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Seth D. Lamden and Jill B. Berkeley
Neal, Gerber & Eisenberg, LLP, Chicago

Coverage for Indemnity Claims in Illinois—Is That Indemnity Agreement You Just Drafted Really an "Insured Contract"?

Contractual indemnification clauses are among the most overused and misunderstood rights that parties argue over and negotiate for in commercial contracts. In negotiating indemnification clauses, many attorneys take comfort in the belief that their client's commercial general liability (CGL) policy will cover indemnity claims for bodily injury and property damage. In many instances, that belief is incorrect. This article provides an overview of Illinois law as it relates to CGL coverage for contractual indemnity claims under the "insured contract" exception to the exclusion in a standard CGL policy for liability assumed under contract.

CGL Coverage for an Insured's Assumption of Third-Party Tort Liability

The insuring agreement in a standard CGL policy obligates the insurer to pay "those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage'" that occurs during the policy period and is caused by an "occurrence" (*i.e.*, an "accident"). (ISO CGL Coverage Form CG 00 01 04 13, Section I, Coverage A.) Often, the insured's liability for bodily injury or property damage is the result of a negligence lawsuit brought directly against the insured. However, the insured also may become liable for bodily injury or property damage because the insured agreed in a commercial contract to indemnify another party for bodily injury or property damage. The CGL insuring agreement does not distinguish between tort liability and contractual liability, but standard CGL policies contain "Contractual Liability" exclusions, which eliminate coverage for "'[b]odily injury' or 'property damage' for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement." (ISO CGL Coverage Form CG 00 01 04 13, Section I at Exclusion (b)).

The "Contractual Liability" exclusion is subject to an exception that restores coverage for liability "[a]ssumed in a contract or agreement that is an 'insured contract,' provided the 'bodily injury' or 'property damage' occurs subsequent to the execution of the contract or agreement . . . ." *Id*. The term "insured contract" is defined to include, among other things, "[t]hat part of any other contract or agreement pertaining to [the named insured's] business . . . under which [the named insured] assume[s] the tort liability of another party to pay for 'bodily injury' or 'property damage' to a third person or organization. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement." *Id*. at Section V.

When the CGL insuring agreement, "Contractual Liability" exclusion, and definition of "Insured Contract" are read together, it would appear that a named insured, as an indemnitor, is entitled to coverage for a contractual indemnity claim brought by an indemnitee seeking damages for bodily injury or property damage caused by an occurrence. Under Illinois law, however, the scope of "Insured Contract" coverage is much narrower than that.

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Many Indemnity Agreements Do Not Qualify as "Insured Contracts" in Illinois

The Illinois Supreme Court has interpreted the "insured contract" exception to apply only in situations in which the named insured expressly assumes liability for the indemnitee's own negligence. *See Virginia Sur. Co., Inc. v. N. Ins. Co. of N.Y.*, 224 Ill. 2d 550, 565 (2007); *Pekin Ins. Co. v. Designed Equip. Acquisition Corp.*, 2016 IL App (1st) 151689, ¶ 29 ("We find that an insured contract exists because the language of the indemnity provision clearly and explicitly evidences the parties' intent that [the indemnitor] agreed to indemnify [the indemnitee] against [the indemnitee's] own negligence."). Under Illinois law, it is rare that an indemnity agreement would be construed to indemnify a party for that party's own negligence. Although nothing in Illinois law prohibits parties from specifically contracting to provide for indemnity for one's own negligence in non-construction related contracts, "[i]t is quite generally held that an indemnity contract will not be construed as indemnifying one against his own negligence, unless such a construction is required by clear and explicit language of the contract or such intention is expressed in unequivocal terms." *Buenz v. Frontline Transp. Co.*, 227 Ill. 2d 302, 316 (2008) (citing *Westinghouse Elec. Elevator Co. v. LaSalle Monroe Bldg. Corp.*, 395 Ill. 429, 433 (1946)).

If an indemnification agreement does not expressly provide contractual indemnity for the indemnitee's own negligence (*i.e.*, "true" indemnity), the indemnitee's indemnification rights will be limited to the liability arising out of the indemnitor's negligence only, which is nothing more than an allocation provided by the Illinois Joint Tortfeasor Contribution Act, 740 ILCS 100/0.01. *See Hankins v. Pekin Ins. Co.*, 305 Ill. App. 3d 1088, 1093 (5th Dist. 1999); *McNiff v. Millard Maint. Serv. Co.*, 303 Ill. App. 3d 1074, 1077 (1st Dist. 1999); *see also Liccardi v. Stolt Terminals, Inc.*, 178 Ill. 2d 540, 549-50 (1997); *Braye v. Archer-Daniels-Midland Co.*, 175 Ill. 2d 201, 217-18 (1997). By way of example, an agreement that provides that "[Indemnitor] will indemnify the [Indemnitee] for claims relating to or arising from [Indemnitor's] negligence or breach of this Agreement," does not give rise to an enforceable right to indemnification because that language does not contain any rights indicating that the indemnitor has agreed to provide indemnification for claims arising out of the indemnitee's own negligence.

This rule derives from the legal distinction between contribution and indemnity. As the Illinois Supreme Court has observed, "[t]here is an important distinction between contribution, which distributes the loss among the tortfeasors by requiring each to pay his proportionate share, and indemnity, which shifts the entire loss from one tortfeasor who has been compelled to pay it to the shoulders of another who should bear it instead." *Virginia Sur.*, 224 Ill. 2d at 555 (quoting W. PROSSER, HANDBOOK OF THE LAW OF TORTS, sec. 51, at 310 (4th ed. 1971)). An "indemnity provision" that requires the indemnitor to "indemnify and hold harmless" the indemnitee for only the indemnitor's negligence is not really indemnity at all, but is actually a form of contractual contribution (sometimes labeled "partial indemnity"). *See Stevens v. Silver Mfg. Co.*, 70 Ill. 2d 41, 46 (1977) ("Although stated in terms of partial indemnity rather than contribution, the prayer for relief clearly seeks contribution based on the relative degree to which the employer's misuse of the product or assumption of the risk contributed to cause plaintiff's injuries.").

Under *Virginia Surety*, a "contractual contribution" or "partial indemnity" provision does not give rise to a valid claim for indemnification and would not constitute an "insured contract" in Illinois because it is not an assumption by the indemnitor of the indemnitee's tort liability for the indemnitee's own negligence.

Illustrative Case: *Bituminous Casualty Corp. v. Plano Molding Co.*

Based on its plain language, the determination of whether there is coverage under the "Insured Contract" exception is based on the nature of the indemnitee's liability to the third party (i.e., the liability assumed under contract), not the nature of the insured's liability to the indemnitee. However, as noted above, the Illinois Supreme Court held in *Virginia Surety*, 224 Ill. 2d 550, that only an agreement to indemnify a third party for that party's own negligence qualifies as an "insured contract" in Illinois. As illustrated by *Bituminous Casualty Corp. v. Plano Molding Co.*, 2015 IL App (2d) 140292, the *Virginia Surety* holding has served to dramatically limit the scope of CGL coverage for liability assumed under contract.

In *Plano Molding*, the insured, Plano, manufactured and sold storage boxes, which were produced from steel injection molds. In 2004, Plano ordered two molds from China. World Commerce Services (World) arranged to ship the molds from China to Illinois. World issued a bill of lading which defined "merchant" to include Plano. The bill of lading stated, in relevant part, that "[m]erchant warrants that the stowage and seals of the containers are safe and proper and suitable for handling and carriage and indemnifies Carrier for any injury, loss or damage caused by breach of this warranty." *Plano Molding*, 2015 IL App (2d) 140292, ¶ 3.

The molds were loaded onto a shipping container and transported by sea to California, at which time Union Pacific Railroad Company began transporting the molds by rail. The train derailed in Oklahoma when the molds broke through the floor of the rail car. Various cargo owners sued Union Pacific for damage to their cargo that occurred as a result of the derailment. Union Pacific, in turn, sued Plano, seeking reimbursement for the cargo owners' property damage claims. *Id*. ¶ 4. Union Pacific's lawsuit against Plano alleged counts for negligence and for contractual indemnity under World's bill of lading.

Plano's CGL insurer defended Plano against Union Pacific's lawsuit until the court in that lawsuit dismissed Union Pacific's negligence counts, but held that Union Pacific had valid causes of action against Plano that stemmed from Plano's contractual obligations under the bill of lading. *Id*. ¶ 5. Following that ruling, Plano's CGL insurer denied coverage based on the contractual liability exclusion in Plano's CGL policy. The contractual liability exclusion in Plano's policy stated that the policy did not cover property damage "for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement." *Id*. ¶ 9.

Plano agreed with the insurer that the bill of lading was a contract and that the contractual liability exclusion applied to the claims under the bill of lading, but argued that the exception to the contractual liability exclusion for "insured contracts" restored coverage for Union Pacific's claims. According to Plano, this exception restored coverage because Union Pacific was seeking indemnification for Union Pacific's tort liability to the third-party cargo owners. In response, the insurer argued that the bill of lading was not an "insured contract" because Plano was only liable for its own breach of warranty under the bill of lading and did not assume liability for Union Pacific's negligence. *Id*. ¶ 10.

The *Plano Molding* court agreed with the insurer, holding that the bill of lading was not an "insured contract" and, therefore, Union Pacific's claims against Plano were not covered, because "a contract in which the insured agrees to indemnify against the insured's own negligence is not an insured contract." *Id*. ¶ 15 (citing *Virginia Surety*, 224 Ill. 2d at 565). As the *Plano Molding* court explained, the bill of lading provided that Plano would indemnify Union Pacific:

> "for any injury, loss or damage caused by breach of this warranty." The language of the agreement unequivocally states that defendant warranted that the stowage and seals of the containers were safe and proper and suitable for

> handling and carriage. Therefore, defendant agreed to indemnify [Union Pacific] for [Plano's] breach of those warranties. The agreement says nothing about indemnifying [Union Pacific] against [its] own negligence. It is generally held that an indemnity contract will not be construed as indemnifying the indemnitee against its own negligence unless such a construction is required by the clear and explicit language of the contract, or such intention is expressed in unequivocal terms.

Plano Molding, 2015 IL App (2d) 140292, ¶ 18. In ruling in favor of the insurer, the *Plano* court also rejected the insured's argument that tort liability can mean "tort-liability-as-imposed-by-law, rather than negligence." *Id*. ¶ 16.

A Recent Decision by the Southern District of Illinois Provides Guidance for Drafting an "Insured Contract"

The decision in *BNSF Railway Co. v. Gilster-Mary Lee Corp*., No. 15-cv-250, 2016 U.S. Dist. LEXIS 85332 (S.D. Ill. June 30, 2016), provides some guidance as to what an "insured contract" would look like under Illinois law. At issue in *Gilster-Mary Lee* was whether an indemnification agreement in a railroad shipping contract that included a provision for allocating liability when both the customer and shipper were liable for an injury qualified as an "insured contract." The dispute between the insurer and insured centered on whether the indemnity provision in the shipping contract constituted an agreement by the customer to indemnify the shipper for the shipper's own negligence. The indemnity agreement in *BNSF Railway* stated, on one hand, that the customer would indemnify the shipper for "any and all losses" and, on the other hand, that if both customer and shipper were negligent, they would apportion fault. *See Gilster-Mary Lee*, 2016 U.S. Dist. LEXIS 85332, at *7-8.

The *Gilster-Mary Lee* court held that while an agreement to indemnify the shipper for "any and all losses," without more, would constitute an agreement to indemnify the shipper for its own negligence, the inclusion of proportionate liability provisions in the agreement meant that there was no clear intent that the customer would indemnify the shipper for the shipper's own negligence. *Id*. at *12-13. The court held that absent clear intent in the agreement that the customer would indemnify the shipper for the shipper's own negligence, it could not construe the indemnity agreement as indemnifying the shipper for its own negligence and, therefore, the indemnity agreement was not an "insured contract." *Id*. at *14. As the court explained:

> Read together . . . the first and second sentences of the indemnity clause create uncertainty about if and when the parties intended for [Customer] to indemnify [Shipper] for its own negligence. The first sentence provides for full indemnity regardless of degree of fault; the second sentence provides for proportionate indemnity based on degree of fault. For example, assume [Shipper] and [Customer] were each partially at fault but [Shipper] is adjudged to have 100% liability under FELA based on breach of its non-delegable statutory duty to provide a reasonably safe work environment. Sentence one would provide for full indemnity from [Customer] for the entire judgment. Sentence two, on the other hand, would provide for indemnity for only [Customer's] percentage of fault. Because the sentences are inconsistent with each other, they cannot be said to amount to the "clear and explicit language" or expression of intent "in unequivocal terms" as required . . . before an indemnity agreement will be read to indemnify a party for its own negligence.

Id. at *13-14.

Importantly, the court rejected the shipper's argument that the agreement to indemnify the shipper for "any and all losses" constituted an agreement to indemnify the shipper for its own negligence when the customer was 0% at fault and the shipper was 100% at fault. *Id*. at *13-14. The court noted, however, that if that were the parties' intent, the indemnity provisions could have been modified by:

> combining the two sentences and connecting them with, ". . . ; Provided, if any claim or liability shall arise from the joint or concurring negligence . . . ." That would imply the second sentence is an exception to the first. This understanding could also have been accomplished by introducing the second sentence with language such as, "Notwithstanding the foregoing, if any claim or liability shall arise from the joint or concurring negligence . . . ."

Id. at *15.

Conclusion

It is a commonly-held assumption that a CGL policy covers bodily injury and property damage claims that fall within the broad indemnification agreements included in many commercial contracts. Some indemnitors may be surprised to learn that their indemnification obligations are, in fact, not broad enough to fall within the scope of "insured contract" coverage provided by their CGL policies.

About the Authors

Seth D. Lamden is a litigation partner at *Neal, Gerber & Eisenberg LLP* in Chicago. He concentrates his practice on representing corporate and individual policyholders in coverage disputes with their insurers. In addition to dispute resolution, Mr. Lamden counsels clients on matters relating to insurance and risk management, including maximizing insurance recovery for lawsuits and property damage, policy audits and procurement, and drafting contractual insurance specifications and indemnity agreements. He obtained his B.A. from Brandeis University and his J.D., *magna cum laude*, from The John Marshall Law School.

Jill B. Berkeley of *Neal, Gerber & Eisenberg LLP* chairs the firm's Insurance Policyholder Practice Group. Ms. Berkeley represents policyholders and claimants in insurance coverage disputes involving toxic torts and hazardous wastes, environmental pollution, construction, products liability, intellectual property, first-party property, business interruption and excess liability matters. In addition to her robust litigation practice, Ms. Berkeley offers her clients strategic advice on insurance coverage to help them manage risk and has served as an arbitrator and mediator. She has counseled clients in connection with all types of insurance policies, including directors' and officers' and professional liability, commercial general liability, first-party property and builder's risk, and personal and advertising injury liability. Her client base is focused on utilities, general contractors, manufacturers, professional service providers, financial institutions, trucking companies, and real estate developers, though her experience stretches to other industries as well.

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