

# Construction & Design Contracts: What the Terms Mean When Your Insured is Sued

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## What is in the Contract? Four Big Areas to Review

- 1) What is the Scope of Work and extent of your contract?
- 2) What are the risk transfer provisions?
- 3) What dispute resolution obligations are in the contract?
- 4) Any damage or liability limitation provisions?

# No. 1 – Scope of Work and Extent of Contractual Responsibilities

# No. 1 - Scope of Work and Extent of Responsibilities

- The scope of work will often be broadly set forth in the contract and more specifically defined in an exhibit to the contract.
- The contract documents can be comprised of the original contract, the prime contract, plans and specifications, project manual, submittals, change orders, and written modifications to the contract.
- What other responsibilities are included elsewhere in the contract?



# Your Representations and Warranties

- Making representations or promises as to the quality of the work or performance.
- Examples:
  - Perform services with professional skill and care;
  - Quality of construction or design;
  - Rely on one's own skill and expertise;
  - Ensure design complies with all contract documents, codes, permits, industry standards
- Warranties applicable to the finished work

# What Other Parties' Responsibilities Impact the Work?

- Owner's Responsibilities: The contract will define the responsibilities of the owner, including information the owner must provide, its duties and responsibilities during the project, and the role of its subcontractors, if any.
  - There may be language that limits your ability to rely upon Owner information.
- Others impacting the work: design professionals, manufacturers, other subcontractors, and governmental authorities

# No. 2 - Risk Transfer Provisions

## No. 2 - Risk Transfer Provisions

- When receive notice of claim/lawsuit:
  - Review your client's risk transfer provisions in their contract
    - Contractual Indemnity Agreements
    - Additional Insured Provisions
  - If represent GC or owner, put relevant lower tier contractors and their insurance companies on notice and tender claim to lower tier subs for defense/indemnity.



# Risk Transfer Provisions

- Two Main Risk Transfer Provisions in Construction Contracts:
  1. Additional Insured Provisions - Requires a party to be added as an insured in the name insured's liability policy, subject to the terms and conditions of the policy and the additional insured endorsement.
  2. Contractual Indemnity Agreements - promise or safeguard to hold the indemnitee harmless against damage or bodily injury.

# Risk Transfer Provisions – Contractual Indemnity Provision

- Standard Clause:
- TO THE FULLEST EXTENT PERMITTED BY LAW, PROFESSIONAL AGREES TO INDEMNIFY AND HOLD OWNER HARMLESS FROM AND AGAINST ANY LIABILITIES, CLAIMS, DAMAGES AND COSTS (INCLUDING REASONABLE ATTORNEY'S FEES) TO THE EXTENT CAUSED BY THE ANY ERROR OR OMISSION, NEGLIGENCE, OR WILLFUL MISCONDUCT OF PROFESSIONAL AND/OR PROFESSIONAL'S CONTRACTORS, EMPLOYEES, AGENTS AND/OR CONSULTANTS.

# Risk Transfer Provisions – Contractual Indemnity Provision

- Three main types of indemnity agreements:
  1. Broad form indemnity – Full indemnification regardless of fault.
  2. Intermediate Form Indemnity – Full indemnification so long as any fault rests with the indemnitor.
  3. Limited form Indemnity – Indemnification only to the extent of the indemnitor's own fault in contributing to the loss.

# Risk Transfer Provisions – Contractual Indemnity Provision

- Historically, the risk shifting agreements were enforceable if they passed Fair Notice Doctrine:
  1. Express Negligence Test:
    - *Ethyl Corp. v. Daniel Construction Co.*, 725 S.W.2d 705 (Tex. 1987). A party seeking indemnity from the consequences of his/her own negligence must express that intent in specific terms
  2. Conspicuousness Requirement:
    - *Dresser Industries, Inc. v. Page Petroleum*, 853 S.W.2d 505 (Tex. 1993). “a provision is ordinarily conspicuous when a reasonable person against whom it is to operate ought to have noticed it.”

# Risk Transfer Provisions – Contractual Indemnity Provision

- Trend in recent years to limit or prohibit indemnity agreements
- Over 42 states have enacted anti-indemnity statutes

| State       | Bars Indemnity for Sole Fault | Bars Indemnity for Sole or Partial Fault | Closes Additional Insured Loophole | Comments   |
|-------------|-------------------------------|--|------------------------------------|--|
| Alabama     |                               |  |                                    | No statute.  |
| Alaska      | ✓                             |  |                                    | Alaska Stat. § 45.45.900. Exception for hazardous substances.  |
| Arizona     | ✓<br>(private work)           | ✓<br>(public work)                       | ✓<br>(public work)                 | Ariz. Rev. Stat. §§ 32-1159, 34-226, 41-2586. Exception for entry onto adjacent land. Recent amendments to § 34-226 and § 41-2586, limit indemnity on public work projects to only those damages caused by the negligence, recklessness, or intentional wrongful conduct of the contractor, subcontractor or design professional, and any express duty to defend is prohibited.  |
| Arkansas    | ✓                             |  |                                    | Ark. Code § 4-56-104, 22-9-214   |
| California  | ✓                             | ✓  |                                    | Civ. Code §§ 2782 and Civil Code §§ 2782.05 (effective with Contracts entered after January 1, 2013).  |
| Colorado    |                               | ✓  | ✓                                  | Colo. Rev. Stat. §§ 13-50.5-102, 13-21-111.5 [SB 87 (2007)].   |
| Connecticut |                               | ✓  |                                    | Conn. Gen. Stat. § 52-572k (P.A. 01-155).  |
| Delaware    |                               | ✓  | See comments.                      | Del. Code, Title 6, § 2704. See <i>Chrysler v. Merrell &amp; Garaguso</i> , 796 A.2d 648 (Del. 2002) (a.i. requirement "may, under certain circumstances, be unenforceable," but endorsement is enforceable).  |
| D.C.        |                               |  |                                    | No statute; <i>N.P.P. Contractors, Inc. v. John Canning &amp; Co.</i> , 715 A.2d 139, 142 (D.C. 1998) (indemnification contract allowed).  |
| Florida     |                               | ✓<br>(public work)                       |                                    | For private work, Fla. Stat. § 725.06 [SB 428 (2001)] requires only a monetary limitation and reproduction in bid documents and specs.   |
| Georgia     | ✓                             |  | ✓                                  | Ga. Code § 13-8-2 [HB 136 (2007)].   |
| Hawaii      | ✓                             |  |                                    | Hawaii Rev. Stat. § 431:10-222.  |
| Idaho       | ✓                             |  |                                    | Idaho Rev. Stat. § 29-114.   |
| Illinois    |                               | ✓  |                                    | Ill. Compiled Stat., 740 ILCS 35/1-3.  |
| Indiana     | ✓                             |  |                                    | Ind. Code § 26-2-5, "dangerous instrumentality" exception.   |
| Iowa        |                               | ✓  |                                    | Iowa Code § 537A.5.  |
| Kansas      |                               | ✓  |                                    | Kansas Stat. § 16-121 voids promises on public and private projects to indemnify or provide liability coverage to another person as an additional insured for that person's own negligence, acts or omissions. There are six exceptions. Kansas Stat. § 16-1803 (private) and § 16-1903 (public) nullify contract clauses that waive subrogation rights for losses covered by liability or workers compensation insurance with certain exceptions. |
| Kentucky    |                               | ✓  |                                    | Kentucky Rev. Stat. § 371.180 [HB 449 (2005)].   |
| Louisiana   |                               | ✓<br>(but see comments)                  |                                    | La. Rev. Stat. § 38:2216.G only protects primes on public works. Compare the Louisiana Oilfield Indemnity Act, La. Rev. Stat. Ann. § 9:2780, applied in <i>Babineaux v. Reading &amp; Bates Drilling</i> , 806 F.2d 1282 (5 <sup>th</sup> Cir. 1987) (both "hold harmless" and "additional insured" void).   |
| Maine       |                               |  |                                    | No statute.  |
| Maryland    | ✓                             |  |                                    | Md. Code. Ann., Cts. & Jud. Proc. §5-401 (2008).   |

| State          | Bars Indemnity for Sole Fault | Bars Indemnity for Sole or Partial Fault | Closes Additional Insured Loophole | Comments   |
|----------------|-------------------------------|--|------------------------------------|--|
| Massachusetts  | ✓<br>But see comments         |  |                                    | Mass. Gen. Laws, ch. 149, § 29C as written voids any provision which requires subcontractor to indemnify for injury or damage not caused by the subcontractor or his employees, sub-subs, etc. However, a recent court decision upheld a provision which required sub to indemnify for injury or damage "arising out of or in consequence of" his work, because the court found those words to be the equivalent of "caused by". The indemnification standard has thus been lowered to something less than negligence or proximate causation, but how much lower is not clear.   |
| Michigan       | ✓                             |  |                                    | Mich. Comp. Laws § 691.991.  |
| Minnesota      |                               | ✓  |                                    | Minn. Stat. §§ 337.01, 337.02. Exception permits owners to indemnify environmental liabilities. Allows contract provision requiring sub to insure general and owner for own fault.   |
| Mississippi    |                               | ✓  |                                    | Miss. Code § 31-5-41.  |
| Missouri       |                               | ✓  |                                    | Mo. Rev. Stat. § 434.100. Expressly allows additional insured.   |
| Montana        |                               | ✓  | ✓                                  | Mont. Rev. Code § 28-2-2111 prohibits requirements to "insure or defend," but authorizes OCP, PMPL (for private construction contracts). See Mont. Rev. Code § 18-2-124 for equivalent provision governing public contracts.   |
| Nebraska       |                               | ✓  |                                    | Neb. Rev. Stat. § 25-21,187.   |
| Nevada         |                               |  |                                    | No statute. See <i>Reyburn Lawn &amp; Landscape Designers, Inc. v. Plaster Development Co., Inc.</i> , 255 P.3d 268 (Nev. 2011) ("while the parties are free to contractually agree to indemnify another for its own negligence, 'an express or explicit reference to the indemnitee's own negligence is required.' Therefore, 'contracts purporting to indemnify a party against its own negligence will only be enforced if they clearly express such an intent, and a general provision indemnifying the indemnitee 'against any and all claims,' standing alone, is not sufficient.'")   |
| New Hampshire  |                               | ✓  |                                    | N.H. Rev. Stat. §§ 338-A:1 (design professionals) and 338-A:2 (construction contracts generally)   |
| New Jersey     | ✓                             |  |                                    | N.J. Stat. § 2A:40A-1.   |
| New Mexico     |                               | ✓  |                                    | N.M. Stat. § 56-7-1 [SB 280 (2003)] prohibits requirements to "insure or defend," but authorizes OCP, PMPL.  |
| New York       |                               | ✓  |                                    | N.Y. Gen. Oblig. Laws §5-322.1 (contractor cannot require subcontractor to indemnify the contractor for contractor's negligence. However, statute does not prohibit contractor from requiring subcontractor to indemnify contractor from negligence of subcontractor and other trades. Thus, claims "arising out of" subcontractor's work may require the subcontractor to indemnify the contractor, even if caused by the negligence of another subcontractor. Note, also, N.Y. Labor Law §§240 and 241 holds owner and contractors strictly liable for injuries sustained for falls from elevated levels, and are subject to indemnity provisions without regard to negligence.) |
| North Carolina |                               | ✓  |                                    | N.C. Gen. Stat. § 22B-1.   |

| State          | Bars Indemnity for Sole Fault | Bars Indemnity for Sole or Partial Fault | Closes Additional Insured Loophole | Comments   |
|----------------|-------------------------------|--|------------------------------------|--|
| North Dakota   |                               |  |                                    | No statute; <i>But see</i> N.D.Cent.Code 9-08-02.1 prevents owner shifting design risk.  |
| Ohio           |                               | ✓  | See comments.                      | Ohio Rev. Code § 2305.31. <i>Compare</i> <i>Buckeye Union Ins. v. Zavarella Bros.</i> , 699 N.E.2d 127 (Ohio 8 <sup>th</sup> App. 1997) (a.i. barred) and <i>Stickovich v. Cleveland</i> , 757 N.E. 2d 50, 61 (Ohio 8 <sup>th</sup> App. 2001) (a.i. permitted). |
| Oklahoma       |                               | ✓  | ✓                                  | Okla. Stat. § 15-221 [S.B. 324 (2006)].  |
| Oregon         |                               | ✓  | ✓                                  | Or. Rev. Stat. § 30.140 prohibits subcontractor's "surety or insurer" from indemnifying another's negligence. <i>Walsh Construction</i> , 104 P.3d 1146 (Or. 2005).  |
| Pennsylvania   |                               |  |                                    | Pa. Stat., Title 68, § 491, prohibits indemnity of design professionals.   |
| Rhode Island   |                               | ✓  |                                    | R.I. Gen. Laws § 6-34-1.   |
| South Carolina | ✓                             |  |                                    | S.C. Code § 32-2-10.   |
| South Dakota   | ✓                             |  |                                    | S.D. Codified Laws § 56-3-18.  |
| Tennessee      | ✓                             |  |                                    | Tenn. Code § 62-6-123.   |
| Texas          |                               | ✓<br>(See Comments)                      | ✓<br>(See Comments)                | Tex. Insurance Code Ch. 151 – Exception for employee claim §151.103; see § 151.105 for exclusions; Civ. P&R Code § 130.002 only prohibits indemnity of design professionals.   |
| Utah           |                               | ✓  |                                    | Utah Code § 13-8-1 exception permits indemnity of owner.   |
| Vermont        |                               |  |                                    | No statute.  |
| Virginia       | ✓                             |  |                                    | Va. Code § 11-4.1.   |
| Washington     |                               | ✓  |                                    | Wash. Rev. Code § 4.24.115.  |
| West Virginia  | ✓                             |  |                                    | W.Va. Code § 55-8-14.  |
| Wisconsin      |                               |  |                                    | Wis. Stat. § 895.447 provides no protection; see <i>Gerdmann v. U.S. Fire Ins. Co.</i> , 350 N.W.2d 730 (Ct. App. 1984).   |
| Wyoming        |                               |  |                                    | No Statute. <i>But see</i> Wyo. Stat. § 30-1-131 voids covenants or promises pertaining to "any well for oil, gas or water, or mine for any mineral" which purport to indemnify the indemnitee from loss or liability caused by his or her own negligence.       |



# Texas Anti-Indemnity Act

- In 2011, the Texas Legislature enacted the Texas Anti-Indemnity Act, which limits and makes void certain liability shifting agreements.
- Went into effect on January 1, 2012 – only applies to an original contract with an owner of an improvement or contemplated improvement that is entered into on or after Jan. 1, 2012
- Codified in Texas Insurance Code Section 151.001 to 151.151

# Texas Anti-Indemnity Act

- Prohibits and makes void broad form and intermediate form indemnity agreements (claims involving the sole or concurrent negligence of indemnitee) for construction projects, *if the Act applies to your contract*

# Texas Anti-Indemnity Act

- Chapter 151 has wider application than project with consolidated insurance programs. It applies to all construction contracts, unless excepted by 151.105.

# Texas Anti-Indemnity Act

- What is a “Construction Contract”?
- Texas Ins. Code 151.001(5) - Definition of “construction contract” is broad, and includes a range of private and public contracts, subcontracts and agreements:
  - Includes design, construction, alteration, renovation, remodeling, repair, or the furnishing of material or equipment;
  - Includes an owner, architect, engineer, contractor, construction manager, subcontractor, supplier, or material or equipment lessor;
  - Includes building, structure, appurtenance, or other improvement to or on public or private real property, including moving, demolition and excavation connected with the real property.

# Texas Anti-Indemnity Act

- AGREEMENT VOID AND UNENFORCEABLE (151.102)
  - “... a provision in a construction contract, or in an agreement collateral to or affecting a construction contract, is void and unenforceable as against public policy to the extent that it requires an indemnitor to indemnify, hold harmless, or defend a party, including a third party, against a claim caused by the negligence or fault, the breach or violation of a statute, ordinance, governmental regulation, standard, or rule, or the breach of contract of the indemnitee, its agent or employee, or any third party under the control or supervision of the indemnitee, other than the indemnitor or its agent, employee, or subcontractor of any tier.”

# Texas Anti-Indemnity Act - EXCLUSIONS

## ➤ Some of the main exclusions:

- Employee Claims
- Residential Construction Exception
- Public Projects
- Breach of contract or warranty actions that exists independent of an indemnity obligation
- Indemnity Provisions pertaining to claim based upon copyright infringement

## Texas Anti-Indemnity Act – How it affects Additional Insured Provisions

151.104: Any requirement in a construction contract for a party to name another as an AI under a policy of insurance with a scope of coverage that would cover the other party's own negligent conduct would be void to the extent it required coverage for the other party's own negligence.

**NO. 3 – DISPUTE RESOLUTION**  
**PROVISIONS**



# Dispute Resolution Provisions

- Mediation
  - Require as a precondition to bringing a legal action?
  - Mandatory during a legal proceeding?
- Lawsuit
  - Waiver of trial by jury
  - Bench trial
  - Controlling law
  - Forum Selection Clause



# Dispute Resolution Provisions: Arbitration

- Is there an agreement to arbitrate?
- Does the arbitration clause apply to the dispute?
- How is the arbitration structured under the contract?

# Dispute Resolution Provisions

- Basic arbitration clause from the AAA:
- Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association under its Construction Industry Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

# Dispute Resolution Provisions – Do you have a choice to arbitrate?

- Parties to a contract with an arbitration clause do not have to arbitrate if both parties agree to proceed with litigation.
- If only one party wants to arbitrate and the dispute is subject to the arbitration agreement, the willing party can compel the other party to arbitrate.
  - There is a strong presumption in favor of arbitration under Federal and Texas law.

# Dispute Resolution Provisions

- Other terms that may be contained within the arbitration clause:
  - The governing rules (i.e. AAA);
  - How the arbitrator will be selected;
  - Forum selection clause;
  - Choice of law clause;
  - Hearing procedure;
  - What relief may be awarded by the arbitrator?

# Dispute Resolution Provisions

## Advantages of Arbitration

- Knowledgeable arbitrator
- More informal
- Confidentiality
- Flexibility on rules of discovery and evidence
- Potential speed and efficiency of the process
- Less adversarial
- Finality of the award

# Dispute Resolution Provisions

## Disadvantages of Arbitration

- Finality of the award. Limited recourse for review/appeal of the arbitrator's award.
- Risks relating to the decision-maker
- Costs: can be very expensive
- May not save that much time over litigation
- Not all parties to the dispute may be subject to or will participate in the arbitration
- Summary judgment may be more difficult to obtain.

# Why Remain in Court?

- Appellate review of the judge or jury's decision
- Jury trial
- Impartial judge who is not dependent on the parties hiring her again as an arbitrator
- Following established rules and procedures for discovery and evidence
- Enforcement of established legal precedent
- Easier to join all necessary parties

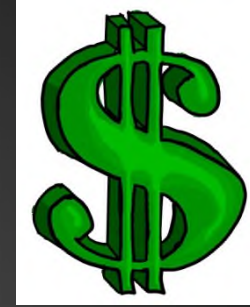


# Do Other Parties Have to Arbitrate?

- Generally, non-signatories to an arbitration agreement cannot be forced to arbitrate and cannot force a party to an arbitration agreement to arbitrate.
  - A non-signatory can agree to participate.
- Exceptions:
  - Equitable Estoppel: a non-signatory can compel arbitration if the plaintiff's claims are based upon the contract which contains the arbitration clause and the plaintiff is a signatory to the contract.
  - Third-Party Beneficiary of the Contract

**No. 4 – Damage or Liability**  
**Limitations Provisions**

# Liquidated Damages



- Liquidated Damages: Such clauses stipulate an amount of recoverable damage resulting from some event, usually a delay on a project's construction.
  - Ex: a delay may trigger a per-day amount penalty. The amount may increase after 30-60 days of delay. Exceeding a specified number of days can allow the owner to seek additional recovery without a cap on damages.
  - Many times unenforceable!

# Liquidated Damages

- It cannot be used as a penalty.
- Two Part Test:
  1. the harm caused by the breach is incapable or difficult of estimation, and
  2. the amount of liquidated damages is a reasonable forecast of just compensation

# Liquidated Damages

- Determining the “Reasonableness” – Examine the ratio between the liquidated damages and the actual loss, as well as the nature of the breach that triggers the provision.
- Can’t Be Disproportionate – If the liquidated damages are shown to be disproportionate to the actual damages, then the liquidated damages must be declared a penalty and recovery limited to the actual damages proven.

# Consequential Damages Waiver

- Consequential Damages: flow from results of an action
  - lost profit, lost rent, interest or finance charges, additional labor costs, and so on.
- Purpose of a waiver is to eliminate uncertainty and unpredictability surrounding the awarding of consequential damages.
- **EXAMPLE:**
  - **CONTRACTOR AND OWNER WAIVE ALL CONSEQUENTIAL, SPECIAL, INDIRECT OR INCIDENTAL DAMAGES AGAINST EACH OTHER. THESE DAMAGES INCLUDE, BUT ARE NOT LIMITED TO, LOSS OF USE, LOSS OF BUSINESS OPPORTUNITY, LOSS OF PRODUCT OR OUTPUT, LOSS OF PROFIT OR REVENUE, COST OF CAPITAL, AND CLAIMS OF OTHERS NOT A PARTY TO THE CONTRACT.**

# Consequential Damages Waiver

- Waivers are enforceable unless they are unconscionable.
- In Determining if Unconscionable, a Court Must Examine:
  - 1) the entire atmosphere in which an agreement is formed;
  - 2) the alternatives available to the parties at the time of contracting;
  - 3) the lack of bargaining ability of one party;
  - 4) whether the contract is contrary to public policy or illegal; and
  - 5) whether the contract is oppressive or unreasonable.

# Liability Limitation and/or Waiver

- LIMITATION OF LIABILITY
- THE CLIENT AND CONTRACTOR AGREE TO LIMIT THE LIABILITY OF CONTRACTOR TO THE CLIENT AND OWNER ON THE PROJECT FOR CONTRACTOR'S ACTS, ERRORS AND/OR OMISSIONS SUCH THAT CONTRACTOR'S TOTAL LIABILITY FOR ANY ALL INJURIES, CLAIMS, LOSSES, EXPENSES OR DAMAGES, INCLUDING ATTORNEY FEES, WHATSOEVER ARISING OUT OF OR RELATED TO THE PROJECT OR THIS AGREEMENT FROM ANY CAUSE, INCLUDING BUT NOT LIMITED TO NEGLIGENCE, BREACH OF CONTRACT, BREACH OF EXPRESS OR IMPLIED WARRANTIES, OR STRICT LIABILITY, SHALL NOT EXCEED CONTRACTOR'S STATED FEE FOR THE PROJECT. CONTRACTOR SHALL NOT BE RESPONSIBLE FOR ANY CONSEQUENTIAL OR INCIDENTAL DAMAGES ARISING FROM ANY ACT, ERROR AND/OR OMISSION OF CONTRACTOR UNDER THIS AGREEMENT.



If you have any questions, please contact us!

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