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The Texas Anti-Indemnity Act.

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RECENT DEVELOPMENT

THE TEXAS ANTI-INDEMNITY ACT

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I. INTRODUCTION

Commercial construction is growing in Texas.[1] But these projects are inherently risky.[2] Owners, general contractors, and subcontractors employ risk-transferring agreements to ameliorate risk amongst those who actually exercise control.[3] Some of these agreements include hold-harmless agreements,[4] indemnity agreements,[5] releases,[6] and conferring additional insured status to others.[7]

Usually parties to an agreement enjoy a certain amount of autonomy to contract their desired terms.[8] Historically, risk-shifting agreements were enforceable if they passed the fair notice requirements:[9] the express

1. *See* Nancy Samoff, *Texas (Nearly) Tops for Commercial Real Estate*, HOUS. CHRON. (Nov. 4, 2013), http://blog.chron.com/primeproperty/2013/11/texas-nearly-tops-for-commercial-real-estate (contributing "$4.34 billion in new projects" for commercial real estate).

2. 2 PATRICK J. WIELINSKI ET AL., CONTRACTUAL RISK TRANSFER: STRATEGIES FOR CONTRACT INDEMNITY AND INSURANCE PROVISIONS, at XVII.B.1 (Int'l Risk Mgmt. Inst. 1996).

3. *See* Dresser Indus., Inc. v. Page Petrol., Inc., 853 S.W.2d 505, 508 (Tex. 1993) (suggesting that indemnity contracts shift risks amongst contractors and subcontractors); *see also* Green Int'l, Inc. v. Solis, 951 S.W.2d 384, 387 (Tex. 1997) (distinguishing the exculpatory agreement in *Dresser* with shifting economic damages).

4. *See* BLACK'S LAW DICTIONARY 658 (5th ed. 1979) ("A contractual arrangement whereby one party assumes the liability inherent in a situation, thereby relieving the other party of responsibility."); *see also Dresser Indus.*, 853 S.W.2d at 508 (defining a hold-harmless agreement).

5. *See Dresser Indus.*, 853 S.W.2d at 508 ("An indemnity agreement is a promise to safeguard or hold the indemnitee harmless against either existing and/or future loss liability." (citation omitted)).

6. *See id.* ("In general, a release surrenders legal rights or obligations between the parties to an agreement." (citing Cox v. Robison, 105 Tex. 426, 150 S.W. 1149, 1155 (1912))).

7. *See* Getty Oil Co. v. Ins. Co. of N. Am., 845 S.W.2d 794, 803 (Tex. 1992) (opining that the "insurance-purchaser's insurers" become liable for the losses incurred by the indemnitor).

8. *See* El Paso Field Servs., LP v. MasTec N. Am., Inc., 389 S.W.3d 802, 811–12 (Tex. 2012) ("We have long recognized Texas's strong public policy in favor of preserving the freedom of contract." (citation omitted) (quotations omitted)); *see also* Mid-Continent Supply Co. v. Conway, 240 S.W.2d 796, 804 (Tex. Civ. App.—Texarkana 1951, writ ref'd n.r.e.) (reiterating the strong public policy of the freedom to contract).

9. *See* Sydlik v. REEIII, Inc., 195 S.W.3d 329, 332 (Tex. App.—Houston [14th Dist.] 2006, no pet.) ("Thus, fair notice is the chief test we must apply, and conspicuousness and express negligence are merely the two prongs of that test."). *See generally* Ryan C. Hudson et al., *When the Extraordinary*

negligence rule[10] and the conspicuousness test.[11] However, the trend in recent years has been to limit exculpatory clauses.[12] In 2011, the Texas Legislature appeared to effectively void risk-transferring agreements in commercial construction as against public policy under the Texas Anti-Indemnity Act (the Act).[13] The Act includes sections that render indemnity agreements and other liability-shifting agreements void and unenforceable,[14] and that specify the applicability of the Act,[15]

Becomes Ordinary: Is the Express Negligence Rule Under Attack in Texas?, 60 BAYLOR L. REV. 941 (2008) (discussing recent case law and the fair notice requirements).

10. *See* Ethyl Corp. v. Daniel Constr. Co., 725 S.W.2d 705, 707–08 (Tex. 1987) (emphasizing that in order to be released or indemnified from liability, the intent must be expressed in unambiguous terms); *see also Dresser Indus.*, 853 S.W.2d at 508 (applying the express negligence test to releases along with other risk-shifting agreements).

11. Conspicuousness means that on the face of the contract, it draws the attention of the parties. *See Dresser Indus.*, 853 S.W.2d at 511 ("When a reasonable person against whom a clause is to operate ought to have noticed it, the clause is conspicuous."); *see also* Stephanie J. Greer & Hurlie H. Collier, *The Conspicuousness Requirement: Litigating and Drafting Contractual Indemnity Provisions in Texas After* Dresser Industries, Inc. v. Page Petroleum, Inc., 35 S. TEX. L. REV. 243, 269 (1994) ("[W]ould a reasonable person against whom it is to operate have noticed it?"). This may include bold font, underlined text, differing colors, all caps, or different typefaces. *See generally id.* (outlining the conspicuousness requirement in indemnity agreements).

12. In recent years, several states passed similar anti-indemnity statutes limiting indemnity agreements and additional insured status. COLO. REV. STAT. §§ 13-50.5-102, 13-21-111.5 (2011); KAN. STAT. ANN. § 16-121 (2007); N.M. STAT. ANN. § 56-7-1 (LexisNexis 2010); OR. REV. STAT. § 30.140 (2011). For a comprehensive list of anti-indemnity statutes by state, see AM. SUBCONTRACTORS ASSOC., INC., ANTI-INDEMNITY STATUTES IN THE 50 STATES (2013), *available at* http://www.keglerbrown.com/content/uploads/2013/10/ASA-Anti-Indemnity-Chart-2013.pdf.

13. Act approved June 17, 2011, 82d Leg., R.S., ch. 1292, § 1, 2011 Tex. Gen. Laws 3612, 3612–14 (codified at TEX. INS. CODE ANN. §§ 151.001–.151 (West Supp. 2013)). Prior to 2011, an anti-indemnity provision in construction contracts existed in construction contracts "entered into by a state governmental entity . . . concerning the construction, alteration, or repair, of a state public building or carrying out or completing any state public work." Acts of 2001, 77th Leg., ch. 1422, § 14.17, 2001 Tex. Gen. Laws 5068, 5068 (codified at TEX. GOV'T CODE ANN. § 2252.902), *repealed by* Acts approved June 17, 2011, 82d Leg., R.S., ch. 1292, § 2, 2011 Tex. Gen. Laws 3612, 3614. While this act contains many similarities to the Act passed in 2011, it was much narrower in scope as it only applied to governmental entities. Acts of 2001, 77th Leg., ch. 1422, § 14.17, 2001 Tex. Gen. Laws 5068, 5068 (repealed 2011). Under the Texas Civil Practice and Remedies Code, exculpatory agreements with "a registered architect, licensed engineer" were void as against public policy. TEX. CIV. PRAC. & REM. CODE ANN. § 130.002 (West 2012). However, under the Act the prohibition on risk-transferring contracts was substantially broadened. Act approved June 17, 2011, 82d Leg., R.S., ch. 1292, § 1, 2011 Tex. Gen. Laws 3612, 3612–14 (codified at TEX. INS. CODE ANN. §§ 151.001–.151 (West Supp. 2013)).

14. TEX. INS. CODE ANN § 151.102 (West Supp. 2013).

15. *Id.* § 151.101.

exemptions,[16] exclusions,[17] and—perhaps most troubling—the inability to waive any provision of the Act.[18]

The Act went into effect on January 1, 2012[19] and is codified in sections 151.001 to 151.151 of the Texas Insurance Code.[20] The Act was passed to protect insurance companies from exposure to liability for claims which they did not agree to underwrite.[21] The counter-argument is that the Act was implemented to protect the imbalance between subcontractors, who typically bear the brunt of indemnity agreements, and contractors, who have more bargaining power.[22]

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16. *Id.* §§ 151.103, 151.104(b).

17. *Id.* § 151.105.

18. *Id.* § 151.151.

19. *See* Act approved June 17, 2011, 82d Leg., R.S., ch. 1292, § 3, 2011 Tex. Gen. Laws 3612, 3614 (codified at TEX. INS. CODE ANN. §§ 151.001–.151 (West Supp. 2013)) ("[T]his Act, applies only to a . . . construction project that begins on or after January 1, 2012.").

20. INS. §§ 151.001–.151 (West Supp. 2013).

21. There is little legislative intent or history on this Act, as is typical in Texas. The only statement of intent given concerns the duration of insurance programs currently in place, in that there is no requirement as to how long a contractor must maintain insurance for a given construction contract. House Comm. on Insurance, Bill Analysis, Tex. H.B. 2093, 82d Leg., R.S. 1 (2011), *available at* http://www.lrl.state.tx.us/scanned/srcBillAnalyses/82-0/HB2093ENG.pdf. However, while section 151.051 requires insurance coverage for at least three years, the statute of repose is ten years. *Compare* INS. § 151.051 (West Supp. 2013) (requiring coverage for three years), *with* TEX. CIV. PRAC. & REM. CODE ANN. § 16.008 (West 2002) (limiting suits against an "architect, engineer, interior designer, or landscape architect" to a period of 10 years after completion of the project), *and* CIV. PRAC. & REM. § 16.009 (West 2002) (stating that a suit against someone who improves real property must be filed within "10 years after the substantial completion of the improvement"). While it appears that it is the indemnitor, or subcontractor, who bears the burden of risk-shifting contracts, "[i]n reality, many of the risks that are transferred contractually . . . are ultimately transferred to an insurer by the party accepting the risk transfer (the indemnitor)." 2 PATRICK J. WIELINSKI ET AL., CONTRACTUAL RISK TRANSFER: STRATEGIES FOR CONTRACT INDEMNITY AND INSURANCE PROVISIONS, at XVII.G.1 (Int'l Risk Mgmt. Inst. 2002).

22. The relationship between owners, contractors, and subcontractors is like a food chain; those on the bottom support the top. *See* 2 PATRICK J. WIELINSKI ET AL., CONTRACTUAL RISK TRANSFER: STRATEGIES FOR CONTRACT INDEMNITY AND INSURANCE PROVISIONS, at XVII.S.14 (Int'l Risk Mgmt. Inst. 2002) (noting that contractors and owners both "look to the subcontractors' insurance for protection"). Based on recent case law and skyrocketing insurance prices, it can be deduced that this Act was enacted to protect subcontractors. *See generally* Trisha Strode, *From the Bottom of the Food Chain Looking Up: Subcontractors and the Full Costs of Additional Insured Endorsements*, 25 CONSTR. LAW. 21 (2005) (arguing that subcontractors pay a disproportionate amount compared to contractors and owners in construction projects). "Owners' and contractors' risks are often transferred down to the subcontractor pursuant to the incorporation by reference of the general contract into the subcontract. Risks may be further transferred in contracts between the subcontractor and its own sub-subcontractors and suppliers as well." 2 PATRICK J. WIELINSKI ET AL., CONTRACTUAL RISK TRANSFER: STRATEGIES FOR CONTRACT INDEMNITY AND INSURANCE PROVISIONS, at XVII.B.1 (Int'l Risk Mgmt. Inst. 1996). A similar argument was made when the Texas Oilfield Anti-Indemnity Act was passed in the early 1970s. *See* Getty Oil Co. v. Ins. Co. of N.

The language of the statute and how and when the Act applies is discussed in Part II of this article. Part III deals with the exemptions and exclusions from the Act, including residential and municipal projects. Part IV addresses the inability to waive the statute on commercial construction in Texas. Finally, Part V discusses where to go from here.

II. REQUIREMENTS RELATED TO INDEMNIFICATION[23]

Constructions contracts typically include both indemnity agreements and additional insured provisions.[24] These differ greatly in application.[25] Indemnity agreements are the rare exception to the general rule that parties are not liable for their own negligence.[26] In an indemnity agreement, an indemnitor[27]—usually the subcontractor—is liable to the indemnitee[28]—typically the owner, general contractor, or another subcontractor—for the negligence of the indemnitee and the indemnitee's agents and employees.[29] Under such an agreement, a completely innocent

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Am., 845 S.W.2d 794, 803 (Tex. 1992) (citing the "perceived inequity" between owners, general contractors, and subcontractors as the reason behind passing the statute).

23. This section covers subchapter C of chapter 151 of the Texas Insurance Code. INS §§ 151.101–.105 (West Supp. 2013).

24. The Act also limits other risk-shifting agreements, but for brevity this Article will focus on indemnity agreements and additional insured status.

25. *See* Fireman's Fund Ins. Co. v. Commercial Standard Ins. Co., 490 S.W.2d 818, 823 (Tex. 1972) (emphasizing that additional insured status allows an indemnitee to recover from an insurance company in the event the indemnitor is insolvent versus an indemnity agreement where the indemnitee can only see recovery from the indemnitor), *overruled by* Ethyl Corp. v. Daniel Constr. Co., 725 S.W.2d 705 (Tex. 1987); *see also Getty Oil Co.*, 845 S.W.2d at 803 (differentiating between additional insured provisions and indemnity agreements).

26. Hous. Lighting & Power Co. v. Atchison, Topeka & Santa Fe Ry. Co., 890 S.W.2d 455, 458 (Tex. 1994); *see also* 2 PATRICK J. WIELINSKI ET AL., CONTRACTUAL RISK TRANSFER: STRATEGIES FOR CONTRACT INDEMNITY AND INSURANCE PROVISIONS, at IV.E.1 (Int'l Risk Mgmt. Inst. 1995) ("[Indemnity] clauses conflicted with the principle that every party should be responsible for its own negligence."); Ryan C. Hudson et al., *When the Extraordinary Becomes Ordinary: Is the Express Negligence Rule Under Attack in Texas?*, 60 BAYLOR L. REV. 941, 953 (2008) (opining that risk-shifting agreements are extraordinary in nature).

27. *See* INS. § 151.001(6) (West Supp. 2013) ("'Indemnitor' means a party to a construction contract that is required to provide indemnification or additional insured status to another party to the construction contract or to a third party."); *see also* DONALD S. MALECKI ET AL., THE ADDITIONAL INSURED BOOK 177 (5th ed. 2004) (defining indemnitor as the one who "assumes the other party's liability").

28. *See* DONALD S. MALECKI ET AL., THE ADDITIONAL INSURED BOOK 177 (5th ed. 2004) (stating that the indemnitee transfers its liability to another).

29. *See id.* ("A project owner will typically require that the contractor(s) it hires to perform the work will also hold the project owner harmless . . . . The same contractual relationship will typically exist between contractors and their subcontractors, with the contractor being the indemnitee and the subcontractor being the indemnitor."). Indemnity is defined as: "1) A duty to make good any loss, damage or liability incurred by another. 2) The right of an injured party to claim reimbursement for

party may be held liable and accountable for damages.[30] Indemnity agreements are classified in three different categories—broad, intermediate, and limited form—"based on the scope of the indemnification obligation undertaken by the indemnitor."[31] Broad form agreements transfer all liability and loss to the indemnitor, regardless of fault.[32] Limited form indemnity agreements are oftentimes called a "comparative fault indemnification agreement" where an indemnitor is only responsible for their own fault.[33] Intermediate agreements fall in the middle: "[T]he indemnitor assumes all liabilities of the indemnitee relating to the subject matter of the agreement, except where the injury or damage is caused by the indemnitee's sole negligence."[34] Indemnity agreements, along with releases, hold-harmless agreements, and other liability-transferring clauses, have been routinely upheld as enforceable.[35]

On the other hand, additional insured clauses are typically included in construction contracts, either in the same section of the contract as the indemnity agreement or as a separate condition.[36] "Additional insured" status provides another layer of protection to the indemnitee, as the indemnitor's insurance carrier covers the indemnitee.[37] An "additional insured" is separate and distinct from a "named insured" on an insurance policy.[38] A "named insured" is the one who typically purchases the insurance policy, is responsible for paying the premiums on the policy, and

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its loss, damage, or liability from a person who has such a duty. 3) Reimbursement or compensation for loss, damage, or liability." BLACK'S LAW DICTIONARY 784 (8th ed. 2004).

30. *See Hous. Lighting & Power Co.*, 890 S.W.2d at 458 (emphasizing that indemnity agreements keep innocent parties on the hook for damages).

31. 2 PATRICK J. WIELINSKI ET AL., CONTRACTUAL RISK TRANSFER: STRATEGIES FOR CONTRACT INDEMNITY AND INSURANCE PROVISIONS, at IV.D.1 (Int'l Risk Mgmt. Inst. 1995).

32. *Id.*

33. *Id.* at IV.D.4 (emphasis omitted).

34. *Id.* at IV.D.3.

35. *See, e.g.*, James Stewart & Co. v. Mobley, 282 S.W.2d 290, 293 (Tex. Civ. App.—Dallas 1955, writ. ref'd) ("[W]e are of the opinion that in the majority of such cases . . . liability exists under an indemnity agreement for such indemnitee's own negligence."), *overruled on other grounds by* Ethyl Corp. v. Daniel Constr. Co., 725 S.W.2d 705 (Tex. 1987); N. Tex. Traction Co. v. City of Polytechnic, 236 S.W. 73, 77 (Tex. Comm'n App. 1922, judgm't adopted) (enforcing an indemnity agreement contained in a city ordinance).

36. *See* DONALD S. MALECKI ET AL., THE ADDITIONAL INSURED BOOK 177 (5th ed. 2004) (requiring additional insured status along with indemnitor and indemnitee status in construction contracts).

37. *See* Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc., 256 S.W.3d 660, 675 (Tex. 2008) (forcing the indemnitor's insurer to cover the negligence of the indemnitee as an additional insured).

38. *See* AMY ELIZABETH STEWART, TEXAS INSURANCE COVERAGE LITIGATION § 2–4, at 24–31 (2013) (discussing the differences between the varying types of insured on an insurance policy).

is entitled to a defense by the insurer.[39] On the other hand, an "additional insured" is not responsible for paying premiums on the policy or for initially purchasing the policy, but is protected as if he was a "named insured" on the policy.[40]

A. *Agreement Void and Unenforceable*

When interpreting a statute, courts and practitioners must first look to the plain language of the statute and determine the legislature's intent from the words themselves.[41] Section 151.102 of the Act states:

> Except as provided by Section 151.103, 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.[42]

Reading the statute as a whole, the legislature effectively overruled thirty years of precedent in Texas with respect to certain broad and intermediate form indemnity agreements, leaving much ambiguity in construction law.[43] Since 1990, Texas has employed a two-part test to determine fair notice of the enforceability of contractual broad and intermediate form indemnity agreements: the "express negligence" test and the "conspicuousness" test.[44]

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39. *See* W. Indem. Ins. Co. v. Am. Physicians Exch., 950 S.W.2d 185, 188–89 & n.5 (Tex. App.—Austin 1997, no writ) (outlining the difference between a named and an additional insured).

40. *Id.* at 188–89. An "additional named insured" is another way to be covered under an insurance policy. There are both advantages and disadvantages to being an "additional named insured" versus simply an "additional insured." *Id.*; *see also* Trisha Strode, *From the Bottom of the Food Chain Looking Up: Subcontractors and the Full Costs of Additional Insured Endorsements*, 25 CONSTR. LAW. 21, 21 (2005) (discussing the relationship between a named insured and an additional insured). For purposes of the Act and this Article, only "additional insured" will be discussed.

41. Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 19 (Tex. 2007).

42. TEX. INS. CODE ANN. § 151.102 (West Supp. 2013).

43. As discussed above, limited form agreements are not included under the statute's language. There are also notable exemptions and exclusions from the statute's scope. These include: owner controlled insurance programs; contractor controlled insurance programs; and both municipal and residential construction projects. These exclusions and exemptions will be discussed in detail below. Reading the statute on its face, it appears much broader in scope; however, no court has yet to interpret this statute and what exactly it renders void and unenforceable.

44. Enserch Corp. v. Parker, 794 S.W.2d 2, 8 (Tex. 1990). *See generally* 2 PATRICK J. WIELINSKI

Under the express negligence test, the court stated: "[P]arties 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."[45] Therefore, parties to a contract must explicitly state their intent for the indemnitor to indemnify the indemnitee, even if the indemnitee's negligence caused or contributed to causing the complained of damages.

Second, the requirement of conspicuousness is determined by whether a reasonable person would notice it.[46] Courts have adapted the test from the Texas Business & Commerce Code to determine conspicuousness.[47] The statute's operative language is: "'Conspicuous' . . . means so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it."[48] Conspicuousness includes bold font, large type, different typeface, or anything else to draw attention to the language.[49] Both fair notice requirements are necessary to enforce a broad or intermediate form indemnity agreement; however, if the indemnitor had actual knowledge, the courts may implement the contractual agreement.[50]

At this juncture, the express negligence and conspicuousness tests are effectively dead as to the contracts that are covered by the Act. The Act

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ET AL., CONTRACTUAL RISK TRANSFER: STRATEGIES FOR CONTRACT INDEMNITY AND INSURANCE PROVISIONS, at IV.E.13 to IV.E.18 (Int'l Risk Mgmt. Inst. 1995) (outlining the application of the express negligence test and conspicuousness requirement). Different states employ different standards of interpretation in enforcing indemnity agreements; many use the "clear and unequivocal" standard while others have adopted a fact specific test. *Compare* Craig Constr. Co. v. Hendrix, 568 So. 2d 752, 756 (Ala. 1990) (requiring "clear and unequivocal language" to enforce an indemnity agreement), *with* Bonner Cnty. v. Panhandle Rodeo Ass'n, 620 P.2d 1102, 1105–07 (Idaho 1980) (using a fact specific determination to uphold the indemnity agreement).

45. Ethyl Corp. v. Daniel Constr. Co., 725 S.W.2d 705, 708 (Tex. 1987).

46. Dresser Indus., Inc. v. Page Petrol., Inc., 853 S.W.2d 505, 508 (Tex. 1993).

47. *See, e.g.*, *In re* Bank of Am., N.A., 278 S.W.3d 342, 344 (Tex. 2009) (orig. proceeding) (per curiam) (quoting section 1.201(b)(10) of the Texas Business & Commerce Code to determine whether a provision in a contract was conspicuous to allow for the waiver of a jury trial); *Dresser Indus.*, 853 S.W.2d at 508 (providing a standard for conspicuousness).

48. TEX. BUS. & COMM. CODE ANN. § 1.201(10) (West 2009).

49. *Id.*; *see also* Stephanie J. Greer & Hurlie H. Collier, *The Conspicuousness Requirement: Litigating and Drafting Contractual Indemnity Provisions in Texas After* Dresser Industries, Inc. v. Page Petroleum, Inc., 35 S. TEX. L. REV. 243, 265–70 (1994) (discussing ways to satisfy the conspicuousness requirement).

50. *See* Am. Home Shield Corp. v. LaHorgue, 201 S.W.3d 181, 184 (Tex. App.—Dallas 2006, pet. denied) ("However, if both contracting parties have actual knowledge of the plan's terms, an agreement can be enforced even if the fair notice requirements were not satisfied." (quoting Storage & Processors, Inc. v. Reyes, 134 S.W.3d 190, 192 (Tex. 2004))); *see also Dresser Indus.*, 853 S.W.2d at 508 n.2 ("The fair notice requirements are not applicable when the indemnitee establishes that the indemnitor possessed actual notice or knowledge of the indemnity agreement.").

completely negates the fair notice requirements and renders most risk-transferring clauses obsolete, at least in commercial construction contracts. How courts interpret the Act will determine whether the fair notice requirements are still viable tests in this context, or whether they have been gutted by the legislature. For example, other provisions of the Insurance Code have been construed very liberally.[51] Meanwhile, the Texas Oil Field Anti-Indemnity Act (TOAIA)[52] has been interpreted very narrowly.[53] The precedent courts choose to follow will determine how much ambiguity remains. If the Act is narrowly interpreted like TOAIA, that may alleviate some ambiguity; however, if courts expand the current broad definitions, that may further complicate matters.

B. *"An Agreement in a Construction Contract, Collateral to or Affecting" a Construction Contract*

The first issue in determining when a risk-transferring agreement is void and unenforceable is whether it is "a *provision in* a construction contract, or in an agreement *collateral to or affecting* a construction contract."[54] The inquiry of whether a provision is "in a construction contract" is straightforward enough. The difficulty lies in whether a provision is in a *collateral* agreement or in an agreement *affecting* a construction contract.

The statute does not exactly define "collateral to or affecting." As there is no case law defining what the legislature meant, courts may look to how TOAIA was interpreted or to the plain meaning of the words "collateral to or affecting a construction contract." TOAIA contains a similar provision expanding coverage to contracts that are "collateral to, or affecting an agreement" relating to an oil or gas well or a mineral mine.[55] Several cases under TOAIA have interpreted this language to require some connection between the contract and actual services performed on a well or mine.[56]

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51. *See* Amstadt v. U.S. Brass Corp., 919 S.W.2d 644, 654 (Tex. 1996) (Gonzalez, J., concurring in part and dissenting in part) ("The [l]egislature has expressed a policy that the DTPA be liberally construed to protect consumers in their dealings with merchants and tradesmen."). The Deceptive Trade Practices Act, now part of the Texas Business and Commerce Code, was formerly part of the Insurance Code. BUS. & COMM. ch. 17 (West 2011).

52. TEX. CIV. PRAC. & REM. CODE ANN. §§ 127.001–.007 (West 2011).

53. *See* Getty Oil Co. v. Ins. Co. of N. Am., 845 S.W.2d 794, 805 (Tex. 1992) (refusing to read any more into the statute than what was plainly written); *see also In re* Complaint of John E. Graham & Sons, 210 F.3d 333, 339 (5th Cir. 2000) ("The Texas Supreme Court has counseled that the TOAIA is to be strictly construed to permit parties to contract freely with regard to agreements not covered by the statutory language.").

54. TEX. INS. CODE ANN. § 151.102 (West Supp. 2013) (emphasis added).

55. CIV. PRAC. & REM. § 127.003(a) (West 2011).

56. *See* Coastal Transp. Co. v. Crown Cent. Petrol. Corp., 20 S.W.3d 119, 128 (Tex. App.—

If the connection between the contracted act and the actual drilling or servicing of a well or mine is too attenuated, TOAIA will not apply.[57]

The result will be different if the courts look to the plain meaning of the words "collateral to or affecting a construction contract." "Collateral" is defined as "accompanying as secondary or subordinate."[58] Another interpretation is "serving to support or reinforce."[59] There are also several definitions for "affecting," including "to produce a material influence upon or alteration in" or "to act upon . . . so as to produce a response."[60]

How courts interpret what exactly "collateral to or affecting" means will have significant impact on agreements surrounding construction contracts. If construed liberally, the Act may severely limit when indemnity agreements may be included, even when not in the original construction contract. If, on the other hand, courts follow the precedent under TOAIA, only agreements that have some nexus to a construction contract may be void and unenforceable.

C. *Types of Agreements Included in the Definition of "Construction Contract"*

Interpretation problems of the meaning of "collateral to or affecting" are exacerbated when coupled with the definition of "construction contract" under the statute.[61] Section 151.001(5) defines a "construction contract" as:

> [A] contract, subcontract, or agreement, or a performance bond assuring the performance of any of the foregoing, entered into or made by an owner, architect, engineer, contractor, construction manager, subcontractor, supplier, or material or equipment lessor for the design, construction, alteration, renovation, remodeling, repair, or maintenance of, or for the furnishing of material or equipment for, a building, structure, appurtenance,

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Houston [14th Dist.] 2000) (holding that a sufficient connection did not exist between the transportation of petroleum products and the drilling of an oil well), *rev'd on other grounds*, 136 S.W.3d 227 (Tex. 2004); *accord Complaint of John E. Graham & Sons*, 210 F.3d at 340 ("[F]or an agreement to fall within the TOAIA, it must bear a close nexus to a well drilled for oil, gas, or water, or to a mine for a mineral.").

57. *See* Transworld Drilling Co. v. Levingston Shipbuilding Co., 693 S.W.2d 19, 23 (Tex. App.—Beaumont 1985, no writ) (refusing to apply TOAIA to "the repair of an off-shore drilling rig" as there was no relation between the repair and any actual drilling).

58. *Collateral*, MERRIAM–WEBSTER DICTIONARY, http://www.merriam-webster.com/ dictionary/collateral (last visited Mar. 21, 2014).

59. *Id.*

60. *Affect*, MERRIAM–WEBSTER DICTIONARY, http://www.merriam-webster.com/ dictionary/affecting?show=1&t=1387254871 (last visited Mar. 21, 2014).

61. TEX. INS. CODE ANN. § 151.001(5) (West Supp. 2013).

> or other improvement to or on public or private real property, including moving, demolition, and excavation connected with the real property. The term includes an agreement to which an architect, engineer, or contractor and an owner's lender are parties regarding an assignment of the construction contract or other modifications thereto.[62]

Based on this language, a "construction contract" means much more than the stereotypical construction contract. A construction contract, under the statutory definition, comprises a broad spectrum of contracts and agreements. These contracts include anything from a floor maintenance contract, to repairs of an elevator, to the painting of the outside of a building.

Notwithstanding the breadth of services covered, there must be at least some connection to real property, as stated in the definition.[63] Any attenuation from the real property being improved, either the actual property itself, a building on the property, or an appurtenance to the property, may not invoke the application of the Act. This argument is echoed under TOAIA, as there must be some connection between the contracted service and the drilling of a well or mining for a mineral.[64]

The definition of construction contract is not only limited to contracts between owners and general contractors. Architects and engineers are also included, which may affect errors and omission (E&O) insurance policies. E&O insurance is another term for "professional liability insurance."[65] Both architects and engineers routinely procure E&O insurance, but their policies may be limited under the Act.[66]

Under the Act a construction contract could be almost anything; the only limitations are whether there is some connection to real property and the parties to the contract. The parties must be one of those listed, namely "an owner, architect, engineer, contractor, construction manager, subcontractor, supplier, or material or equipment lessor."[67] But the current laundry list of "contract, subcontract, or agreement, or a performance bond" suggests that the Act's reach is far more pervasive

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62. *Id.*

63. *See id.* (emphasizing that the contract must affect "public or private real property").

64. *See* Coastal Transp. Co. v. Crown Cent. Petrol. Corp., 20 S.W.3d 119, 128 (Tex. App.—Houston [14th Dist.] 2000) (discussing the connection required to invoke TOAIA), *rev'd on other grounds*, 136 S.W.3d 227 (Tex. 2004).

65. *See* AMY ELIZABETH STEWART, TEXAS INSURANCE COVERAGE LITIGATION 45 (2013) (denoting the different types of E&O insurance offered and damages covered).

66. *Id.* at 49.

67. INS. § 151.001(5). "Contractor" is defined under the Act as "any person who has entered into a construction contract or a professional services contract and is enrolled in the consolidated insurance program." *Id.* § 151.001(3).

than perhaps intended.[68] However, a complete lack of clarity in drafting the statute and lack of legislative intent leaves courts to decipher what the statute in fact covers.

D. *Application of Agreements "Collateral to or Affecting a Construction Contract"*

While the Act is extremely broad in scope, it is important to emphasize that the Act only applies to certain indemnity agreements. Section 151.101 limits the application to construction contracts and any insurance procured under title 10 and chapter 151 of the Insurance Code.[69] Chapter 151 is the chapter where the Act is located; it also covers all consolidated insurance programs.[70] Title 10 covers property and casualty insurance, including physicians and health care providers,[71] automobile insurance,[72] fire insurance,[73] and workers' compensation.[74] Subject to certain exceptions and exclusions, as discussed below, the Act prohibits risk-transferring contracts if they are procured either under chapter 151 or as part of property or casualty insurance.

Most of the title 10 insurance contracts are first-party insurance contracts, meaning that they cover the insured's loss directly.[75] First-party insurance contracts are by definition indemnity contracts.[76] First-party insurance covers more than contractually-assumed indemnity obligations, and is routinely obtained and enforced in commercial construction projects.[77] It is enforced by the owner of the policy or the additional

68. *Id.* § 151.001(5).

69. *Id.* § 151.101.

70. *Id.* §§ 151.001–.151. Consolidated insurance programs will be discussed later in this Article.

71. *Id.* tit. 10, subtit. B (West 2009).

72. *Id.* tit. 10, subtit. C.

73. *Id.* tit. 10, subtit. D.

74. *Id.* tit. 10, subtit. E.

75. *See* Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 18 (Tex. 2007) ("A life, accident, and health policy is an example."); BLACK'S LAW DICTIONARY 817 (8th ed. 2004) ("A policy that applies to an insured or the insured's own property, such as life insurance, health insurance, disability insurance, and fire insurance.").

76. BLACK'S LAW DICTIONARY 817 (8th ed. 2004); *see also Lamar Homes*, 242 S.W.3d at 17–18 ("A first-party insurance policy is typically payable only to the insured or a named beneficiary for losses personal to the insured.").

77. Protective coverage, for example, is a type of "first party coverage that indemnifies the named insured for costs it incurs, excess of the design professional's professional liability insurance, that the named insured is legally entitled to recover as a result of negligent acts, errors and omissions committed by design professionals under contract with the named insured." Jeffery M. Slikva, *Construction Industry Update – Advancements in Contractors Professional and Pollution Liability Insurance*, CAVIGNAC & ASSOCIATES INSURANCE BROKERS (2010), http://www.cavignac.com/publications/publications-construction-industry-update/construction-industry-update-advancements-in-contractors-professional-and-pollution-liability-insurance.

named insured.[78] However, under the new Act, if the named insured is not the same person as the indemnitor, the indemnitor cannot enforce the policy. The Act makes void additional insured coverage provisions in construction contracts within its scope.[79]

Another type of insurance that will likely fall under title 10, and under the Act, is builders risk insurance. Builders risk insurance is "property coverage for insuring construction projects while they are in progress."[80] These policies typically cover the actual structure under construction, including any materials or fixtures incorporated into the structure, as well as the property of others to whom the insured may be liable.[81] To the extent that indemnity is involved in these contracts, they may fall under the Act.

The Act also closes the additional insured loophole. Under section 151.104(a), a construction contract cannot "require[] the purchase of additional insured coverage."[82] The differences between an additional insured provision and an indemnity agreement were discussed above. Parties have avoided the harsh realities of previous anti-indemnity statutes, including the TOAIA, as the parties were still allowed to contract for additional insured status.[83]

The statute also prohibits duty to defend provisions in agreements entered into by an indemnitor.[84] However, the duty to defend is separate and distinct from the duty to indemnify.[85] The duty to defend "is construed more broadly than any other insurance claim, as courts tend to apply it not only to covered claims[,] but to potentially covered claims or even claims that are merely artfully pleaded."[86] The duty to defend is based on the "eight-corners rule," which is the combination of the actual policy and the pleading's allegations.[87] While the duty to defend is not the

78. *Id.*

79. INS. § 151.104(a) (West Supp. 2013).

80. 2 PATRICK J. WIELINSKI ET AL., CONTRACTUAL RISK TRANSFER: STRATEGIES FOR CONTRACT INDEMNITY AND INSURANCE PROVISIONS, at XVII.K.1 (Int'l Risk Mgmt. Inst. 2000).

81. *Id.*

82. INS. § 151.104(a).

83. *See* Getty Oil Co. v. Ins. Co. of N. Am., 845 S.W.2d 794, 804 (Tex. 1992) (upholding an additional insured provision as outside the scope of the TOAIA anti-indemnity clause prohibition).

84. INS. § 151.102 (West Supp. 2013).

85. D.R. Horton-Tex., Ltd. v. Markel Int'l Ins. Co., 300 S.W.3d 740, 743 (Tex. 2009); *see also* Utica Nat'l Ins. Co. v. Am. Indem. Co., 141 S.W.3d 198, 203 (Tex. 2004) ("The duty to defend and the duty to indemnify are distinct and separate duties." (citation omitted) (internal quotation omitted)).

86. Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 29 (Tex. 2007).

87. *See id.* at 15 (noting that the "eight-corners rule" determines whether the duty to defend is implicated (citing Farmers Tex. Cnty. Mut. Ins. v. Griffin, 955 S.W.2d 81, 82 (Tex. 1997))).

same as the duty to indemnify, the statute effectively eliminates it within the commercial construction arena if it is included in an indemnity or additional insured agreement.[88]

The Act will also significantly impact insurance companies. Insurance companies will face a dilemma from the outset. If companies interpret the statute broadly, they risk losing business, as they can no longer offer additional insured status or obtain indemnity agreements from other insurance companies. Premiums may also increase, especially for owners and general contractors, as they can no longer look to their indemnitee's insurers for coverage. On the other hand, if insurance companies read the statute narrowly, they may be able to offer similar, if not the exact same, coverage as they did prior to the Act. Insurance companies may try to play the statute both ways, first arguing that they can provide coverage under the statute, but then later arguing that they are prohibited from paying out on policies issued. Until courts decide how to interpret the language of the Act, insurance companies will be caught in limbo as to how to respond to coverage questions.

Another major concern for insurance companies is how the Prompt-Payment Statute[89] of the Insurance Code will interplay with the Act. The Prompt-Payment Statute allows an insured to recover against their insurance company for failure to comply with the statute.[90] The insurance company must then pay its insured "the amount of the claim" plus 18% interest.[91] If an insurance company wrongly refuses to cover a claim based upon an additional insured status or a duty to defend, as prohibited under the statute, the Prompt-Payment Statute may end up costing the insurance company more money than it had anticipated.[92]

III. TYPES OF AGREEMENTS ALLOWED UNDER THE ACT

Certain exculpatory agreements are allowed, provided that they are either excepted from the scope of the Act or that they qualify as one of the numerous exclusions in section 151.105.

88. INS. § 151.102.

89. *Id.* § 542.060 (West 2009).

90. *Id.*

91. *Id.*

92. For a discussion of the Prompt-Payment Statute after *Lamar Homes*, see generally Ernest Martin, Jr., *The Texas Prompt Pay Statute Post* Lamar*: Understanding Its Application to Defense Costs*, ADVANCED INS. LAW (2008), *available at* http://www.haynesboone.com/files/Uploads/Documents/Attorney%20Publications/TX_Prompt_Pay_Statute.pdf.

A. *Exceptions from the Definition of "Agreement Void and Unenforceable"*

1. Employee Claims

The Act allows indemnity agreements for claims of bodily injury or death of an employee of an indemnitor:

> Section 151.102 does not apply to a provision in a construction contract that requires a person to indemnify, hold harmless, or defend another party to the construction contract or a third party against a claim for the bodily injury or death of an employee of the indemnitor, its agent, or its subcontractor of any tier.[93]

At least for death or bodily injury claims, the fair notice requirements would still apply.[94]

2. Named Insured to an Insurance Policy

Provisions in an insurance contract under a consolidated insurance program, discussed below, may be allowed to add or delete a named insured from the policy.[95]

B. *Types of Agreements Excluded from the Definition of "an Agreement Collateral to or Affecting a Construction Contract"*

1. Consolidated Insurance Programs

Section 151.105(1) includes two types of consolidated insurance programs that are allowed under the Act: "owner-controlled or owner-sponsored consolidated insurance program or a contractor-controlled or contractor-sponsored consolidated insurance program."[96] Section 151.001(1) defines a "consolidated insurance program" as "a program under which a principal provides general liability insurance coverage, workers' compensation insurance coverage, or both that are incorporated into an insurance program for a single construction project or multiple construction projects."[97]

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93. INS. § 151.103 (West Supp. 2013).

94. *See* Dresser Indus., Inc. v. Page Petrol., Inc., 853 S.W.2d 505, 508 (Tex. 1993) (outlining the fair notice requirements to uphold an indemnity agreement); Stephanie J. Greer & Hurlie H. Collier, *The Conspicuousness Requirement: Litigating and Drafting Contractual Indemnity Provisions in Texas After* Dresser Industries, Inc. v. Page Petroleum, Inc., 35 S. TEX. L. REV. 243, 247–49 (1994) (discussing the fair notice requirements of express negligence and conspicuousness).

95. INS. § 151.104(b) (West Supp. 2013).

96. *Id.* § 151.105(1).

97. *Id.*

These consolidated insurance programs are also known as "wrap-up" programs.[98] They cover all of the contractors and subcontractors on a particular job.[99] Wrap-up programs have several advantages and disadvantages, but the particulars of wrap-up programs are beyond the scope of this Article.[100] Typically, consolidated insurance programs are more cost-efficient for the general contractor, but they may limit the coverage available for both the contractor and subcontractors.[101] While consolidated insurance programs are allowed under the Act, the limitation against additional insured status remains.[102]

2. Texas Oilfield Anti-Indemnity Act (TOAIA)

As discussed earlier, TOAIA is a prior anti-indemnity statute that is limited to drilling a well or servicing a mine. Under the Act, agreements subject to TOAIA are excluded.[103] However, TOAIA is much less restrictive than the Act, as it still allows for additional insured status.[104] Also, contracts that are too attenuated from drilling or mining may fall under the Act as they concern real property.

3. Residential Construction

The Act also excludes residential construction.[105] Under section 151.105(10), the Act does not affect "an indemnity provision in a construction contract, or in an agreement collateral to or affecting a construction contract, pertaining to: (A) a single family house, townhouse, duplex, or land development directly related thereto."[106] The Act does not, however, define what is residential versus commercial. A single-

98. 2 PATRICK J. WIELINSKI ET AL., CONTRACTUAL RISK TRANSFER: STRATEGIES FOR CONTRACT INDEMNITY AND INSURANCE PROVISIONS, at XVII.C.14 (Int'l Risk Mgmt. Inst. 1998).

99. *Id.* (citing Gary E. Bird, *Consolidated Insurance Programs: A Partnership for Major Construction Projects*, *in* CONSTRUCTION RISK MANAGEMENT, at section IX (Int'l Risk Mgmt. Inst. 1998)).

100. *See id.* at XVII.C.14–.15 (detailing the advantages and complaints associated with consolidated insurance programs).

101. *Id.*

102. Section 151.105(1) is subject to limitations under section 151.104. *Compare* TEX. INS. CODE ANN. § 151.105(1) (West Supp. 2013) (allowing wrap-up programs "except as provided by Section 151.104"), *with id.* § 151.104 (prohibiting additional insured status, but permitting endorsements and provisions to insurance policies that "list[], add[], or delete[] named insureds to the policy").

103. *Id.* § 151.105(7); *see also* TEX. CIV. PRAC. & REM. CODE ANN. §§ 127.001–.007 (West 2011) (outlining the agreements subject to TOAIA).

104. *See* Getty Oil Co. v. Ins. Co. of N. Am., 845 S.W.2d 794, 804 (Tex. 1992) (emphasizing that additional insured agreements do not violate TOAIA).

105. INS. § 151.105(10)(A) (West Supp. 2013).

106. *Id.* § 151.105(10).

family house is easy enough to distinguish, but at what point is a townhouse, a duplex, or land development related to either of those not commercial construction?

4. Other Statutorily Excluded Agreements, Services, and Benefits

Section 151.105 also excludes other important agreements, services, and benefits including:

(a) breach of contract not related to indemnity agreements;[107]
(b) sureties under the execution of bonds;[108]
(c) benefits under workers' compensation;[109] and
(d) governmental immunity.[110]

IV. WAIVER OF THE ACT

Finally, and perhaps most importantly, the Act cannot be waived.[111] Typically, parties enjoy freedom to contract as they wish. Texas has long recognized that it is part of public policy to allow parties to draft contracts however they wish.[112] Now, the legislature is worried about unequal bargaining positions between owners, general contractors, and subcontractors.[113] Instead of correcting this imbalance, the legislature completely excluded from the Act residential construction, where there is a greater likelihood of unequal bargaining power.[114]

The other problem with the inability to waive this section is that it limits

107. Parties to a contract may require indemnification or other exculpatory clauses for breach of contract causes of action as long as the breach of contract "exists independently of an indemnity obligation" or under an owner-controlled or contractor-controlled consolidated insurance program. *Id.* § 151.105(2).

108. *Id.* § 151.105(4).

109. *Id.* § 151.105(5).

110. *Id.* § 151.105(6).

111. *Id.* § 151.151.

112. *See* El Paso Field Servs., LP v. MasTec N. Am., Inc., 389 S.W.3d 802, 811–12 (Tex. 2012) (recognizing the public policy of allowing parties to construct their own contract terms); Fairfield Ins. Co. v. Stephens Martin Paving, LP, 246 S.W.3d 653, 690 (Tex. 2008) (emphasizing the freedom to contract); Mid-Continent Supply Co. v. Conway, 240 S.W.2d 796, 804 (Tex. Civ. App.—Texarkana 1951, writ ref'd n.r.e.) ("There is perhaps, no higher public policy of the state than to uphold contracts validly entered into and legally permissible in subject matter.").

113. *See generally* Trisha Strode, *From the Bottom of the Food Chain Looking Up: Subcontractors and the Full Costs of Additional Insured Endorsements*, 25 CONSTR. LAW. 21, 21 (2005) (opining that subcontractors bear the brunt of the burden in construction situations).

114. *See* INS. § 151.105(10)(A) (permitting exculpatory agreements in residential construction). It could be argued that in commercial construction, parties to a construction contract know and typically deal with risk-shifting contracts. They understand the risks involved and are interdependent. On the other hand, in residential real estate, many homebuyers have no clue what they are doing and instead take people at their word.

parties' constitutional right to contract.[115] Parties should be allowed to create contracts however they wish, as long as they do not violate the States' police power or public policy.[116] However, in order to fall under the police power, it must be for the public health of the citizens of the state.[117] But the Act "is an illegal interference with the rights of individuals, both employers and employees, to make contracts regarding labor upon such terms as they may think best, or which they may agree upon with the other parties to such contracts."[118]

This provision binds parties' hands and prevents them from contracting as they wish. It also interferes with the constitutional right to contract, as there is no infringement of the State's police power. Ultimately, the inability to waive the Act will severely limit the drafting of contracts between owners, contractors, and subcontractors.

V. CONCLUSION

Clearly there are numerous unresolved issues and ambiguities surrounding the Act. Courts have yet to tackle this issue, as it only applies to contracts entered into after January 1, 2012.[119] However, this Article attempts to provide analysis that determines whether the Act applies and if an indemnity agreement or any other risk-shifting contract will be forever void and unenforceable.

115. TEX. CONST. art. 1, § 16 ("No bill of attainder, ex post facto law, retroactive law, or any law impairing the obligation of contracts, shall be made."); *see also* Lochner v. New York, 198 U.S. 45, 57 (1905) (emphasizing the "right of the individual to liberty of person and freedom of contract" under the United States Constitution), *overruled in part by* Ferguson v. Skrupa, 372 U.S. 726 (1963).

116. *See Lochner*, 198 U.S. at 57 (balancing the State's police power against the freedom to contract); *accord* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 815 (Tex. 1982) (upholding the right to contract as long as the terms do not violate public policy of the state).

117. *Lochner*, 198 U.S. at 57.

118. *Id.* at 61.

119. Act approved June 17, 2011, 82d Leg., R.S., ch. 1292, § 3, 2011 Tex. Gen. Laws 3611, 3614 (codified at TEX. INS. CODE ANN. §§ 151.001 *et seq.* (West Supp. 2013)).