

**INTERRELATED RISK TRANSFER DEVICES -- PART 1:  
INDEMNITY AND ADDITIONAL INSURED PROTECTION**

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## **PART 1**

### **ANALYZING INDEMNITY AGREEMENTS**

#### **I. INTRODUCTION**

An enforceable indemnity agreement is the single most effective way of transferring risk. It is rare indeed these days to find a construction contract that does not contain an indemnity agreement. When discussing indemnity agreements, clients and management usually ask one of two questions: (1) is the indemnity agreement enforceable? or (2) can you draft an indemnity agreement the courts will find enforceable? Part 1 of Interrelated Risk Transfer Devices -- Indemnity and Additional Insured Protection is intended to help the construction lawyer answer yes to both questions.

#### **II. EXPRESS INTENT RULE**

Any discussion regarding indemnity must begin with an understanding of the Supreme Court's opinion in *Ethyl Corporation vs. Daniel Construction Company*, 725 S.W.2d 705 (Tex. 1987). The original rule known as the Express Negligence Doctrine provided, that parties seeking to indemnify the indemnitee from the consequences of its own negligence must express that intent in specific terms. Under the doctrine of express negligence, the intent of the parties must be specifically stated within the four corners of the contract. @ *Id.* at 708.

Since *Ethyl*, appellate courts have written opinion after opinion criticizing scrivener's for not expressing clearly the intent of various indemnity provisions. It is critical in the creation of an indemnity agreement to expressly identify the risks to be transferred.

In 1994, the Supreme Court expanded the Express Negligence Doctrine and called it the Express intent rule. @ In *Houston Lighting and Power Company vs. Atchison, Topeka & Santa Fe Railway Co.*, 890 S.W.2d 455 (Tex. 1994), a railroad employee brought suit against the railroad for personal injuries allegedly resulting from the employer's violation of two federal statutes. The railroad filed a third-party complaint against HL&P for contractual indemnification. A jury trial ensued and the railroad was found strictly liable for the personal injuries of its employee. The indemnity agreement between HL&P and the railroad read as follows:

Notwithstanding anything contained in section 3 of Article I of Original Contract to the contrary [HL&P] agrees that it will at all times indemnify and save harmless Railway Company against all claims, demands, actions or causes of action, arising or growing out of loss of or damage to property, including said rotary dumper and appurtenances, and injury to or death of persons, including employees of Railway Company, resulting in any manner from the construction, maintenance, use, state of repair or presence of said

rotary dumper and appurtenances under or adjacent to TV Tract, whether such loss, damage, injury or death be caused or contributed to by the negligence of Railway Company, its agents or employees, or otherwise . . .

*Id.* at 456.

HL&P as the indemnitor argued it should not be held responsible for the statutory violation [negligence per se] of the railroad since the indemnity agreement did not express an intent to require the indemnitor to indemnify for the statutory liability of the indemnitee. The Supreme Court agreed with HL&P and held that parties seeking to indemnify an indemnitee against strict liability must expressly state that intent in their indemnity agreement.@ *Id.* At 456. Justice Gonzales, writing for a unanimous Supreme Court, explained the rationale for the decision when he wrote:

Contracts indemnifying an indemnitee against the consequences of strict liability involve an extraordinary shifting of the risk and may have great financial impact on the parties. Thus, fairness dictates against imposing liability on an indemnitor unless the agreement clearly and specifically expresses the intent to encompass strict liability claims.

*Id.* at 458.

Since 1987, appellate courts have criticized indemnity agreements that do not expressly identify the risks against which the indemnitee is seeking to be indemnified. The express intent rule@ is the reason the newer indemnity agreements you see may contain a laundry list of claims for which the indemnitee seeks indemnification. While every construction project involves different risks, the following represents a list of risks this author has seen expressed in various indemnity agreements: negligent act, error or omission, sole negligence, concurrent negligence, joint negligence, active or passive negligence, gross negligence, negligence per se, strict liability, patent infringement, copyright, unseaworthiness of any vessel or vessels, condition of property or its premises, latent defects, defects in materials, workmanship or design, workers= compensation claims, disability act claims, employee benefit acts or claims, and failure to comply with any of the provisions of this subcontract or the contract documents.

I have included in the list of risks intended to be transferred, gross negligence. However, in *Webb vs. Lawson-Avila Construction, Inc.*, 911 S.W.2d 457 (Ct. App.--San Antonio 1995, writ dismissed), the Court of Appeals found the following indemnity agreement not only met the express negligence test, but also provided indemnification for gross negligence even though the indemnity agreement did not expressly include gross negligence:

. . . Upon request Subcontractor agrees to defend at its own cost and to indemnify and hold harmless the Contractor and its agents and employees from any and all liability, damages, losses, claims

and expenses howsoever caused resulting directly or indirectly from or connected with the performance of this agreement, irrespective of whether such liability, damages, losses, claims and/or expenses are actually or allegedly, caused wholly or in part through the negligence of Contractor or any of its agents, employees or other Subcontractors.

*Id.* at 460.

The *Webb* decision discussed several Supreme Court decisions involving negligence and gross negligence, and concluded the term negligence included gross negligence. The court noted no exact line could be drawn between negligence and gross negligence and the difference was simply one of degree rather than of kind. While the *Webb* case does stand for the proposition that the term negligence can be interpreted to include gross negligence, the author of the particular indemnity agreement included a clause which allowed the court to apply a different standard of review. The general rule requires an indemnity agreement to be strictly construed in favor of the indemnitor. However, this particular contract included a provision stating it was the intent of the parties that the agreement was to be construed fairly and reasonably and neither more strongly for nor against either party. *Id.* at 461. This softer approach to interpretation may not be followed by other courts when reviewing agreements that do not contain such a favorable contract construction provision.

### III. CONSPICUOUSNESS

Since 1973, Texas courts have required an indemnity provision to be conspicuous in order to be enforceable. See *K & S Oilwell Service, Inc. vs. Cabot Corp.*, 491 S.W.2d 733 (Tex. Civ. App.--Corpus Christi 1973, writ ref'd n.r.e.). Following *K & S*, various courts of appeal reached inconsistent conclusions with regards to the conspicuousness of indemnity agreements. Courts even differed on whether conspicuousness was a question of fact or of law.

In 1993, the Texas Supreme Court established the standard used today for determining the conspicuousness of an indemnity agreement. In *Dresser Industries, Inc. vs. Page Petroleum, Inc.*, 853 S.W.2d 505 (Tex. 1993), the court adopted the TEX. BUS. & COM. CODE ANN. ' 1.201(10)(Tex. UCC) as the standard for determining conspicuousness for indemnity agreements and in releases that relieve a party in advance of responsibility for its own negligence. *Id.* at 511. Subsection 1.201(10) reads as follows:

(10) AConspicuous: A term or clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it. A printed heading in capitals (as: Non-Negotiable Bill of Lading) is conspicuous. Language in the body of a form is Aconspicuous if it is in larger or other contrasting type or color. But in a telegram any stated term is Aconspicuous. Whether a term or clause is Aconspicuous or not is for decision by the court.

One caveat to the court's adoption of the Texas UCC for conspicuousness concerns a situation where the indemnitor has actual notice or knowledge of the existence of the indemnity agreement. The court, in a footnote, said "The fair notice requirements are not applicable when the indemnitee establishes that the indemnitor possessed actual notice or knowledge of the indemnity agreement." *Id.* at 508, citing *Cate vs. Dover Corp.*, 790 S.W.2d 559, 561 (Tex. 1990).

The court, however, did not discuss the difference between actual notice and actual knowledge. In *U.S. Rentals, Inc. vs. Monday Service Corp.*, 901 S.W.2d 789 (Tex. App.--Houston [14th Dist.] 1995), in what can only be described as the battle of the footnotes, the court wrote in footnote 8 the following:

8. Notably, however, the *Cate* opinion addressed only actual *knowledge*, and not actual *notice*, as an exception to the fair notice requirement. This distinction is important in that forms containing indemnity provisions are commonly signed by or on behalf of the ostensible indemnitor. To the extent such a form is signed without reading the indemnity provision, the signature might not alone evidence actual *knowledge*. See *Cate*, 790 S.W.2d at 562. However, such a signature could arguably evidence actual *notice*. Thus, if actual *notice* is also an exception to the fair notice requirement, as suggested by the footnote in *Dresser*, and if a signature on the forms signifies actual notice for this purpose, then the fair notice requirement could be thereby rendered largely ineffectual. *Id.* at 793n.8.

Artful scrivener's will no doubt insert knowledge and notice provisions into signature blocks in an attempt to eliminate or at least minimize the factual contest of actual notice or knowledge after a loss occurs. Although not specifically discussed, it seems apparent that any issue dealing with actual notice or knowledge of the indemnity agreement would be a fact question and not a question of law for the court. In *U.S. Rentals*, the court dealt with the issue of burden of proof for conspicuousness when the issue of actual notice or knowledge is in play. The court, citing both *Dresser* and *Cate*, held it was the indemnitee's burden to prove (not the indemnitor's burden to disprove) actual notice or knowledge. *Id.* at 793. The court found actual notice or knowledge was in the nature of an affirmative defense to a claim of lack of conspicuousness and thus the burden of proof fell on the indemnitee.

#### **IV. DETERMINING THE ENFORCEABILITY OF AN INDEMNITY AGREEMENT \***

The Aexpress intent rule<sup>@</sup> and Aconspicuousness rule<sup>@</sup> have collectively been referred to as the AFair Notice Requirements<sup>@</sup> for indemnity agreements. *See Dresser* at 508. However, in determining the enforceability of indemnity agreements, counsel is required to look beyond the Fair Notice Requirements. There is a four step analysis that is required in order to determine the enforceability of any indemnification agreement. The following flow chart created by Pat Wielinski outlines the four steps.

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\* Thanks to Pat Wielinski for allowing me the use of a portion of his treatise contained within *Contractual Risk Transfer* published by International Risk Management Institute, Inc. in 1995. The two volume treatise is a must for any construction lawyer.

**A. Step One: Does the Liability Arise Out of the Subject Matter of the Clause?**

Step one in determining the enforceability of the indemnity agreement is whether the claim for which indemnification is sought is actually covered by the indemnity clause. In *Robert H. Smith, Inc. vs. Tennessee Tile, Inc.*, 719 S.W.2d 385 (Tex. App.-Houston [1st Dist.] 1986, no writ), a tile company employee was electrocuted when he attempted to move electrical wiring. The employee sued the general contractor who in turn filed suit against the employer for contractual indemnity. The contract required the employer to indemnify the contractor for all claims arising out of or resulting from the performance of the subcontractor's work under the contract, ...<sup>6</sup>. The court found there was no indemnity since there was no proof the employee's handling of electrical wiring would have been within the scope of the subcontract involving tile work.

In *Sun Oil Co. vs. Renshaw Well Service*, 571 S.W.2d 64 (Tex. Civ. App.--Tyler 1978, writ ref'd, n.r.e), the court held that an injury to an employee of a well service contractor was not an injury arising out of, incident to or in connection with<sup>6</sup> the contractor's performance of work under the well servicing agreement where the injury occurred after the specific well servicing work had been completed and no further work remained to be done at the well site.

In *Boyd vs. Amoco Production Co.*, 786 S.W.2d 528 (Tex. App.--Eastland 1990, no writ), a welder's employee was injured while performing welding operations pursuant to a well servicing contract. The owner sought indemnity from the welder after paying the claim of the injured employee. The court upheld the owner's entitlement to indemnity, rejecting the contractor's attempt to characterize its employee's operation of cutting anchor bolts as actually being work arising out of the owner's operations, rather than the welding operations. The court held the welder's employees and the owner's employees were all working to prepare a pumping unit for removal and replacement, and the welder's injuries arose out of the welder's operations pursuant to the contract.

The cases illustrate that even where an indemnification agreement may be enforceable, the facts and circumstances surrounding the injury, property damage, or claim must be carefully examined to determine whether they fall within the scope of the indemnification obligation.

**B. Steps Two & Three Require the Application of the Express Intent Rule and Conspicuousness Rule Discussed Above**

**C. Step Four -- Anti-Indemnity Statutes**

The final hurdle to clear before you can determine whether an indemnity agreement is enforceable is whether there is any anti-indemnity statute that prohibits the particular type of risk shifting involved. The most common anti-indemnity statutes encountered in construction cases deal with architects and engineers ' 130.003 TEX. CIV. PRAC. & REM. CODE, and the oil and gas indemnity statutes contained in ' 127.003 of the TEX. CIV. PRAC. & REM. CODE. A thorough reading of the anti-indemnity statutes is required in order to determine their possible application.

' **130.002. Covenant or Promise Void and Unenforceable**

A covenant or promise in, in connection with, or collateral to a construction contract is void and unenforceable if the covenant or promise provides for a contractor who is to perform the work that is the subject of the construction contract to indemnify or hold harmless a registered architect, registered engineer or an agent, servant, or employee of a registered architect or registered engineer from liability for damage that:

(1) is caused by or results from:

(A) defects in plans, designs, or specifications prepared, approved, or used by the architect or engineer; or

(B) negligence of the architect or engineer in the rendition or conduct of professional duties called for or arising out of the construction contract and the plans, designs, or specifications that are a part of the construction contract; and

(2) arises from:

(A) personal injury or death;

(B) property injury; or

(C) any other expenses that arises from personal injury, death, or property injury.

**' 127.003. Agreement Void and Unenforceable**

(a) Except as otherwise provided by this chapter, a covenant, promise, agreement, or understanding contained in, collateral to, or affecting an agreement pertaining to a well for oil, gas, or water or to a mine for a mineral is void if it purports to indemnify a person against loss or liability for damage that:

(1) is caused by or results from the sole or concurrent negligence of the indemnitee, his agent or employee, or an individual contractor directly responsible to the indemnitee; and

(2) arises from:

(A) personal injury or death;

(B) property injury; or

(C) any other loss, damage, or expense that arises from personal injury, death, or property injury.

## V. EXAMPLES

No paper on indemnity would be complete without providing several examples of indemnity agreements Texas courts have held enforceable.

1. *Atlantic Richfield Co. v. Petroleum Personnel, Inc.*, 768 S.W.2d 724 (Tex. 1989).

### INDEMNITY LANGUAGE

The specific indemnity clause in question in the *Atlantic Richfield* case stated:

CONTRACTOR [PPI] agrees to hold harmless and unconditionally indemnify COMPANY [ARCO] against and for all liability, cost, expenses, claims and damages which [ARCO] may at any time suffer or sustain or become liable for by reason of any accidents, damages or injuries either to the persons or property or both, of [PPI], or of the workmen of either party, or of any other parties, or to the property of [ARCO], in any matter arising from the work performed hereunder, including but not limited to any negligent act or omission of [ARCO], its officers, agents, or employees...

2. *Adams Resources Exploration Corp. v. Resource Drilling, Inc.*, 761 S.W.2d 63 (Tex. App.--Houston [14th Dist.] 1988, no writ).

### INDEMNITY LANGUAGE

#### 14.8- Contractor-s Indemnification of Operator:

Contractor agrees to protect, defend, indemnify, and save operator, its officers, directors, employees, and joint owners harmless from and against all claims, demands, and causes of action of every kind and character, without limit and without regard to the cause or causes thereof or the negligence of any party or parties, arising in connection herewith in favor of Contractor-s employees or Contractor-s subcontractors or their employees, or Contractor-s invitees, on account of bodily injury, death or damage to property....@

#### 14.13- Indemnity Obligation:

Except as otherwise expressly limited herein, it is the intent of the parties hereto that all indemnity obligations and/or liabilities assumed by such parties under terms of this Contract, including, without limitation, paragraphs 14.1 through 14.12 hereof, be without limit and without regard to the cause or causes hereof (including pre-existing conditions), the unseaworthiness of any vessel or vessels, strict liability, or the negligence of any party or

parties, whether such negligence be sole, joint or concurrent, active or passive. The terms and provisions of paragraphs 14.1 through 14.12 shall have no application to claims or causes of action asserted against Operator or Contractor by reason of any agreement of indemnity with a person or entity not a party hereto.

3. *Aerospatiale Helicopter Corp. v. Universal Health Serv., Inc.*, 778 S.W.2d 492 (Tex. App.--Dallas 1989, writ denied).

## **INDEMNITY LANGUAGE**

### **V. INDEMNITY:**

The LESSEE will indemnify and hold harmless the LESSOR, its agents, servants, and assigns from and against any and all losses, damages, injuries, claims, demands and expenses including legal expenses of whatsoever kind and nature arising on account of (i) the use or operation of the helicopter or any part thereof, by whomsoever used or operated other than the LESSOR, its agents, servants, or employees and (ii) the installation or removal of any unit of equipment pursuant to any provisions of this lease; provided, however, that in no event shall LESSEE be liable for any loss, damage, injury or claim resulting from any latent defect which is not discovered or discoverable by LESSEE-s inspection prior to taking of possession by LESSEE. LESSEE shall not be liable for loss, damage, injury or claim which is the proximate result of the sole negligence of the LESSOR or LESSOR-s agents, servants, or assigns.

4. *Amoco Oil Co. v. Romaco, Inc.*, 810 S.W.2d 228 (Tex. App.--Houston [14th Dist.] 1989, no writ).

## **INDEMNITY LANGUAGE**

The contractor [Romaco] shall indemnify and save company [Amoco] harmless from and against any and all losses, claims, demands, liabilities, suits or actions (including all reasonable expenses and attorneys= fees) for injuries to or the death of any person or persons, including the property of company, caused by or resulting from the negligence of the contractor or any of its subcontractors or employees of either, or from poor, improper or unworkmanlike performance of any of the work to be performed hereunder, or by materials (except such as company may have furnished) used in said work which are defective, or by reason of any other thing in connection with the performance of this contract

whether caused by a negligent act or omission of either party hereto, or their employees, or otherwise and the contractor agrees to reimburse the company for all sums which company may pay or be compelled to pay in settlement of any claim on account thereof, including any claim under the provisions of any workmen's compensation law or other similar law, or under any plan for employees benefits which company may have or adopt, except that the contractor assumes no liability for the sole negligent acts of company, its agents, servants, or employees.

5. *Faulk Mgmt. Serv. v. Lufkin Indus., Inc.*, 905 S.W.2d 476 (Tex. App.--Beaumont 1995, writ denied).

## **INDEMNITY LANGUAGE**

### **HOLD HARMLESS AGREEMENT**

LUFKIN INDUSTRIES, INC. will exercise no control or right of control over the employees or details of the work. Contractor is to furnish his own tools and Lufkin Industries is interested only in the final results of the completed contract. Contractor is doing the work under contract and is an independent contractor and not an employee of the company.

By signing the below statement, the seller agrees to protect, defend, indemnify, and save harmless Lufkin Industries, Inc. against loss, damage, or expense by reason of any suits, claims, demands, or judgment and causes of action caused by the seller, its employees, agents or any subcontractor arising out of or in consequence of the performance of this contract.

It is the intention of the Seller and/or Contractor to indemnify Lufkin Industries, Inc. even in the event that any such claims, demands, actions or liability arises in whole or in part from warranties, express or implied, defects in materials, workmanship or design, condition of property or its premises and/or negligence of Lufkin Industries, Inc. or any other fault claims as a basis of liability for Lufkin Industries, Inc.

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

## **INDEMNITY LANGUAGE**

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

**6.9 Neither CONTRACTOR nor its affiliates nor its subcontractors or vendors, either individually or jointly shall be liable to OWNER or its affiliates, irrespective of whether alleged to be due to negligence or otherwise, for loss of anticipated profits or interest, for loss by reason of Plant shut-down or non-operation of the Plant or other equipment, for loss of catalysts or chemicals or for any consequential or special loss or damage arising from any reason whatsoever.**

## **BIBLIOGRAPHY**

Wielinski, Patrick J., Woodward, W. Jeffrey, and Gibson, Jack P.; *Contractual Risk Transfer Strategies for Contract Indemnity and Insurance Provisions*; International Risk Management Institute, Inc., Dallas, Texas, 1995.