and both contain a similar other insurance clause, the clauses usually cancel each other out and the policies are treated as coinsurance. When confronted with similar other insurance clauses, each insurer is liable for its pro-rata share of the loss. In most cases, a pro-rata share is determined according to the amount the insurer's policy limit bears to the aggregate limit of all other valid and collectible insurance. *See Atlantic Mut. Ins. Co. v. Truck Ins. Exch.*, 797 F.2d 1288 (5th Cir. 1986).

C. CONFLICTING OTHER INSURANCE CLAUSES

Policies that provide coverage at the same level

Most courts have no problem handling policies that contain similar other insurance clauses. The difficulty arises when two or more policies contain conflicting other insurance clauses. Most courts attempt to reconcile dissimilar other insurance clauses by giving effect to

the intent of the policies through an examination of the language in the “other insurance” clauses. The minority approach is to disregard the other insurance clause and pro-rate the loss amongst the insurers that have available coverage.

Similar Clauses

If two policies have the same or similar “other insurance” clauses, enforcement is not particularly difficult. If neither policy contains an “other insurance” clause, courts will simply pro-rate the loss. *E.g. Federal Ins. Co. v. Gulf Ins. Co.*, 162 S.W.3d 160 (Mo. App. 2005); *Aetna Cas. & Sur. Co. v. Continental Ins. Co.*, 110 N.C.App. 278, 428 S.E.2d 406 (1993); *Oregon Auto Ins. Co. v. U.S. Fidelity & Guar. Co.*, 195 F.2d 958 (9th Cir. 1952). If only one policy contains an “other insurance” clause, courts will generally give effect to the clause. *E.g. U.S. Fidelity & Guar. Co. v. Budget Rent-A-Car Sysytems, Inc.*, 842 P.2d 208 (Colo. 1992); *Fremont Indem. Co. v. New England Reinsurance Co.*, 168 Ariz. 476, 815 P.2d 403 (1991); *Carriers Ins. Co. v. American Policyholders’ Ins. Co.*, 404 A.2d 216 (Me. 1979). When both policies contain pro-rata “other insurance” clauses, most courts will distribute the loss by the “contract limits” method. *E.g. State Farm Fire & Cas. Co. v. Griffin*, 888 S.W.2d 150 (Tex.App.—Houston [1st Dist.] 1994, no writ); *Tarolli v. Cont. Cas. Co.*, 181 A.D.2d 1021, 581 N.Y.S.2d 510 (4th Dep’t 1992); *but see Western Cas. & Sur. Co. v. Universal Underwriters Ins. Co.*, 232 Kan. 606, 657 P.2d 576 (1983) (applying “equal shares” method when neither “other insurance” clause specified method of sharing).

When multiple policies potentially cover a loss, but each contains excess clauses or escape clauses, courts generally treat the clauses as mutually repugnant and pro-rate the loss. If the clauses were enforced as written, then the ensured would have no coverage under either policy. *E.g. Allstate Ins. Co. v. Tokio Marine & Nichido Fire Ins. Co. Ltd.*, 464 F.Supp.2d 452 (E.D.Pa. 2006) (two excess clauses); *Twin City Fire Ins. Co. v. Fireman’s Fund Ins. Co.*, 386 F.Supp.2d 1272 (S.D.Fla. 2005), *aff’d* 200 Fed.App. 953 (11th Cir. 2006) (two excess clauses); *Commerce & Industry Ins. Co. v. Chubb Custom Ins. Co.*, 89 Cal.Rptr.2d 415 (Cal. App. 1999) (two escape clauses).

Pro-Rata v. Excess Clause

The majority of courts that have compared an excess clause with a pro-rata clause have held that the excess clause prevails and the excess insurer is not liable for the loss until the policy containing the pro-rata clause has been exhausted. *See generally David P. Van Knapp, Annotation Resolution of Conflicts in Non-Automobile Policies, Between Excess or Pro-Rata Other Insurance Clauses*, 12 A.L.R. 4th 993 (1982); *Annotation, Apportionment of Liability Between Automobile Liability Insurers Where One of the Policies Has an Excess Clause and the Other a Proportionary or Pro-Rata Clause*, 76 A.L.R. 2d 502 (1961). The policy containing the excess clause is usually not considered “other valid collectible insurance” for the purpose of triggering the operation of the pro-rata clause in the other policy. In other words, when there is other valid and collectible insurance available to the insured, the policy containing the excess clause becomes secondary coverage only.

Texas courts appear to follow the majority rule. *See e.g. Allstate Ins. Co. v. Universal Und. Ins. Co.*, 439 S.W.2d 385 (Tex. Civ. App.—Houston [14th Dist.] 1969, no writ); *Canal Ins. Co. v. Gensco, Inc.*, 404 S.W.2d 908 (Tex. Civ. App.—San Antonio 1966, no writ). A Fifth Circuit decision creates some uncertainty as to whether a Texas court would follow the majority

rule or pro-rate the loss. *See St. Paul Mercury Ins. Co. v. Lexington Ins. Co.*, 888 F.Supp. 1372 (S.D. Tex. 1995), *aff'd*, 78 F.3d 202 (5th Cir. 1996) (court pro-rated loss between insurers when one had escape clause and other had pro-rata clause). However, it appears no Texas court has had the opportunity to revisit this precise issue.

Pro-Rata v. Escape Clause

Similar to an excess clause, an escape clause has generally been found to trump a pro-rata clause. A policy that contains a pro-rata provision is liable prior to a policy that contains an escape clause. The rationale is the same as that applied to an excess clause; the policy containing the escape clause does not provide other valid and collectible insurance within the terms of the policy containing the pro-rata clause while the policy containing the pro-rata clause is other insurance that gives effect to the escape clause. *E.g. American Intern. Specialty Lines Ins. CO. v. Canal Indem. Co.*, 352 F.3d 254 (5th Cir. 2003) (predicting Louisiana law); *McFarland v. Chicago Express, Inc.*, 200 F.2d 5 (7th Cir. 1952).

It is unclear how a Texas court will rule on this issue. In a Fifth Circuit decision, the court pro-rated the loss between the insurers when one policy contained an escape clause and the other policy contained a pro-rata clause. *See St. Paul Mercury Ins. Co. v. Lexington Ins. Co.*, 888 F.Supp. 1372 (S.D. Tex. 1995), *aff'd*, 78 F.3d 202 (5th Cir. 1996) (applying Texas law). In *St. Paul*, the court found that an escape clause conflicted with a pro-rata clause relying on the Texas Supreme Court's decision in *Hardware Dealers. Id.* at 210. We believe a Texas court will likely follow the majority and reject the Fifth Circuit's opinion.

Excess Clause v. Escape Clause

Courts have had difficulty reconciling conflicts between escape and excess clauses. The majority of courts have held that the excess clause prevails over the escape clause, reasoning that the policy with the excess clause does not provide other valid collectible coverage within the meaning of the escape clause. *See Mosca v. Ford Motor Credit Co.*, 150 A.D.2d 656 (N.Y. 1989); *Protective Nat'l Ins. Co. v. Bell*, 361 S.2d 1058 (Ala. 1978). Other courts have held the opposite. *See e.g., State Farm Mut. Auto Ins. Co. v. Bursin*, 752 F.Supp. 877 (W.D. Ark. 1990); *Calder Race Course, Inc. v. Hialeah Race Course, Inc.*, 389 S.2d 215 (Fla. App. 1980). This has the effect of making the policy with the escape clause primary and the policy with the excess clause excess. Texas courts follow the minority, and pro-rate the loss between the policies when one policy contains an excess clause and the other an escape clause. *See Hardware Dealers Mut. Fire Ins. Co. v. Farmers Ins. Exch.*, 444 S.W.2d 583 (Tex. 1969); *see also St. Paul Mercury Ins. Co. v. Lexington Ins. Co.*, 888 F.Supp. 1372 (S.D. Tex. 1995), *aff'd*, 78 F.3d 202 (5th Cir. 1996). Only a few other courts have found that the excess and escape clauses are mutually repugnant, and pro-rate the loss. *E.g. Yarbrough v. Fed. Land Bank of Jackson*, 731 So.2d 482 (La.App. 1999); *Planet Ins. Co. v. Ertz*, 920 S.W.2d 591 (Mo.Ct.App. W.D. 1996); *Brown v. Travelers Ins. Co.*, 610 A.2d 127 (R.I. 1992).

Conflicting Clauses in policies that provide coverage at different levels

While most courts give effect to “other insurance” clauses in policies that provide coverage at the same level, courts are reluctant to give effect to “other insurance” clauses in policies that provide coverage at different levels. *See Olympic Ins. Co. v. Employers Surplus Lines Ins. Co.*, 126 Cal. App. 3d 593 (Cal. App. 1981). Most courts will require the primary

policies to exhaust before the “true excess” policy must respond. Unlike primary policies containing excess “other insurance” clauses, the true excess contract, by its own terms, does not cover a loss until the underlying insurance is exhausted. Texas courts have followed the general rule and have not required an excess policy to pro-rate with a primary policy that contains an excess other insurance clause. *See Liberty Mut. Ins. Co. v. United States Fire Ins. Co.*, 590 S.W.2d 783 (Tex. Civ. App.—Houston [14th Dist.] 1979, writ ref’d n.r.e.); *Carrabba v. Employers Cas. Co.*, 742 S.W.2d 709 (Tex. App.—Houston [14th Dist.] 1987, no writ). In *Carrabba*, the court held that the excess other insurance clause in the umbrella policy was not mutually repugnant with the excess other insurance clause in the primary policy because the policies are not of the same character and do not supply coverage at the same level. *Id.* at 715. Texas courts require primary policies to exhaust before excess insurers become liable. *See St. Paul Mercury Ins. Co. v. Lexington Ins. Co.*, 888 F.Supp. 1372 (S.D. Tex. 1995) *aff’d* 78 F.3d 202 (5th Cir. 1996).

Other insurance issues in many cases can be resolved by examining the other insurance clauses in the policies. However, when multiple policies are involved with conflicting other insurance clauses, the other insurance issue can become complicated and may require more than simply a review of the policies. As one court put it:

This is an area in which hair splitting and nit picking has been elevated to an art form. “Other insurance” clauses have been variously described as: “the catacombs of insurance policy English, a dimly lit underworld where many have lost their way,” a circular riddle, and “polic[ies] which cross one’s eyes and boggle one’s mind.”

South Carolina Ins. Co. v. Fidelity & Guar. Ins. Underwriters, Inc., 327 S.C. 207, 489 S.E.2d 200 (1997) (citing *Ins. Co. of North America v. Home & Auto Ins. Co.*, 256 Ill.App. 3d 801, 195 Ill.Dec. 179, 628 N.E.2d 643 (1st Dist. 1993)).