Closing the Loophole: Anti-indemnity Statutes Should Apply to Additional Insured Provisions

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Introduction

Construction is risky business. Injury to workers and property loss are major risks inherent in any construction project. Parties to a construction project, attempt to transfer these risks using indemnification agreements and additional insured provisions. Indemnification is the action of compensating for loss or damage sustained. The term “additional insured” refers to an entity that has been added to another entity’s insurance policy. One purpose of the additional insured obligation is to reinforce the indemnification agreement and to ensure that there are adequate funds available to support the indemnification obligation.

Thirty seven states have enacted legislation that voids certain types of indemnification agreements on the basis that these agreements are against public policy. An indemnified party may use the additional insured obligation to circumvent some states’ prohibitions on overly broad indemnification agreements though.

This article will focus on the loop-hole that is present in many anti-indemnification statutes. Namely, while an indemnification agreement that purports to indemnify for the sole negligence of the indemnified party may not be enforceable, it is perfectly acceptable to provide insurance coverage, purchased by the indemnifying party

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3 Black’s Law Dictionary (8th ed., West 2004). Indemnification is distinct from exculpation, but there is some overlap. Contractual exculpation is where one party that may suffer losses agrees that it will not pursue the party that is legally responsible for such losses. Exculpatory clauses deny the right of one party to use the legal process when it would otherwise have had the opportunity to do so. In contrast, indemnification does not preclude first instance liability. It deals with the ultimate responsibility by shifting loss from one party to another. Justin Sweet, Legal Aspects of Architecture, Engineering and the Construction Process, 7th Ed., § 31.05, at 690-691 (2004).
5 Id.
6 Strode, supra note 4, at 21.
that does provide coverage for the sole negligence of the party. Very few states have addressed this loop-hole in their anti-indemnification statutes. There is a solution.

**Major Players in the Construction Process**

The typical construction process involves at least four major participants, the owner, the general contractor, the subcontractor and the design professional. This article will focus primarily on the relationship between general contractors and subcontractors.

A general contractor will typically contract directly with an owner to provide a finished product. This finished product may be extremely complicated. Consider the Willis Tower (formerly the Sears Tower) in downtown Chicago. The one-hundred and ten-story tower contains twenty five miles of plumbing, one thousand five hundred miles of electrical wiring, eighty miles of elevator cable and one-hundred and forty-five thousand light fixtures. General contractors will contract with specialty subcontractors, often called trade contractors. Subcontractors specialize in one particular area like electrical, mechanical, carpentry etc.

Even though a general contractor may not perform much, if any, of the actual work itself, the general contractor is nevertheless exposed to risk. In 2008, workers in the construction industry incurred nine-hundred and sixty-nine fatalities, the most fatalities of any industry in the private sector. Most states allow an injured worker to sue the general contractor, even if that employee has already collected worker’s compensation insurance from his employer, the subcontractor. Construction defect lawsuits are also common.

Thus, contractors desire protection from these risks.

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10 The problem is so significant that, in one industry study by the University of California, a third of all condominium projects reported construction defects—and nearly forty percent of those had major flaws. Almost fourteen percent of the owners had filed lawsuits against their developers and another twelve percent had threatened suit. There are several reasons why condominiums have such a high claims history. Condominium developers are frequently over-leveraged and may give quality little consideration. Often the design team isn’t given the chance to provide construction phase services; construction observation may be on call at the developer’s discretion or eliminated altogether to save money. In addition, the potential occupants are frequently first-time homebuyers, older people with limited
General contractors use indemnification and additional insured provisions to shift risk from the general contractor to the subcontractor. Ostensibly, the rationale is that the party that can best avoid the risk should suffer the financial consequences of failing to avoid the risk. 11 This rationale is reasonable if the subcontractor is providing indemnification and additional insured status to the extent of the subcontractor’s negligence only. It is much harder to justify why a subcontractor must indemnify and insure against risks that are not caused by its negligence. It is even more difficult to understand why a subcontractor would ever be required to indemnify and insure against the general contractor’s own negligence. Certainly, the subcontractor is not the best party to avoid the risk should suffer the financial consequences of failing to obtain liability insurance. 13 This insurance may be used to pay for defense costs, settlements, or judgments arising out of claims related to the insured’s work. 14 The

Additional Insured Provisions

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resources, or, perhaps, less sophisticated consumers. They believe the advertisements, promotional materials, and marketing tactics that tend to promise much more than their dollars can realistically buy. Then there are the condominium homeowners associations, whose directors set the budget for maintenance of the common areas and building exteriors. Perhaps because the money must come from their own pockets, associations tend to be reluctant to set dues high enough to cover all the necessary upkeep. The result is poor maintenance, deferred maintenance, or no maintenance at all.


12 Davis v. Commonwealth Edison Co., 61 Ill. 2d 494, 498-99 (1975) “It is generally known that indemnity and hold-harmless agreements are most widely used in the construction industry.”; BRUNER, supra note 9, at §10.8 (2010) “As a general rule, these provisions are drafted in such a way so as to require the contractor to indemnify the owner against loss. Similarly, the general contractor requires its subcontractors to provide it with indemnity. The intent behind the overall effect of these indemnity provisions is to push down through the contracting chain the responsibility for loss or injury.”

13 “The Contractor shall purchase from and maintain in a company or companies lawfully authorized to do business in the jurisdiction in which the Project is located such insurance as will protect the Contractor from claims set forth below which may arise out of or result from the Contractor’s operations and completed operations under the Contract and for which the Contractor may be legally liable, whether such operations be by the Contractor or by a Subcontractor or by anyone directly or indirectly employed by any of them, or by anyone for whose acts any of them may be liable” AIA Document A201-2007 § 11.1
14 Strode, supra note 4.
insurer issues the insurance policy to the “named insured”.\textsuperscript{15} The named insured pays the premium and deductibles, has the power to cancel the policy and receives any notice of cancellation from the insurer.\textsuperscript{16}

In a standard construction contract, the owner requires the general contractor to name the owner as an additional insured on the general contractor’s policy. In turn, the general contractor will require that a subcontractor name both the owner and the general contractor as additional insured on the subcontractor’s policy.\textsuperscript{17}

In order to obtain additional insured status for the general contractor, the subcontractor must purchase an additional insured endorsement to its commercial general liability policy.\textsuperscript{18} As an additional insured on the subcontractor’s policy, the general contractor obtains a direct contractual relationship with the subcontractor’s insurer; however, the general contractor does not pay the premium or the deductible.\textsuperscript{19}

**Additional Insured Provisions Protect Higher Tiered Contractor’s Insurance Policies**

The general contractor will contractually require every subcontractor working on a project to name the general contractor as an additional insured. Thus, several insurance policies may cover the general contractor in addition to the general contractor’s own general liability policy. If a general contractor is faced with a claim, the general contractor would rather use someone else’s insurer than its own.\textsuperscript{20} This tactic protects the general contractor’s pocketbook.\textsuperscript{21} Certain jurisdictions recognize the “targeted tender” rule. As defined by the Illinois Supreme Court in *Kajima Const. Services, Inc. v. St Paul Fire and Marine Ins. Co.*,\textsuperscript{22} the “targeted tender doctrine” or “selective tender doctrine” allows an insured covered by multiple insurance policies to select or target which liability insurer will defend and indemnify it with regard to a specific claim.\textsuperscript{23} If the general contractor chooses to tender its claim to the subcontractor’s insurer, the subcontractor’s

\textsuperscript{15} Malecki, supra note 11.
\textsuperscript{16} Strode, supra note 4.
\textsuperscript{17} Bruner, supra note 9, at §11.206 (2010)
\textsuperscript{19} Bruner, supra note 9, at §11.206 (2010)
\textsuperscript{20} Strode, supra note 4.
\textsuperscript{21} Id. (The general contractor does not pay the deductible and escapes any increase in premium due to claims and does not face the risk that its policy may be cancelled.)
\textsuperscript{22} 227 Ill. 2d 102 (Ill. 2007)
insurer cannot sue the general contractor’s insurer to recover any money paid out on the
general contractor’s behalf.24

Waiver of Subrogation

The subcontractor’s insurer cannot sue the general contractor directly, even if the
general contractor caused the loss.25 An insurance carrier usually has the right of
subrogation, and can “step into the shoes” of its insured and recover from the third party
that caused the loss.26 However, an insurer cannot recover from its insured, including
additional insured.27

Modern Interpretation of Additional Insured Provisions – The Meaning of “Arising
out of the Named Insured Work”

Courts broadly construe the language contained in an additional insured
endorsement.28 Likely, this is because courts fail to draw any distinction between the
coverage that should be afforded to the named insured and the coverage that should be
afforded to the additional insured.29 If an insurance policy is clear and unambiguous, a
court must enforce the policy according to its terms.30 In the likely event that there is an
ambiguity, at least some courts will construe this ambiguity against the insurer.31
Consequently, if a court draws no distinction between the named insured and any
additional insured and the court resolves any ambiguities against the insurer then one
would expect that in close cases the court will rule that insurance policy provides
coverage to the additional insured. Indeed, perhaps the only limit arises from the
language of the additional insured endorsements. Most endorsements contain language

26 NEED CITE
27 NEED CITE
28 Strode, supra note 4, at 23.
29 Douglas Richmond, The Additional Problems of Additional Insured, 33 Tort & Ins. L.J. 945 (1997) (As a
general rule, an additional insured should have rights no greater than those enjoyed by the named
insured. This is because the additional insured is a third party beneficiary of the contract between the
insurer and the named insured. Third party beneficiaries’ rights under a contract can rise no higher than a promisee’s.)
30 Mark Pomerantz, Recognizing the Unique Status of Additional Named Insured, 53 Fordham L.R. 117, 120
31 Mark Pomerantz, Recognizing the Unique Status of Additional Named Insured, 53 Fordham L.R. 117, 120
that is similar to “but only with respect to liability arising out of the named insured’s work.”\textsuperscript{32}

The vast majority of courts have broadly interpreted the phrase “arising out of.”\textsuperscript{33} In \textit{Marathon Ashland Pipe Line LLC v. Maryland Casualty Co.},\textsuperscript{34} Marathon operated an energy pipeline and other related properties.\textsuperscript{35} Marathon entered into a service contract with Steel Structures, Inc. (“SSI”).\textsuperscript{36} SSI was required, by contract, to name Marathon as an additional insured under SSI’s liability insurance policy.\textsuperscript{37} Marathon requested that SSI hire a seventeen-year-old high school student, Berg, to work under Marathon’s direction as a temporary employee.\textsuperscript{38} SSI hired the student and paid his wages, while Marathon directed and controlled all of the student’s work assignments, some of which were not related to any building SSI was erecting for Marathon.\textsuperscript{39}

Berg was seriously injured after a front loader, that Berg was driving, overturned and caused Berg to lose a leg.\textsuperscript{40} Berg sued Marathon for the injuries.\textsuperscript{41} Marathon tendered its defense to SSI’s insurer, but the insurer did not respond.\textsuperscript{42} Marathon eventually settled with Berg and sued the insurer.\textsuperscript{43}

The operative language of the additional insured endorsement provided that Marathon was covered “but only with respect to liability arising out of [SSI’s] ongoing operations performed for [Marathon].”\textsuperscript{44} The trial court granted summary judgment to the insurer.\textsuperscript{45} The trial court reasoned that the contract language only covered claims based on the negligence of SSI and that SSI was not the alleged negligent party.\textsuperscript{46} The Tenth

\begin{thebibliography}{99}
\bibitem{Strode} Strode, \textit{supra} note 4, at 23.
\bibitem{Marathon} 243 F.3d 1232 (10th Cir. 2001)
\bibitem{SSI} 243 F.3d 1232, 1234-1235 (10th Cir. 2001)
\bibitem{Marathon} Id.
\bibitem{SSI} Id.
\bibitem{Marathon} Id.
\bibitem{SSI} Id.
\bibitem{Marathon} Id.
\bibitem{SSI} Id.
\bibitem{Marathon} Id.
\bibitem{SSI} Id. at 1237
\bibitem{Marathon} Id.
\bibitem{SSI} Id.
\bibitem{Marathon} Id.
\end{thebibliography}
Circuit reversed.\textsuperscript{47} The court cited Wyoming precedence, and defined “arising out of” to mean “the natural and reasonable incident or consequence of.”\textsuperscript{48} The court held that SSI’s act of hiring and paying Berg at Marathon’s request and sending Berg to work under Marathon’s sole direction and control, constituted an “ongoing operation out of which Mr. Berg’s injuries were a natural consequence.”\textsuperscript{49} Therefore, the insurer was obligated to provide insurance coverage to Marathon.\textsuperscript{50}

In \textit{County of Hudson v. Selective Insurance Co.}\textsuperscript{51}, an even more remote causal connection between the injury and the named insured’s activities led to coverage for the additional insured.\textsuperscript{52} In that case, Hudson County hired a general contractor, Malpere Enterprises, Inc. to perform masonry restoration work at a courthouse.\textsuperscript{53} Malpere was required to name the County as an additional insured.\textsuperscript{54} The endorsement to Malpere’s liability policy provided that the County was an additional insured, “but only with respect to liability arising out of [Malpere’s] work.”\textsuperscript{55}

Malpere sought to subcontract some of the work.\textsuperscript{56} A potential subcontractor visited the courthouse in order to prepare its bid.\textsuperscript{57} While performing this site visit, an employee of the potential subcontractor slipped and fell on a marble staircase at the courthouse.\textsuperscript{58} The staircase was not under construction at the time, and there was no allegation that Malpere’s conduct had caused or contributed to accident.\textsuperscript{59} The employee of the subcontractor sued the County for his injuries and the County asked Malpere’s insurer to defend and indemnify the County since the County was an additional insured.\textsuperscript{60} The insurer denied coverage.\textsuperscript{61} The insurer claimed that the injured employee was not

\textsuperscript{47}\textit{Id.} \hfill \textsuperscript{48}\textit{Id.} \hfill \textsuperscript{49}\textit{Id.} \hfill \textsuperscript{50}\textit{Id.} \hfill \textsuperscript{51}752 A. 2d 849 (N.J. App. 2000) \hfill \textsuperscript{52}\textit{Id.} \hfill \textsuperscript{53}\textit{Id.} \hfill \textsuperscript{54}\textit{Id. at 850} \hfill \textsuperscript{55}\textit{Id.} \hfill \textsuperscript{56}\textit{Id.} \hfill \textsuperscript{57}\textit{Id.} \hfill \textsuperscript{58}\textit{Id.} \hfill \textsuperscript{59}\textit{Id. at 850} \hfill \textsuperscript{60}\textit{Id. at 851} \hfill \textsuperscript{61}\textit{Id. at 850}
engaged in Malpere’s work when he slipped and fell. 62 The injured worker obtained a judgment against the County.63 The County then sued the insurer seeking indemnification.64

The court found for the County. 65 The court noted that purchasers of insurance are entitled to a broad measure of protection necessary to fulfill their reasonable expectations. 66 Additionally, the court noted that the phrase “arising out of” should be interpreted in a broad and comprehensive sense to mean ‘originating from or “growing out of,”’ and found a “substantial nexus” between the dangerous condition that caused the potential subcontractor’s employee to fall and Malpere’s work. 67 Moreover, the court reasoned that the insurer could reasonably anticipate that the general contractor would use subcontractors to perform its work and that such subcontractors would send representatives to the worksite. 68

This standard seems overly broad. Suppose the potential subcontractor had fallen, not because he slipped, but because a County worker had negligently bumped into him near the steps. Applying the same broad standards of causation, it would appear that the County could seek coverage as an additional insured.

In Shell Oil Co. v. AC & S Inc, 69 AC & S was a subcontractor of Sachs, which in turn was a subcontractor to Bechtel, the general contractor.70 Bechtel had contracted with Shell, the premises owner, to provide construction work.71 Shell was named as an additional insured on both AC & S’ and Sachs’ insurance policies. 72 The additional insured endorsement provided that the coverage only applied to liability “arising out of” the named subcontractor’s work. 73

62 Id.
63 Id. at 851
64 Id.
65 Id.
66 Id. at 852
67 Id.
68 Id. at 853
70 Id. at 948
71 Id.
72 Id.
73 Id. at 951
An employee of AC & S tripped over a pipe and sustained injuries. The injured employee filed a personal injury suit against Shell. Shell claimed that both Sachs’ insurer and AC & S’ insurer must defend and indemnify Shell.

Despite the fact that the pipe that the employee tripped over had nothing to do with the work being performed by either Sachs or AC & S, the court ordered the two insurers to provide coverage to Shell as an additional insured. The court held that any language in the insurance contract “must be liberally construed in favor of the insured; accordingly, ‘but for’ causation, not necessarily proximate causation satisfies this language.” Applying this broad standard, the court reasoned that the employee’s injuries did arise out of the subcontractors’ work because the employee would not have been on Shell’s premises “but for” the operations of the subcontractor, his employer.

For an example of an even more remote connection to the named insured’s work, in Acceptance Insurance Company v. Syufy Enterprises, Syufy Enterprises (the building owner and the additional insured) hired C+C Building Automation Company (an electrical contractor and the named insured) to perform electrical work. An employee of the electrical contractor working on the building owner’s roof was injured as he climbed through a defective roof hatch that provided the only access to and from the roof. As the employee was climbing down through the hatch, it fell shut, severing one of his fingers.

In affirming the trial court’s decision in favor of coverage for the building owner, the court of appeal reasoned that the building owner's liability arose while the electrical contractor was on the building owner's premises to perform the work for which it was contracted. The court further reasoned that liability need not arise directly from the electrical contractor's work product. So long as there is a minimal, or tenuous, causal connection or incidental relationship between the claimant's injury and the work performed by the electrical contractor, liability coverage is extended to the building

74 Id.
75 Id.
76 Id. at 952
77 81 Cal. Rptr. 2d 557 (Cal. App. 1 Dist. 1999)
78 Id.
79 Id.
80 Id.
81 Id.
82 Id.
owner as an additional insured.\textsuperscript{83} But for the fact that the electrical contractor was on the building owner's premises to perform work for the building owner, the claimant would not have been injured (i.e., the claimant could not have performed his work on behalf of the electrical contractor without passing through the defective hatch).\textsuperscript{84}

These four cases illustrate that the relationship between the injury and the work provided to the additional insured need only be tangential in order to for the additional insured to invoke coverage.\textsuperscript{85} This broad interpretation meshes well with the courts’ reasoning that insurance coverage is primarily in place to provide a source of funds for injured persons.\textsuperscript{86} However, this interpretation misses the point. This broad interpretation does accomplish the goal of providing a source of funds for an injured worker. What the courts often overlook, however, is that denying additional insured status would not necessarily cut off this source of funds. As mentioned earlier, general contractors are required to carry their own insurance policies. An injured worker would still have access to a source of funds, namely, those funds provided by the general contractor’s insurer. Additionally, the injured worker would still have access to funds provided by his employer’s worker’s compensation insurer.

**Indemnification Agreements in Construction Contracts**

Indemnification is a powerful risk transfer technique that is available to general contractors and owners.\textsuperscript{87} The Supreme Court of California has defined indemnity as “the obligation resting on one party to make good a loss or damage another party has incurred.”\textsuperscript{88} Courts generally divide indemnification agreements into either Type I, Type II or Type III agreements.\textsuperscript{89} A Type I agreement provides that the indemnitor will indemnify the indemnitee for the negligence of the indemnitee. The indemnitor is

\textsuperscript{83} Id.

\textsuperscript{84} Id.


\textsuperscript{88} Rossmoor Sanitation, Inc. v. Pylon Inc., 13 Cal. 3d 622, 628 (1975).

\textsuperscript{89} BRUNER, *SUPRA* NOTE 9, at §10.2 (2010)
required to indemnify the indemnitee even if the liability arises solely from the
negligence of the indemnitee. A Type II agreement provides that the indemnitor is
required to to indemnify the indemnitee unless the liability arises from the sole
negligence of the indemnitee. A Type III agreement provides that the indemnitor is
required to indemnify the indemnitee against the consequences of the indemnitor’s
negligence only.

Anti-Indemnification Statutes

Most state legislatures have recognized that a lower tiered construction participant
may lack sufficient bargaining power to effectively avoid broad indemnification
agreements. Additionally, states enacted anti-indemnification statutes as an incentive
for those responsible for construction activities to protect workers and others from injury.
Thirty-seven states have statutes that prohibit the enforcement of certain types of
indemnification agreements. These anti-indemnification statutes can be classified as
either Type I or Type II.

90 Mac Donald & Kruise Inc., 29 Cal. App. 3d at 419.
91 Id.
92 Id.
93 Bruner, supra note 9, at §10.90 (2010)
94 For examples of Illinois courts interpreting Illinois’ anti-indemnification statutes, see American Pecco
Corp v. Concrete Bldg. Systems Co., 392 F. Supp. 789 (N.D. Ill. 1975) (By enacting this paragraph, providing
that with respect to contracts, either public or private, for construction, alteration, repair or maintenance
of a building, structure, highway bridge or other work dealing with construction, every covenant, promise
or agreement to indemnify or hold harmless another person from that person's own negligence is void,
the legislature manifested a clear intent to void exculpatory clauses that purport to hold a person
harmless from his own negligence in construction related activities.); Pierre Condominium Ass’n v. Lincoln
Indemnification for Negligence Act was enacted to thwart the common construction industry practice of
using indemnity agreements to avoid liability for negligence and to ensure a continuing incentive for
individuals responsible for construction activities to protect workers and others from injury.); Estate of
Construction Contract Indemnification for Negligence Act that renders void as against public policy any
agreement that indemnifies a party for that party’s own negligence is to protect workers and the public
from attempts to avoid liability through the use of indemnity agreements and encourage worksite safety.)
95 Alabama, Arkansas, the District of Columbia, Iowa, Louisiana, Maine, Nevada, New Hampshire, North
Dakota, Oklahoma, Pennsylvania, Vermont, Wisconsin and Wyoming do not have statutes that bar certain
types of indemnification agreements.
96 There is a third type of statute that voids provisions that purport to indemnify a design professional for
liability arising from its services. Allen Holt Gwyn & Paul E. Davis, Fifty State Survey of Anti-Indemnity
Statutes and Related Case Law, 23 Constr. Law. 26 (2003). However, this type of anti-indemnification
statute is outside the scope of this article and will not be discussed.
Type I statutes void provisions for losses or damages arising from the indemnitee’s sole negligence. This type of legislation is present in fourteen states. An illustrative example is the Virginia statute:

Any provision contained in any contract relating to the construction, alteration, repair or maintenance of a building, structure or appurtenance thereto, including moving, demolition and excavation connected therewith, or any provision contained in any contract relating to the construction of projects other than buildings by which the contractor performing such work purports to indemnify or hold harmless another party to the contract against liability for damage arising out of bodily injury to persons or damage to property suffered in the course of performance of the contract, caused by or resulting solely from the negligence of such other party or his agents or employees, is against public policy and is void and unenforceable. This section applies to such contracts between contractors and any public body, as defined in § 2.2-4301.

This section shall not affect the validity of any insurance contract, workers’ compensation, or any agreement issued by an admitted insurer. The provisions of this section shall not apply to any provision of any contract entered into prior to July 1, 1973.

Type II statutes void provisions that purport to provide indemnification for losses or damages arising from the indemnitee’s negligence, whether sole or concurrent. Twenty-three states have enacted such legislation. Illinois’ statute is typical:

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97 The fourteen states with their statutes are Alaska, ALASKA STAT. § 45.45.900; Arizona, ARIZ. REV. STAT. § 32-1159; California, CAL. CIV. CODE § 2782 (note that there is an exception for contracts entered into after January 1, 2009, but only for residential construction. The statute forbids indemnification, by the subcontractor, for construction defects to the extent that the claims arise out of, pertain to, or relate to the negligence of the builder or contractor. CALIFORNIA, CAL. CIV. CODE § 2782(c)); Georgia, Ga. Code Ann. § 13-8-2; Hawaii, HAWAII REV. STAT. § 431:10-222; Idaho, IDAHO REV. STAT § 29-114; INDIANA, IND. CODE § 26-2-5; Maryland, MD. CODE, CTS AND JDCL PRO, § 5-401; Michigan, MICH. COMP. LAWS § 691.991; New Jersey, N.J. STAT. § 2A:40A-1; South Dakota, S.D. CODIFIED LAWS § 56-3-18; Tennessee, TENN. CODE § 62-6-123; Virginia, VA. CODE § 11-4-1; West Virginia, W.VA. CODE § 55-8-14.

98 VA CODE § 11-4-1.

99 The twenty-three states and their statutes are Colorado, COLO. REV. STAT. § 13-50.5-102; Connecticut, CONN. GEN. STAT. § 52-572k; Delaware, DEL. CODE, Title 6, § 2704; Florida, FLA. STAT. § 725.06 (applies to public work only); Illinois, ILL. COMP. STAT.35/1-3; Kansas, KANSAS STAT. § 16-121; Kentucky, KENTUCKY REV. STAT., chap 371; Massachusetts, MASS. GEN. LAWS, ch 149, § 29C; Minnesota, MINN. STAT §§ 337.01, 337.02; Mississippi, MISS. CODE § 31-5-41; Missouri, MO. REV. STAT. § 434.100; Montana, MONTANA REV. CODE § 28-2-2111; Nebraska, NEB. REV. STAT § 25-21,187; New Mexico, N.M. STAT. § 56-7-1; New York, N.Y. GEN. OBLIG. LAWS § 5-322.1; North Carolina, N.C. GEN STAT. § 22B-1; Ohio, OHIO REV. CODE § 2305.31; Oregon, ORE. REV. STAT. § 30.140; Rhode Island, R.I. GEN. LAWS § 6-34-1; South Carolina, S.C. CODE § 32-2-10; Texas, Tex. Gov.
With respect to contracts or agreements, either public or private, for the construction, alteration, repair or maintenance of a building, structure, highway bridge, viaducts or other work dealing with construction, or for any moving, demolition or excavation connected therewith, every covenant, promise or agreement to indemnify or hold harmless another person from that person's own negligence is void as against public policy and wholly unenforceable.100

The Illinois Supreme Court has interpreted this statute narrowly. In Liccardi v. Stolt Terminals, Inc.101 the lower courts held that an indemnity provision that covered damages caused by the contractor’s negligence was rendered void by Illinois’ anti-indemnity statute. The indemnification provision provided “‘If Vendor performs services . . . hereunder, Vendor agrees to indemnify and hold harmless Stolt Terminals (Chicago) Inc. from all loss or the payment of all sums of money by reason of all accidents, injuries, or damages to persons or property that may happen or occur in connection therewith.’”102 The appellate court held that the provision was invalid because “there is nothing in the provision’s language that would prevent Gunderson (the contractor) from indemnifying Stolt (the owner) for its own negligence.”103

The Illinois Supreme court disagreed. The court held that the literal terms of a contract are not necessarily controlling.104 Rather, a contract should only be deemed illegal if it is expressly contrary to the law or public policy.105 According to the Illinois Supreme Court, a provision that could provide for indemnification even if the indemnified party is negligent does not violate the Construction Contract Indemnification for Negligence Act. Rather, a provision is only void if the indemnifying party must provide indemnification for the negligence of the indemnified party.

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100 740 ILL. COMP. STAT. 35/1.
101 178 Ill. 2d 540 (1997).
102 Id. at 548
103 Id. at 549
104 Id.
105 Id.
An Illustration of the Use of an Additional Insured Provision to circumvent Illinois’ Anti-Indemnification Statute.

Courts distinguish between contractual provisions that require one party to indemnify another from those provisions that require one party to obtain indemnity from a third source for another. 106 Put another way, an anti-indemnity law will not necessarily void a contractual provisions that require a contractor or subcontractor to obtain insurance for another construction participant. 107 It appears, therefore, that it is not important what kind of indemnification is provided, but rather who is providing the indemnification.

As an illustration, Illinois has a Type II indemnification statute that voids an indemnification clause that provides for losses or damages arising from the indemnified party’s sole or concurrent negligence. 108 However, the anti-indemnification act does not apply to insurance contracts or agreements. 109

In St. John v. City of Naperville 110 the Appellate Court of Illinois for the Second District explained the difference between an agreement to indemnify and an agreement to purchase insurance coverage.

According to an Illinois appellate court, the intent of Illinois’ anti-indemnification act was to “thwart attempts to avoid the consequences of liability and thereby insure a continuing motivation for persons responsible for construction activities to take accident prevention measures and provide safe working conditions.” 111 The court distinguished agreements to indemnify that are contained in bonds or insurance contracts. 112 Agreements in bonds or insurance contracts were valid under section 3 of Illinois’ anti-indemnification statute because these agreements “preserv[ed] supplemental sources of compensation for injured persons.” 113

The court then examined the relevant portions of the agreements between the parties:

106 BRUNER, supra note 9, at §10.82 (2010)
107 id.
108 740 ILL. COMP. STAT. 35/1.
109 740 ILL. COMP. STAT. 35/3
110 155 Ill. App. 3d 919 (Ill. App. 2 Dist 1987)
111 St. John v. City of Naperville, 155 Ill. App. 3d 919, 922 (Ill. App. 2 Dist 1987)
112 id. at 921-922.
113 id. at 921-922.
2. The Contractor shall provide all insurance necessary to protect and save harmless the property, the Owner and his representatives and the Contractor within the statutes of the State, and including, but not limited to those herein enumerated . . .

c. Insurance shall include the following requirements, clauses and policies;
   (1) Operations-Premises Liability
   (2) Elevator Liability
   (3) Contractor's Protective Liability
   (4) Products Liability-Completed Operations Liability
   (5) Contractual Liability equal to the following hold harmless agreement:
   The Contractor agrees to indemnify and save harmless the Owner, their agents and employees from and against all loss and expenses (including costs and attorneys' fees) by reason of liability imposed by law upon the Owner for damages because of bodily injury, including death at any time resulting therefrom sustained by any person or persons on or account of damage to property, including loss of use thereof, arising out of or in consequence of the performance of this work, whether such injuries to persons or damage to property be due to the negligence of the Contractor, his Subcontractors or the Owner.

The court emphasized that the language in section 2(c)(5) which provided for indemnification was a subsection of section 2 of the contract, which provided generally that the contractor was to provide insurance to protect the owner. 114 Accordingly, the court held that “[u]pon consideration of the contract as a whole, we find that the agreement . . . expresses an intent . . . to secure insurance to provide indemnity for [the owner] and did not constitute a promise to to personally indemnify [the owner].”

The court drew a distinction based on who was providing the indemnification, rather than the language of the indemnification agreement itself. This distinction is hard to understand though, in light of the court’s interpretation of the purpose of the statute, namely, to “thwart attempts to avoid the consequences of liability.” 115 While the subcontractor’s insurer, rather than the subcontractor itself, would ultimately be responsible for paying any judgment and costs of defense, the owner did not pay the premiums or the deductible associated with the policy. Thus, it appears that the owner would avoid the consequences of liability. The very behavior that the anti-indemnification statute was designed to prevent.

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114 St. John v. City of Naperville, 155 Ill. App. 3d 919, 924 (Ill. App. 2 Dist 1987)
115 id. at 921.
Oregon’s approach: Interpreting the Anti-Indemnity Statute to Cover an Additional Insured Provision

In *Walsh Const. Co. v. Mutual of Enumclaw*, the Oregon Supreme Court ruled that Oregon’s anti-indemnity law extended to an additional insured endorsement. Walsh, a general contractor, entered into a subcontract with Ron Rust Drywall, Inc. ("Rust") to perform work on a Walsh project. Rust was contractually obligated to procure liability insurance coverage naming Walsh and its agents as additional insured. Rust obtained this endorsement from its insurance carrier, Enumclaw.

A Rust employee was injured on the job and made a claim against Walsh; Walsh tendered the claim to Enumclaw. Enumclaw refused the tender, arguing, in part, that the additional insured provision of the subcontract violated Oregon’s anti-indemnity statute. Walsh argued that the anti-indemnity statute applied to agreements to indemnify only, not agreements to procure insurance.

Oregon’s anti-indemnity statute provides:

> Except to the extent provided under subsection (2) of this section, any provision in a construction agreement that requires a person or that person’s surety or insurer to indemnify another against liability for damage arising out of death or bodily injury to persons or damage to property caused in whole or in part by the negligence of the indemnitee is void.

(Emphasis added.)

Walsh focused on the emphasized parts of the statutory language and argued that its contract with Rust did not require either Rust or Rust’s insurer to indemnify Walsh. Rather, Rust was only required to purchase insurance for Walsh’s benefit. The difference, according to Walsh, was that “indemnity” connotes an unlimited liability

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116 338 Or. 1 (2005)
117 *id.* at 4
118 *id.*
119 *id.*
120 *id.*
121 *id.*
122 *id.*
124 *Walsh Const. Co. at 5*
125 *id.*
exposure, but insurance limits the insurer’s liability to the amount of coverage purchased. 126

Rust, on the other hand, argued that the statute specifically referred to insurance. 127 Further, the only way that a person’s insurer can agree to “indemnify another” is to add that other person to the insurance policy. 128

Ultimately, the Oregon Supreme Court agreed with Rust. In addition to agreeing with the Appellate Court’s conclusion that the legislative history of the statute supported Rust’s interpretation, the Oregon Supreme Court held that the statute was clear on its face and there was no need to resort to the legislative history. 129 Specifically, the Oregon Supreme Court held that Oregon’s anti-indemnity statute “prohibits not only ‘direct’ indemnity arrangements . . . but also ‘additional insurance’ arrangements . . . .” 130

The court’s reasoning recognized the futility of attempting to separate an agreement to provide insurance from an agreement to indemnify.

Whether the shifting allocation of risk is accomplished directly, e.g., by requiring the subcontractor itself to indemnify the contractor for damages caused by the contractor's own negligence, or indirectly, e.g., by requiring the subcontractor to purchase additional insurance covering the contractor for the contractor's own negligence, the ultimate-and [in this respect] statutorily forbidden-end is the same. 131

**Why Oregon’s Approach Makes Sense and the Need for Reform**

The Oregon Supreme Court’s holding that Oregon’s anti-indemnification statute applies to both indemnification agreements and agreements to purchase insurance coverage makes sense. Further, the ideal solution involves both a legislative and judicial fix. Legislatures must draft anti-indemnification statutes that clearly prohibit both direct indemnity agreements and agreements to purchase insurance that purport to protect the indemnified/additional insured party from its own negligence. The judiciary must abandon its rationale that agreements to insure are fundamentally different from

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126 *Id.*
127 *Id.*
128 *Id.* at 6
129 *Id.* at 10
130 *Id.*
131 *Id.*
agreements to indemnify. 132 Parties that are lower down on the contracting chain, lower tiered subcontractors and suppliers, simply lack the bargaining power to negotiate fairer indemnification and additional insured provisions into contracts. 133

The Rationale that Courts Use to Distinguish Between Agreements to Obtain Insurance and Indemnification Agreements Misses the Point

The common rationale that courts use to distinguish agreements to obtain insurance from agreements to indemnify is that agreements to obtain insurance are a proper method of distributing risk, while agreements to indemnify, particularly for the indemnitee’s own negligence, induce carelessness on the job site. 134

While it is true that insurance companies are in the business of dealing with risk and construction companies are in the business of dealing with construction, it is not reasonable to conclude, on these facts alone, that courts should not subject the interpretation of agreements to purchase insurance coverage to the same scrutiny as agreements to provide indemnification. The crucial question is whether the indemnification or additional insured agreement protects the indemnified or insured party from its own negligence. If a party is protected from its own negligence, whether directly via an indemnification agreement or indirectly via an additional insured agreement, there is a good argument that the incentive to reduce carelessness on the job site is removed.

Further, as mentioned earlier, courts often justify a broad interpretation of additional insured endorsements because one purpose of insurance is to provide a source of funds for an injured worker. This argument presupposes that if the court does not construe the additional insured endorsement broadly then the injured worker will not have a source of funds to rely on. This is simply not true. First, the injured worker will almost certainly receive compensation through his employer’s worker’s compensation insurance, even if the injury was not caused by any party’s negligence. 135 Second, if the

134 SWEET, supra note 3, at 701.
135 BRUNER, supra note 9, at §11.299 (2010)
injured worker ultimately does prevail against the responsible party, that party will almost certainly have insurance to cover that risk. Consequently, it is not a question of whether the injured employee will have access to a source of funds. Rather, the issue is who will bear the ultimate cost. If a party is providing its own insurance that party is responsible for paying any deductible and any increase in premium that is associated with claims made against the policy. That party has an incentive to work carefully and avoid claims. If a party obtains insurance via an additional insured endorsement, that party does not have the same incentive.

Even if the logic of the courts were correct, that a broad interpretation is appropriate because the purpose of insurance is to provide a source of funds for an injured worker, courts do not seem to consider the impact on the subcontractor when its policy is called upon to defend. Subcontractor’s Insurance Policy Limits are Likely to be Depleted

In a large construction dispute, multiple insured, both named and additional, may make claims against the same policy and deplete the policy limits. Since the number of additional insured will often exceed the number of named insured, the probability exists that the claims by the additional insured may exhaust coverage. In this case, the subcontractor may be left without coverage and exposed to any unsatisfied additional insured. In order to avoid this issue, general contractors are likely to demand that subcontractors obtain higher limits of insurance. Higher limits mean higher costs, for the subcontractor.

Subcontractor’s Insurance Premiums will Increase

A broad interpretation of additional insured coverage that includes the negligence of others increases the potential for claims and losses. Since most subcontractors’

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136 The responsible party will have the coverage because either the party is reasonably prudent or the party is required to obtain the insurance by contract. *Sweet, supra* at 700.


138 MALECKI, *supra* note 11, at 71; Strode *supra* note 4, at 24.

139 David R. Hendrick, *Insurance Law: Understanding the Basics Regarding “Additional Insured,”* 690 PRACTISING LAW INSTITUTE 591, 642 (2003). When the policy limits have been exhausted, the insurer is released from any further responsibility, whether it be to the additional insured or the named insured. Id. at 635; Strode, *supra* note 4, at 24.

140 When the policy limits have been exhausted, the insurer is released from any further responsibility, whether it be to the additional insured or the named insured. Id. at 635; Strode, *supra* note 4, at 24.

policies are not purchased on a project-by-project basis, insurance companies factor the number of claims made against a policy to calculate the premium. A poor rating will certainly raise premiums and could even result in an insurer denying coverage. Interestingly, this cost is not fully passed on to the general contractor because the subcontractor does not know the cost at the time it submits its price quote. If an insurer does charge a subcontractor for an additional insured endorsement, the fee makes up a small portion of the overall cost of the premium. Interestingly, the party that is responsible for bearing all the future costs, the subcontractor, often is the party least able to handle these increased costs.

The Deductible: The Subcontractor’s Money, not the Insurer’s

Almost all insurance policies have a deductible that must be satisfied before the policy will begin to pay for judgments, settlements, and in some cases, defense costs. The named insured, alone, is responsible for the deductible, which can range from several thousand to several million dollars, per claim. If the subcontractor is primarily responsible for the claim, it makes sense for the subcontractor to pay the deductible. This provides another incentive to work safely. On the other hand, if the subcontractor is minimally at fault or not at fault at all, it is much harder to justify why the subcontractor should have to pay the deductible. The subcontractor is put in a difficult position; it can choose a policy with a lower deductible and correspondingly higher premium cost, or it can choose a policy with a high deductible and try to minimize claims against the policy. Again, the subcontractor can make efforts to work safely to reduce its own claims, but there is nothing that the subcontractor can do to reduce claims by the additional insured.

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142 Brief of Amicus Curiae at 7, Chrysler Corp. v. Merrell & Garaguso, Inc., 796 A.2d 648 (Del. 2002)(No. 38-2001); Strode, supra note 4, at 24.
143 Often called “experience ratings.” Strode, supra note 4, at 24.
144 Hendrick, supra note 139, at 643; Strode, supra note 4, at 24.
145 Strode, supra note 4, at 24.
146 Hendrick, supra note 139, at 643; Strode, supra note 4, at 24.
147 Id. This is not to suggest that the cost is inconsequential. Rather, the insurance companies simply charge a fixed cost for the premium based on the loss rate. This loss rate is not subdivided into losses by the named insured v. losses of the additional insured. From the insurance companies perspective, it makes no difference whether the loss is caused by the named insured or the additional insured, since the insurer will pay regardless.
148 Strode, supra note 4, at 24.
149 Id. at 25.
150 Id.
Legislatures and courts must treat additional insured endorsements like agreements to provide indemnification. If an agreement to provide indemnification for the negligence of the indemnified party is void, an agreement to provide insurance for the negligence of the additional insured should also be void. This interpretation would not remove the source of funds for an injured worker. Rather, it would ensure that the entity paying, either directly or indirectly, was the responsible party. Consequently, all parties on a construction project would have a greater incentive to work safely.