BINDING AUTHORITY
Insurance Coverage Decisions: Issued Today - Impact Tomorrow
White and Williams LLP
Randy J. Maniloff
maniloffr@whiteandwilliams.com

August 17, 2010

What Happens In The Nevada District Court Doesn't Stay In The Nevada District Court: Supreme Court Of Nevada Reverses On Standard For Indemnification For One's Own Negligence

It's Welcome To Lost Wages, Nevada For Party That Agrees To Broad Indemnification

The classic definition given of the Yiddish word chutzpah is the boy on trial for murdering his parents who begs the judge for leniency because he is an orphan. On that basis, the definition of chutzpah in business must be when one person says to another – *Hey, let's do a deal together. Oh, and, by the way, if I screw up, you'll have to pay for it.* That being so, chutzpah in business abounds -- as provisions in contracts that require one party to indemnify another party, for the other party's own negligence, are not in the least bit unusual.

The reason for the frequency of such indemnification provisions in contracts is likely two-fold: First, some parties are sharp enough to understand their benefit and purposely include them. Second, some parties have no idea what's in their contracts and are just lucky enough to have cut and pasted such a favorable provision from a contract that someone else used with them. Whichever the reason, such provisions are common in contracts – especially construction – and they give rise to a lot of disputes over their enforceability.

Issues under indemnification agreements are not "coverage" in the purest sense of the word. However, indemnification agreements become insurance coverage issues because commercial general liability policies typically provide coverage for an insured's obligation to "assume the tort liability of another party to pay for bodily injury or property damage to a third person or organization," *i.e.*, an indemnification agreement. In other words, notwithstanding that indemnification agreements are formed between two parties -- *neither of which is an insurance company* – in certain circumstances the party that is taking on the indemnification obligation likely has insurance to satisfy such obligation. Therefore, while indemnification agreements may not be insurance coverage issues in the technical sense, the extent of an insurer's coverage obligation for a claim is sometimes tied – and inextricably so -- to its insured's agreement to indemnify another party for loss. In my book, this makes indemnification agreements as much insurance coverage issues as any.

For this reason, not surprisingly, an insurer that stands to be required to provide coverage to its insured, for its insured's contractual indemnification obligation, is likely to have a lot of interest in whether its insured will in fact be liable for such obligation. It is for this reason that, despite indemnification agreements technically existing outside of the insurance relationship, those handling claims that arise out of such agreements often pay close attention to their scope and enforceability.

On one hand, indemnification issues have been around for a long time and can be very complex when they arise in specific contexts. *See Weckerly v. German Lutheran Congregation*, 3 Rawle 172 for an 1831 (yes, 1831) Pennsylvania Supreme Court decision addressing public policy concerns over the enforceability of an indemnification agreement. On the other hand, having recently examined the permissible scope of indemnification agreements in all 50 states, the entire body of law can be summarized in the following single paragraph:

Many states have enacted statutes that specifically address the permissible scope of indemnification in construction contracts. Construction contracts have been singled out for special treatment because of, among other things, a concern that general contractors, on account of their leverage in negotiations with subcontractors, can overreach and require that the subcontractor indemnify the general contractor for the general contractor's own negligence. Such construction-based indemnity statutes are generally of two types: (1) broad: prohibit indemnification for *any aspect* of an indemnitee's own negligence; and (2) narrow: prohibit indemnification for only an indemnitee's *sole negligence*. Then, in states that do not have a statute that specifically addresses the permissible scope of indemnification in construction contracts, or for situations outside the construction context, the following majority rule applies: A party is entitled to be indemnified for its own negligence provided that the contract provision is expressed in unequivocal terms. *See Bridston v. Dover Corp.*, 352 N.W.2d 194, 196 (N.D. 1984) ("It is almost universally held that an indemnity agreement will not be interpreted to indemnify a party against the consequences of his own negligence unless that construction is very clearly intended.").

These indemnification rules come into play in the claims context under the following circumstances. An insured entered into an agreement that included an obligation to indemnify the other party to the agreement (the indemnitee) for the indemitee's own negligence. The indemnitee, after being named as an allegedly negligent defendant in a claim that arises out of the conduct at issue in the parties' agreement, seeks defense and indemnification from the insured (indemnitor) – or the indemnitee simply bypasses the insured and goes straight to the indemnitor's insurer [although this is not procedurally correct – but that's a whole other issue].

In this situation, the insurer for the indemnitor now has two choices. First, the insurer, after looking at the facts at issue, comparing them to the language of the indemnity agreement and concluding that the indemnity agreement is legally enforceable, can decide to simply take over the indemnitee's defense. In other words, the insurer sees the writing on the wall and knows that its insured will eventually owe indemnity under the agreement and that the insurer itself will owe coverage for such obligation. Thus, it steps in at an early stage and takes over the indemnitee's defense (and it may be able to do so using the same counsel that is defending the insured).

Second, the insurer, after looking at the facts at issue, comparing them to the language of the indemnity agreement and analyzing whether the indemnity agreement is legally enforceable, concludes that, when all is said and done, its insured may not owe indemnity under the agreement – because the facts do not satisfy the indemnity agreement or such agreement is not legally enforceable. Thus, the insurer declines the demand for defense and indemnification and leaves it to be resolved as a liability issue in the underlying action. If it is determined that the indemnity agreement was satisfied, *i.e.*, its insured owes defense and indemnity under the agreement, then the insurer will handle the claim as one for coverage under its insured's contractual liability insurance for an "insured contract."

However, under both scenarios, the insurer needs to know at the outset whether the relevant state law permits an indemnitee to be indemnified for its own negligence, and, if so, the extent to which such indemnification is permitted.

Despite indemnification issues being around for such a long time, the issue somehow managed to eluded courts in Nevada. Last week the Supreme Court of Nevada addressed what it described as an issue of first impression: An indemnitor's contractual obligation to indemnify its indemnitee for the indemnitee's own negligence.

The issue arose in *Brown Insurance Agency v. Star Insurance Company* as follows. Brown Insurance Agency was an independent insurance agency that contracted to sell insurance policies for various insurers, including Star Insurance Company. To make a long story short, and putting aside the details that are not really relevant, Star, via Brown, issued a workers compensation policy. A claim was required to be paid under the workers comp. policy that Star believed was outside the scope of coverage.

Star sought indemnity from Brown under the following indemnification provision contained in the parties' Producer Agreement:

> [Brown] shall defend, indemnify and hold harmless [Star] for any and all damages, losses, liabilities, fines, penalties, costs, and all other expenses reasonably incurred by [Star] including reasonable attorneys fees, for liabilities imposed upon [Star] in connection with or arising out of any claim, suit, hearing, action or proceeding, or threat thereof in which [Star] is involved by reason of [Brown] having performed services for [Star] under this Agreement, or having failed to perform services required under this Agreement.

Brown at 3.

The Nevada state trial court "interpreted the indemnification provision as requiring Brown to indemnify Star's negligence in the absence of express language that includes indemnity for the indemnitee's own negligence." *Id.* at 8.

The Supreme Court of Nevada reversed, holding as follows: "Where the indemnification clause does not specifically and expressly include indemnity for the indemnitee's own negligence, an indemnification clause 'for any and all liability' will not indemnify the indemnitee's own negligence." *Id.*

While the Nevada high court's decision was simple and brief, it also addressed some of the common public policy arguments that frequently accompany discussions of the scope of indemnification. For example, the court's decision was an adoption of the majority view:

> We reject the rationale of the so-called minority rule because a general clause is not sufficient to impose such an extraordinary remedy. Instead, we adopt the majority rule-an express or explicit reference to the indemnitee's own negligence is required to indemnify an indemnitee for his or her own negligence-because "the character of [such an] indemnity [is] so unusual and extraordinary, that there can be no presumption that the

> indemnitor intended to assume the responsibility unless the contract puts it beyond doubt by express stipulation, and no inference from words of general import can establish it."

Id. at 10 (citation omitted).

The court rejected what it called the "modern minority rule," which provides that an indemnity provision 'for any and all liability' means *all* liability, including that arising from the indemnitee's concurrent negligence. "The rationale behind 'the minority view is that such indemnity contracts are so common in the modern business world that courts should leave the parties with their bargain for 'any and all liability.'" *Id.* at 9 (citations omitted). The court concluded that the majority rule provides clarity and fairness to the parties, while the modern minority rule "allows for too much to be read into the terms of a contract that the parties may not have intended and could substantially benefit one party to the extreme detriment of the other." *Id.* at 10-11.

Interesting, while the Nevada Supreme Court concluded that the majority rule provides clarity to the parties, the exact opposite seems true when you consider the significant amount of litigation addressing whether it is beyond doubt by express stipulation in the agreement that a party is entitled to indemnification for its own negligence.

A copy of the Supreme Court of Nevada's August 12th decision in *Brown Insurance Agency v. Star Insurance Company* can be accessed here:

http://www.nevadajudiciary.us/images/advanceopinions/126nevadvopno31.pdf

Please let me know if you have any questions.

Randy

Randy J. Maniloff
White and Williams LLP
1800 One Liberty Place | Philadelphia, PA 19103-7395
Direct Dial: 215.864.6311 | Direct Fax: 215.789.7608
maniloffr@whiteandwilliams.com

The views expressed herein are solely those of the author and are not necessarily those of his firm or its clients. The information contained herein shall not be considered legal advice. You are advised to consult with an attorney concerning how any of the issues addressed herein may apply to your own situation. The term "Binding Authority" is used for literary purposes only and is not an admission that any case discussed herein is in fact binding authority on any court. If you do not wish to receive future emails addressing insurance coverage decisions, please send an email to the address listed above with "unsubscribe" in the subject line. No animals were harmed in the drafting of this e-mail.