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INDEMNITY AGREEMENTS IN THE
AVIATION CONTEXT AND RELATED ISSUES

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INTRODUCTION

Indemnity agreements are found in almost all aviation contracts – aircraft leasing and use agreements, airport-airline agreements, airline-vendor agreements, etc. These indemnity agreements are simply a means or tool whereby one party to the contract for aviation goods or services transfers the risk of loss or liability to the other party to the contract and/or its insurer. The entity promising indemnity is called the indemnitor, and the entity receiving indemnity is called the indemnitee.

The degree to which the risk of loss or liability is transferred (*i.e.*, the scope of the indemnity) is often determined by the relative bargaining powers of the contracting parties. For example, a small company providing local airplane cleaning services or baggage handling services to a major airline may be required to agree to a broadly worded indemnity clause in favor of the airline in order to obtain and retain the sought after business. Conversely, a large international company providing airplane cleaning, baggage handling and other aviation services on a worldwide basis may be able to negotiate a much more limited indemnity clause with the airline.

Insurance clauses almost always go hand in hand with indemnity provisions and are utilized to guarantee the financial strength of the indemnitor to perform its indemnity obligations to the indemnitee. In almost all instances of contractual indemnity, the indemnitor is contractually required to add the indemnitee as an

additional insured under the indemnitor's liability policy, with certain specified liability limits, and often the insurance clause mandates that the liability insurance provided to the indemnitee must be primary insurance over the indemnitee's own liability insurance. It is commonplace for the contract to require that the indemnitee must be provided with a certificate of insurance attesting that it is covered under the indemnitor's policy for claims arising from or related to the performance of the contract.

A contractual indemnity provision often may involve more than just an indemnity obligation to the contractual indemnitee, and may include "upstream" indemnity exposure to others who have contracted with the indemnitee. For example, an airline may have a contract with an airport regarding gate services and/or lease of space. Typically in such contracts the airline indemnifies the airport owner/operator for any liabilities arising from or related to the contract. The airline cleaning or baggage handling contractor or gate cleaning contractor almost always has a broad indemnity obligation to its airline contract partner. In the event of an accident in which the airport, airline and cleaning contractor are all named as defendants, the indemnity obligation of the cleaning service may very well extend to and pick up the airline's indemnity obligation to the airport, such that the cleaning contractor (vendor) finds itself obligated to defend and indemnify the

airport (with whom it has no contractual relationship), as well as the airline (with whom it does have a contractual relationship).

It should also be understood that many times a contractual indemnity provision can result in the indemnitor being stripped of its worker's compensation exclusive remedy defense in situations involving injury to the indemnitor's employee. For example, an injured employee of an airline baggage handling vendor may sue the airline for causing his injury, and if the contract between the airline and baggage handling vendor has a broadly worded indemnity agreement, the employer/baggage handling service may be required to defend and indemnify the airline against the claims of the indemnitor's own employee, whereas in the absence of the contractual indemnity obligation the baggage handling/employer could plead the exclusive remedy of workers' compensation as a complete defense to an effort by the airline to seek contribution.

Last, as a general matter the contract between the parties will almost always have a choice of law clause specifying which state's law is to be used in interpreting the contract, and the enforceability *vel non* of the indemnity clause may often be determined by such choice of law provision.

Although indemnity agreements are generally different from each other, there are, however, three general types of indemnity agreements:

(1) Broad form indemnity agreements, whereby the indemnitor indemnifies the indemnitee totally for the indemnitee's own negligence. If properly worded with language showing the specific intent to indemnify the indemnitee for its own negligence, these clauses are generally enforceable (but generally not as to the gross negligence or intentional misconduct of the indemnitee).

(2) Intermediate form indemnity agreements, whereby the indemnitee is indemnified only as to its own passive negligence and as to the indemnitor's own negligence.

(3) Narrow form of indemnity agreement, whereby the indemnitee is indemnified only as to the indemnitor's negligence.

Indemnity provisions thus allow the contracting parties to shift certain risks and liabilities from one party to the other, and great care must be taken in drafting such provisions in order to ensure that the intent of the parties can and will be enforced.

INDEMNITY AND HOLD HARMLESS AGREEMENTS

A. Typical Indemnity Provisions.

Indemnity/hold harmless agreements are found in many types of aviation contractual relationships. For example, in a servicing contract with Delta Air Lines, the service company agreed as follows:

“Contractor agrees to indemnify, defend and hold harmless Delta, its directors, officers, agents and employees from and

against all liabilities, demands, claims, damages, suits or judgments, including costs and expenses incident thereto, because of injury or death to persons, or loss, damage, destruction of property, including the property of Delta, contractor and third persons, arising out of the performance of or failure to perform services pursuant to this Agreement; provided, however, that such indemnity and hold harmless obligation shall not extend to liabilities arising out of the gross negligence or willful misconduct of Delta....”

Similarly, in a Lear 60 lease agreement with the aircraft owner, an FBO agreed:

“FBO shall indemnify, defend, and save harmless owner, and owner’s officers, agents, employees, directors, successors and assigns, from and against any and all loss, claims, demands, costs, expenses of every nature, including reasonable attorney’s fees (including fees to enforce this clause) arising directly or indirectly from or in connection with the use and operation of the aircraft by FBO, except when any such claims arise from the sole negligence of owner.”

Indemnity/hold harmless agreement can be found throughout all aspects of the aviation industry, including, but not limited to, the following:

- (1) Agreements concerning the supply of services and/or goods to airports, such as food vendor agreements, security/police agreements, cleaning/maintenance agreements, contracts for the purchase, installation and servicing of elevators, trains, people-movers, etc.;
- (2) Contracts for the provision of goods and services to airlines, such as catering, cleaning, fueling, baggage handling, etc.;

- (3) Any and all types of lessor-lessee situations, including FBO contracts with airport owners, FBO leases of aircraft, leases of hangar space, etc.

Bear in mind that in lease situations the indemnity obligation may be imposed on either the lessor or the lessee, depending on the relative bargaining strength of the parties, or the lessor and lessee may each have independent indemnity obligations.

B. Typical Policy Provisions Concerning Contractual Liability.

A typical insurance policy provision concerning coverage for contractual liability assumed by the insured reads as follows:

“The company will pay on behalf of the insured all sums which the insured, by reason of contractual liability assumed by him under contract designated in the schedule for this insurance, shall become legally obligated to pay as damages because of bodily injury or property damage to which this insurance applies, caused by an occurrence....”

The schedule applicable to contractual liability coverage generally provides: “Any written contract currently entered into by the named insured. Any new contracts must be approved by the company in advance and designated as included under the policy by the company.”

C. Legal Principles Governing Indemnity Agreements.

In determining the validity of indemnity agreements, it is necessary first to determine the particular state law applicable to the contract. As a general

proposition, and in the absence of a choice of law clause, most states follow either the *lex loci contractus* conflicts rule, or a conflicts rule involving determination of the “most significant contacts or relationships.”

Under the *lex loci contractus* rule, the law of the state where the contract was executed or entered into governs all matters pertaining to contract interpretation or validity. Under the “most significant contacts” conflicts rule, the Court generally determines the state that has the most significant relationship to or contacts with the contract and contracting parties, and then utilizes that state law to determine contract validity and interpretation.

The general rule in most states is that an indemnity agreement will not be construed to require the indemnitor to indemnify the indemnitee against the indemnitee’s own negligence unless the contractual agreement clearly and unequivocally so requires. Along these lines, most states hold that a contract clearly requiring indemnification of the indemnitee against the indemnitee’s own negligence is not against public policy, provided such intent is expressed in plain, clear and unequivocal terms, and provided there are no specific statutory prohibitions against such indemnity.

Generally speaking, contracts of indemnification are to be strictly construed against the indemnitee. *Kemira, Inc. v. A-C Compressor Corp.*, 755 F. Supp. 1059, 1063 (S.D. Ga. 1991).

Although there are no “magic words” which establish that the indemnitor contractually intended to indemnify the indemnitee for the indemnitee’s own negligence, the Courts have plainly held that the words used must be “sufficiently explicit so as to evidence a clear intent to hold the indemnitee harmless for its own negligence.” *Batson-Cook Co. v. Georgia Marble Setting Co.*, 112 Ga. App. 226 (1965).

Thus, courts will generally closely scrutinize the contractual language to determine whether the intent to indemnify is actually present, and it should be remembered that generally there is an initial presumption against such an intention. Note also that whether the duty to indemnify exists or not is generally a question of law for judicial, not jury, decision. *SRG Consulting, Inc. v. Eagle Hospital Physicians, LLC*, 282 Ga. App. 842 (2006).

Although the indemnity language must be expressed clearly and plainly, and although there is a presumption against construing the agreement to require indemnity for the indemnitee’s own negligence, it is noteworthy that Courts have somewhat routinely interpreted more or less standard indemnity language to require indemnity for the indemnitee’s own negligence. For example, *Eastern Air Lines, Inc. v. C.R.A. Transportation Co., Inc.*, 167 Ga. App. 16 (1983), involved a transportation contract containing the following provision:

The Contractor [C.R.A.] agrees to indemnify, defend and hold harmless Eastern and the City of Atlanta (City), its or their

directors, officers, employees, agents and representatives from and against all claims, liability, loss or expense, including legal fees and court costs, arising out of or in connection with this agreement including, but not limited to claims of employees of Contractor, claims of employees of Eastern and/or City, claims arising out of injury, death or property damage, direct or consequential, to any person or entity.... The foregoing indemnification does not apply to any claims arising out of the gross negligence or willful misconduct of Eastern and/or City.

While the agreement was in effect, an employee of C.R.A. allegedly sustained injuries in a vehicular accident which he contended was caused by the negligence of Eastern. The C.R.A. employee sued Eastern, and Eastern filed a third-party action against C.R.A. to enforce the indemnity provision.

The sole issue on appeal was whether the indemnity provision included indemnity for liability arising from Eastern's own negligence. Resolving this issue in favor of Eastern, the Court held:

“The clause obligates [C.R.A.] to indemnify [Eastern] “against all claims, liability, loss or expense...arising out of or in connection with this agreement...” (Emphasis supplied). The clause further states specifically that it “does not apply to any claims arising out of the gross negligence or willful misconduct of [Eastern].” Thus, it is readily apparent that the indemnity provision, when read as a whole, was intended by the parties to indemnify [Eastern] for “all ... liability” arising from the agreement, except liability accruing from the “gross negligence or willful misconduct” of [Eastern].”

Id., at 17.

Rejecting C.R.A.'s argument that the provision required it to indemnify Eastern only in those cases where there was no negligence on Eastern's part, the Court explained:

“Any construction that limits the indemnity provision to non-negligent acts of [Eastern] renders meaningless the express limitation of liability arising from grossly negligent and willful acts of [Eastern]. The construction argued by [Eastern] which includes indemnification from liability arising from all sources other than [Eastern's] gross negligence or willful misconduct, is mandated by the plain and unambiguous words of the clause.”

Id.

Finally, the Court concluded by pointing out the defect in C.R.A.'s reasoning:

“The flaw in [C.R.A.'s] argument, however, is that the indemnity provision in question does contain “explicit language,” in the form of the express limitation, by which the parties' intention to cover liability arising from [Eastern's] negligence is plainly stated.... [T]he term “negligence” is not expressly used to describe the scope of the subject indemnity provision, but the provision “does disclose...an intent, in clear terms leaving no doubt as [to] the intention of the parties” [cit.], to include indemnification for losses arising from [Eastern's] negligence.”

Id., at 18.

Similarly, in *Myers v. Texaco Refining and Marketing, Inc.*, 205 Ga. App. 292 (1992), the indemnitor agreed to indemnify Texaco against “each and every claim...except such as may be determined...to have resulted from Texaco's sole negligence.” The indemnitor argued that this agreement was unenforceable

because it did not expressly provide that the indemnitor indemnified Texaco against claims arising out of Texaco's own negligence. The Court, however, affirmed the trial court's grant of summary judgment to Texaco under the indemnity agreement.

The Court held that "in the absence of explicit language to the contrary, Georgia courts will not interpret an indemnity agreement as a promise by the indemnitor to save the indemnitee harmless on account of the latter's own negligence." *Id.*, at 295. The Court further held that "Georgia courts never imply an agreement to indemnify another for one's own negligence in the absence of express language." *Id.* Nevertheless, the Court found that the language of the agreement did indemnify Texaco, because the indemnitor agreed to indemnify Texaco against "each and every claim ... except such as ... resulted from Texaco's sole negligence." *Id.*, at 296. The Court held that this language was clear and that the only claim excluded under the agreement was a claim resulting from Texaco's sole negligence. Because the claim against Texaco had arisen out of the joint negligence of the indemnitor and indemnitee, Texaco was indemnified under the agreement. *Id.*, at 296-297.

In some instances the contract may contain provisions whereby each party mutually agrees to indemnify each other for their own negligence, and whereby each party agrees to insure the other for the other's indemnity liability. In these

situations, several courts have held that the mutual indemnities in effect cancelled each other out, and that the parties intended to look only to their own liability insurance for protection against the loss.

In this regard, it is well-settled in a number of jurisdictions, including Georgia that:

Where parties to a business transaction mutually agree that insurance will be provided as a part of the bargain, such agreement must be construed as providing mutual exculpation to the bargaining parties who must be deemed to have agreed to look solely to the insurance in the event of loss and not to liability on the part of the opposing parties.

General Cigar Co. v. Lancaster Leaf Tobacco Co., 323 F. Supp. 931, 941 (D. Md. 1971). *Accord, Tuxedo Plumbing & Heating Co. v. Lie-Nielsen*, 245 Ga. 27 (1980); *Great Atl. & Pac. Tea Co., Inc. v. F.S. Assocs.*, 257 Ga. App. (2002); *Macon-Bibb County Indus. Auth. v. Nord Bitumi, U.S., Inc.*, 77 F.3d 417 (11th Cir. 1996).

In order for insurance provisions in a contract to be mutually exculpatory, the contract need only require that *one party* obtain insurance for a particular risk. In *Hearst Magazines, etc. v. Cuneo Eastern Press, Inc. of Pa.*, 293 F. Supp. 824, 829 (E.D. Pa. 1968), the Court discussed a line of cases holding that “in commercial agreements between two business concerns, a provision that one will maintain insurance against certain risks indicates an intention to grant immunity to the other from liability, even though loss is caused by the negligence of the other.”

A federal district court in Georgia has held that an insurance clause in a contract requiring one party to obtain insurance for its contractual liability “indicate[s] that the parties intended for [the insured party] to carry insurance to cover its contracted for liability under the indemnification provision” and means that “the parties intended to shift the risk of loss to [the insured party’s] insurance company, regardless of which party was at fault for any prospective injury.” *Federal Paper Board Co., Inc. v. Harber-Yeargin, Inc.*, 53 F. Supp. 2d 1361, 1375 (N.D. Ga. 1999).

The rationale for this result was explained in *Morsches Lumber, Inc. v. Probst*, 180 Ind. App. 202, 205-06 (1979), where the Court held:

[W]here neither party has a legal duty to insure but each foresees the potential of a loss occurring by negligence or accident, the reasonable expectation of both in expressly imposing the duty to insure against the loss upon one of them is that the other will be protected as fully as if he had assumed the duty himself. ... With agreements to insure, the risk of loss is not intended to be shifted to one of the parties; it is intended to be shifted to an insurance company in return for a premium payment. ... Thus, we believe the better reasoning is found in those cases holding that an agreement to insure is an agreement to provide both parties with the benefits of insurance.

This reasoning was earlier enunciated in *Newport News Shipbuilding & Dry Dock Co. v. United States*, 34 F.2d 100 (4th Cir. 1929), where a contract between the United States and a shipbuilding company required the company to “protect and save harmless [the United States] ... against all losses (provided, however,

that the United States will continue the present hull, machinery and equipment insurance upon the vessel ... [and] protect the United States Lines through a Builder's Risk Insurance from ...) accidents, injuries and/or damages of any nature to the vessel ... through any act or default or neglect of the Contractor....”

When the ship was damaged by fire due to the shipbuilding company's negligence, a verdict was entered in favor of the United States against the shipbuilding company, but was later reversed on appeal by the United States Court of Appeals for the Fourth Circuit due to the insurance clause in the contract.

Noting that the contract required the United States to insure the risk of fire on the hull, machinery and equipment, the Court in *Newport News* rejected an argument that the fire insurance was only for the protection of the United States, reasoning:

To say that the meaning of the provision in the contract, as to insurance was that the United States was only to protect itself, and to allow recovery from the shipyard for the total of the damages, would be to place the parties in the exact situation they would have been in without any provision whatever in the contract as to insurance. Something must have been intended by the parties when the insurance provision was written in the contract.

Id., 34 F.2d 100, 107.

In addition, it is well-settled that insurance clauses in commercial contracts operate as waivers of subrogation barring the injured party's insurer from recovering in an action for subrogation against the negligent other party to the

contract. In *General Cigar, supra*, the seminal decision on this point, Lancaster Leaf was in the business of buying tobacco and reselling it to cigar manufacturers such as General Cigar. Lancaster decided to store some of its tobacco in Farmers Warehouse pursuant to an agreement with the warehouse that required Lancaster to insure the tobacco. Lancaster then contracted with General Cigar for General to insure the tobacco *after* Lancaster moved it into its own facility. General already maintained two insurance policies that covered the tobacco. Before the tobacco could be moved into Lancaster's storage facilities, a fire destroyed it. General's insurance companies paid the loss to General and sued Lancaster in a subrogation action alleging breach of contract and negligence.

Noting that “[s]uing here as subrogees, the insurance company plaintiffs possess only those rights against a third party which their insured might have, and any action taken by such insured which would bar its recovery against a third party would also be binding on the insurers,” 323 F. Supp. 931, 935, the Court in *General Cigar* held that the mandatory insurance provision in the contract was exculpatory and operated as General's release of Lancaster. The Court held:

It has been recognized by numerous authorities that where parties to a business transaction mutually agree that insurance will be provided as part of the bargain, such agreement must be construed as providing mutual exculpation to the bargaining parties who must be deemed to have agreed to look solely to the insurance in the extent of loss and not to liability on the part of the opposing party.

Id., 323 F. Supp. 931, 941. ¹

The Court in *General Cigar* further held, “[i]t is further recognized that where as here an insured has entered into a contract which is intended to substitute insurance for personal liability, the insurer is bound by such agreement and may not sue a third party under a theory of subrogation.” *Id.*, at 942.

The decision in *General Cigar Co.* has been widely cited by courts in Georgia and numerous jurisdictions for the general rule that commercial agreements to purchase insurance covering the subject matter of the contract operate as a mutual release of liability and a waiver of subrogation, and that the contract need *not* require *both* parties to obtain first-party property damage insurance. *See, e.g., Tuxedo Plumbing, supra.*

D. Recurring Problems With Indemnity Contracts.

The existence of an indemnity contract often creates one or more problems for lawyers, claims personnel and underwriters:

(1) Disputes may arise as to whether the indemnity agreement is enforceable or applicable to the particular fact situation in question.

Questions may arise as to whether the accident was a result of joint

¹ *Accord, Tuxedo Plumbing & Heating Co. v. Lie-Nielson*, 245 Ga. 27, 28 (1980); *May Dep't Store v. Center Developers*, 266 Ga. 806 (1996); *Pettus v. APC, Inc.*, 162 Ga. App. 804 (1982); *Macon-Bibb County Indus. Auth. v. Nord Bitumi, U.S., Inc.*, 77 F.3d 417 (11th Cir. 1996); *Orr v. Indiana Harbor Belt R.R.*, 976 F. Supp. 1151 (N.D. Ill. 1997); *Norfolk Shipbuilding & Drydock Corp. v. Seabulk Transmarine Pshp.*, No., 93-1312, 1995 U.S. Dist. LEXIS 591 (E.D. La., Jan. 13, 1995); *Tate v. Trialco Scrap, Inc.*, 745 F. Supp. 458 (M.D. Tenn. 1989); *J. Walters Constr., Inc. v. Gilman Paper Co.*, 620 So. 2d 219 (Fla. Dist. Ct. App. 1st Dist. 1993).

negligence, negligence only of the indemnitee, or negligence only of the indemnitor. Depending upon the wording of the particular indemnity agreement in question, indemnity liability may or may not exist with respect to accidents caused solely by the indemnitee's own negligence.

- (2) Enforcement of an indemnity agreement may result in the insurer extending liability coverage for a claim that would otherwise be barred by the workers' compensation exclusion in the policy. For example, if an insured's injured employee sues another company, and if the insured is obligated to indemnify that other company, then the insurer may become obligated to pay damages on a claim that would otherwise be excluded by the workers' compensation exclusion in the policy.
- (3) On many occasions it may be necessary for the insurer to retain separate attorneys to defend both the indemnitor and the indemnitee against the injured plaintiff's claims, and thus the insurer can be exposed to twice the amount of costs and expenses that would normally be associated with the claim.
- (4) In some instances it is appropriate or necessary for the insurer to provide a defense to the indemnitee under a reservation of rights,

while prosecuting a declaratory judgment action (with separate counsel) concerning the enforceability and applicability of the indemnity agreement. In these circumstances, it may become necessary for the insurer to retain three different law firms: one to defend the indemnitor, one to defend the indemnitee, and one to prosecute the declaratory judgment action.

* * *

As can be seen from the foregoing, indemnity agreements can be found throughout the aviation industry, and often result in added problems and expenses for the contracting parties and their insurers. Therefore, from a legal and claims handling standpoint, it is extremely important during the claim investigation process to determine whether the client/insured has entered into any contracts that might contain indemnity agreements relating to the accident. Note that the client/insured might be the beneficiary of an indemnity agreement in its favor, and enforcement of such indemnity agreement may serve to reduce drastically the exposure of the client and its insurer. Conversely, if the indemnity agreement is not for the benefit of the client/insured, then in all likelihood the client and its insurance company will face an increased exposure.

From an underwriting standpoint, it is extremely important for underwriters to be absolutely certain they are aware of all potential indemnity agreements that

may affect the proposed insured, either favorably or unfavorably. The critical factor here is to make certain that a full and adequate underwriting investigation has been undertaken prior to issuing a quotation, so that the true nature of the risk can be realistically evaluated.

Consideration might also be given to avoidance of “open-ended” contractual liability insuring provisions, and to limiting contractual liability coverage to specifically identified contracts.

SUBROGATION WAIVERS

Aviation-related contracts often contain provisions whereby each contracting party agrees to secure and maintain its own insurance, and agrees in advance to waive subrogation rights and other rights that might otherwise exist with respect to insured losses. A provision of this type typically reads as follows:

“To the extent that any loss of any kind is covered or paid by any insurer, the contracting parties hereby waive subrogation or contribution rights against each other and their respective officers, agents and employees, and the contracting parties shall notify their respective insurers of this waiver of subrogation agreement and shall cause this waiver of subrogation agreement to be included in the insurance policies secured by each of the contracting parties.”

Subrogation waivers of this type may be found in all sorts of aviation-related contracts, including airplane leases, airport leases, and leases of hangar space. For example, a hangar space lease agreement involved in a recent hangar fire and blimp loss provided:

“Nothing contained in this sub-lease shall be construed to require either party to repair, replace, reconstruct, or pay for any property of the other party which may be damaged or destroyed by fire ... or other casualty, and each party hereby waives on behalf of itself and its insurer all rights of subrogation and all claims against the other for all loss or damage arising out of perils normally insured against by standard fire and extended coverage insurance.”

Needless to say, subrogation waivers can serve to preclude the insurer from seeking reimbursement from certain parties for losses paid to the insured. And just like indemnity agreements, subrogation waivers can result in a particular insured being moved from the underwriting “profit” column into the underwriting “loss” column.

Thus, from an underwriting standpoint it is extremely important to determine whether the proposed insured has entered into any agreements that might adversely affect the potential for subrogation recoveries. Likewise, from a legal and claims handling standpoint it is important to conduct a thorough investigation to determine whether the insured has entered into any “subrogation waiver agreements” that may prejudice the rights of subrogation recovery. Please also remember that if the insured is the recipient of a favorable subrogation waiver agreement, then such agreement might afford a complete defense to a loss for which the insurer and insured would otherwise be liable.

It should be noted that in some states the insured's execution of a subrogation waiver without the insurer's knowledge or consent may serve to preclude coverage for the loss for which subrogation has been waived.

For example, in *Liberty Mutual Insurance Co. v. Altfillisch Construction Co.*, 70 Cal. App. 3d 789, 139 Cal. Rptr. 91 (1977), the Court allowed an insurer to recover from its insured the amount of a loss payment, because the insured's subrogation waiver agreement (made without knowledge of the insurer) substantially prejudiced the insurer. In arriving at its decision, the court relied on policy condition 17, which provided: "In the event of the payment under this policy, the company shall be subrogated to all the insured's rights of recovery therefor against any person or organization and the insured shall execute and deliver instruments and papers and do whatever else is necessary to secure such rights. The insured shall do nothing after loss to prejudice such rights." Based upon this policy condition, the Court held that the subrogation waiver agreement unduly prejudiced the insured's right of subrogation recovery and precluded coverage for the loss.

Interestingly, in *Altfillisch*, the California Court of Appeals held:

"The inclusion in the policy of Condition No. 17 dealing with the prospective right of subrogation reflects the economic facts of life in the insurance industry. The fixing of reserves and the actuarial process by which premiums are calculated take into account the probabilities of a projected percentage of recoveries from third party tortfeasors against whom the insurer will be

subrogated. Either in aid of this factor or because of it, the law in many jurisdictions is that an insured who gives a release to one responsible for damaging property of the insured, thereby cutting off the insurer's right of subrogation against the tortfeasor, loses his right of action against the insurer under the policy. As a consequence of the foregoing, we see the inclusion of Condition No. 17 in the Liberty policy as indication of a certain climate or level of economic expectations under which the policy was contracted for and issued... Given Liberty's expectation of opportunities to subrogate in the event of payment of a loss caused by the negligence of a third party, it was clearly a breach of the insured's implied covenant of good faith and fair dealing for Conexco to frustrate that expectation by contracting away such opportunity before the loss occurred."

70 Ca. App. 3d, 797-798.

Likewise, in *Leeds Peninsula Pharmacy, Inc. v. American National Fire Insurance Co.*, 125 A.D.2d 551, 509 N.Y.S.2d 627 (1986), the Court held that the insured prejudiced the insurer's subrogation rights by settling with the driver of the car without reservation or limitation, and that such prejudicial action by the insured relieved the insurer of any liability to pay the insured for his loss.

See also *Continental Manufacturing Corp. v. Underwriters at Lloyd's of London*, 185 Cal. App. 2d 545, 8 Cal. Rptr. 276 (1960), holding that an aviation insurer was not obligated to make a hull loss payment to its insured because the insured in an earlier lease agreement had released the party responsible for damage to the aircraft, and had therefore improperly defeated the insurer's right of subrogation.

In other states and under other circumstances, however, it has been held that the existence of a “subrogation waiver” in a lease agreement did not afford any policy defense to the insurer, or provide any basis for the insurer to recoup the loss payment from the insured. Such cases generally turn on the judicial conclusion that the policy requirement that the insured do nothing “after loss” to prejudice the insurer’s rights means exactly what it says, and that since the subrogation waiver was not entered into “after loss,” then the insurer’s liability for the loss was not affected, even though the insurer’s right of subrogation against the tortfeasor had been extinguished by the subrogation waiver. *Insurance Company of North American v. Universal Mortgage Corporation of Wisconsin*, 82 Wis. 2d 170, 262 N.W.2d 92 (Wis. 1978).

Similarly, in *Great Northern Oil Co. v. St. Paul Fire & Marine Insurance Co.*, 291 Minn. 97, 189 N.W.2d 404 (1971), the Court held that the fact that the insured had entered into a contract containing an exculpatory clause or liability disclaimer in favor of the contractor/tortfeasor, which effectively insulated the tortfeasor from the insurer’s subrogation claim, did not serve to violate the policy or provide any policy defense or provide any basis for the insurer to seek recoupment of the loss payment to the insured.

Georgia courts have specifically held that a release by the insured of the tortfeasor after the loss has occurred, and that bars the insurer’s subrogation claim,

serves to extinguish any obligation of the insurer to pay the insured for the loss in question. *Kirkendohl v. State Farm Mutual Automobile Insurance Co.*, 104 Ga. App. 834 (1961); *Universal Credit Co. v. Service Fire Insurance Co.*, 69 Ga. App. 357 (1943).

In summary, clearly worded subrogation waivers in contracts are generally enforceable and have the effect of depriving the parties' insurers of the ability to recoup their loss payment from the tortfeasor. Subrogation waivers thus affect the potential risk exposure involved with a potential insured, either favorably or unfavorably, depending upon whether the insured is a beneficiary of a subrogation waiver or is the grantor of the waiver. And, in some states, the existence of a subrogation waiver affords the insurer either with a defense to a loss payment claim by the insured, or with a right to seek recoupment from the insured of the amount of the loss payment.

LIABILITY DISCLAIMERS

A typical liability disclaimer provides as follows:

“The warranty provided in this contract and the obligations and liabilities thereunder are in lieu of and buyer hereby waives all other warranties, guaranties or liabilities, express or implied, arising by law or otherwise (including without limitation any obligation of seller with respect to consequential damages) and whether or not occasioned by seller's negligence, and shall not be extended, altered or varied except by a written instrument signed by seller and buyer.”

Liability disclaimers of this type are often found in aircraft sales and lease agreements, and in other contracts relating to the sale or lease of various types of aviation products. Liability disclaimers may also be found in contracts and agreements relating to the provision of maintenance services, repair services, and other services. Disclaimers are not limited to sales transactions, but may also be found in leasing arrangements.

Many cases hold that exculpatory clauses, liability disclaimers and limitations of liability voluntarily and knowingly agreed to by competent contracting parties are enforceable and not violative of any “public policy.” *Andrews Motors Co. v. Clement*, 127 Ga. App. 745 (1972); *Delta Air Lines, Inc. v. McDonnell Douglas Corp*, 350 F. Supp. 738 (N.D. Ga. 1972), *aff’d*. 503 F.2d 239 (5th Cir. 1974).

On the other hand, various defenses can be presented in an effort to avoid the impact of disclaimer clauses, including the following:

- (1) The disclaimer was not truly agreed to by the party against whom it is being asserted, or the party against whom the disclaimer is being asserted was not a party to the contract containing the disclaimer;
- (2) There was a lack of equality of bargaining power between the contracting parties, and the disclaimer in effect constitutes an unenforceable contract of adhesion;

- (3) The disclaimer violates Uniform Commercial Code requirements that disclaimers of implied warranties of merchantability and fitness for a particular purpose must be expressed in “conspicuous” language and must specifically mention merchantability;
- (4) The disclaimer improperly attempts to insulate a party from the consequences of violation of a statutorily-imposed and non-delegable duty, and the disclaimer is therefore violative of public policy;
- (5) The effect of the disclaimer causes the entire contract to fail of its essential purchase, such that there is a total failure of consideration for the disclaimer.

Needless to say, the existence of a liability disclaimer or exculpatory clause in a contract can have a substantial effect on the client’s liability exposure, either positive or negative, and can adversely impact the abilities of the insurer and insured to recover economic losses caused by a defective product.

Accordingly, from a legal and underwriting standpoint, it is important to determine whether the client/insured has entered into any contracts that contain liability disclaimers, and from a legal/claims handling standpoint it is equally as important to determine whether there are any liability disclaimers in existence that are either favorable or detrimental to the client’s position in the litigation.

CONCLUSION

I hope the foregoing comments will be of assistance to you in dealing with indemnity agreements and related clauses. Thank you for inviting me to participate in your meeting.

J. ARTHUR MOZLEY