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Effect of Clause in Liability Insurance Policy Excluding Coverage for Contractual Indemnity Liability

COMMENTS

EFFECT OF CLAUSE IN LIABILITY INSURANCE POLICY EXCLUDING COVERAGE FOR CONTRACTUAL INDEMNITY LIABILITY

To what extent is an insurance company responsible on a liability policy containing a clause excluding coverage in instances where the insured has assumed by contract loss or liability which may be incurred by a third party? This problem arises when the insured enters into a contract of indemnity with a third party. The typical exclusion clause in a liability insurance policy reads: "This policy does not apply to liability assumed by the insured under any contract or agreement not defined herein."[1] The problem has two aspects, one economic and the other legal. A greater premium is invariably charged for contractual liability coverage.[2] As to its legal aspects there is a dearth of decisional authority defining the precise meaning and effect of a clause in a general liability policy excluding contractual liability coverage. It is the object of this comment to analyze in the light of the law of indemnity the meaning of the term "contractual liability," and determine, with the aid of the comparatively few cases that have considered the problem, the circumstances under which a clause excluding contractual indemnity coverage may be properly operative.

TYPES OF INDEMNITY CONTRACTS

To understand clearly the nature of the problem presented by clauses excluding liability assumed by contract, it is necessary to distinguish the types of indemnity agreements. Generally an indemnity contract is either express, i.e., consensual, or it may be implied in law.[3] Express indemnity contracts can be conveniently categorized as either sweeping in nature or imposing a limited obligation on the indemnitor. Under the former the indemnitor may contract to save the indemnitee harmless from any liability or loss which the latter may suffer regardless of the indemnitee's own negligence. By reason of such an agreement the indemnitee will be reimbursed even though his own negligence was the sole cause of the injury.[4] Under the limited indemnity contract the indemnitor protects the indemnitee from liability resulting from the indemnitor's negligence. Here the parties are merely expressing contractually a liability which the law itself generally imposes, because where both the indemnitor and the indemnitee were negligent, if the indemnitee was merely passively

1. United States Fidelity & Guaranty Co. v. Virginia Engineering Co., 213 F.2d 109, 111 (4th Cir. 1954).

2. See American Stevedores, Inc. v. American Policyholders' Ins. Co., 138 N.Y.S.2d 513 (Sup. Ct. 1955), where coverage for liability assumed by contract was endorsed on the policy.

3. See, Meriam and Thornton, Indemnity Between Tortfeasors: An Evolving Doctrine in the New York Court of Appeals, 25 N.Y.U.L. Rev. 845, n.2 (1950); 42 C.J.S., Indemnity §§ 4, 20 (1944).

4. The intention to save an indemnitee harmless from his own negligence must be unequivocally expressed in the contract of indemnity. Thompson-Starrett Co. v. Otis Elevator Co., 271 N.Y. 36, 2 N.E.2d 35 (1936).

negligent, he will recover from the actively negligent indemnitor.[5] This recovery is based upon quasi-contractual principles. The passive-active negligence rule is, therefore, the root and essence of recovery where there is a limited indemnity contract or no express indemnity agreement.[6] A recent New York Court of Appeals case has dispelled the notion that to be "passively" negligent for indemnity purposes one has to be inactive or omissive, and to be actively negligent it is necessary to do affirmative, harmful acts or be commissive in conduct.[7] Instead the decision indicates that the terms are merely a guide in determining which of several wrongdoers was more responsible for an injury.

Considering the types of indemnity contract in relation to the effect of a contractual liability exclusion clause, it is submitted that where the insured becomes liable for a third party's negligence by reason of a sweeping type indemnity agreement the exclusion clause is operative to preclude coverage under the policy.[8] This conclusion is consistent not only with the express provision of the contract of insurance, but also with the principles of substantial justice in that the insured under an ordinary liability policy has not paid a premium that was computed with the negligence of another person in mind.

However, the question may be asked, should an exclusion clause be operative in a situation where the insured would have been liable regardless of his contractual promises, as an actively negligent wrongdoer to one merely passively negligent or to one not at all negligent but by statute or otherwise held vicariously liable? Where the insured is the actively negligent wrongdoer or the one solely responsible for the injury, if the insured's liability under an implied in law indemnity obligation would be coextensive with the liability he has incurred under his express contract of indemnity, then the exclusion clause should be inoperative. The express indemnity agreement really adds nothing to the indemnitor's liability. Yet, though such a principle appears obvious, for it to be a workable guide in determining the applicability of a contractual liability

5. Schwartz v. Merola Bros. Constr. Corp., 290 N.Y. 145, 48 N.E.2d 200 (1943); Thompson-Starrett v. Otis Elevator Corp., 271 N.Y. 36, 2 N.E.2d 35 (1936); Dudar v. Milef, 258 N.Y. 415, 180 N.E. 102 (1932).

6. Scott v. Curtis, 195 N.Y. 424, 88 N.E. 794 (1909); Phoenix Bridge Co. v. Creem, 102 App. Div. 354, 92 N.Y. Supp. 855 (2d Dep't 1905).

7. McFall v. Compagnie Maritime Belge, 304 N.Y. 314, 328, 330, 107 N.E.2d 463, 471, 472 (1952). " . . . Whether negligence is passive or active is, generally speaking, a question of fact for the jury.

"The evidence . . . shows that the Belgian Line was guilty of a fault of omission whereas Transoceanic, in negligently handling the drums, and Dow, in supplying inadequate drums, were guilty of faults of commission. . . . While that is not always determinative, since either a fault of omission or one of commission may constitute active negligence, it seems to us that the factual disparity between the delinquency of Transoceanic and Dow and that of Belgian Line is so great here that the jury was justified in concluding that Belgian Line's fault of omission was only passive negligence."

For a comprehensive analysis of the effect of this decision see Note, Indemnity Among Tortfeasors in New York, 39 Cornell L.Q. 484, 497 (1954).

8. See St. Louis Police Relief Ass'n v. Aetna Life Ins. Co., 236 Mo. App. 413, 154 S.W.2d 782 (1941); Union Paving Co. v. Thomas, 213 F.2d 172 (3d Cir. 1951).

exclusion clause, the insured must as a practical matter establish his implied in law indemnity obligation in the course of the litigation.

In those decisions wherein the courts have recognized the distinctions to be made in determining the applicability of a contractual liability exclusion clause, this liability has been called one "imposed by law" as distinguished from one "assumed by contract." Those terms are actual phrases used in typical policy and indemnity agreements, and when viewed in their context the possibility for ambiguity is lessened. However, since the phrase "liability imposed by law" contains " . . . words of very broad significance and as used in their ordinary sense, would include the total liability imposed by the law . . . "[9] the more appropriate phrase for the test of determining the application of a contractual liability exclusion clause would seem to be, implied in law indemnity obligation.

THE CASES

The case that has come closest to formalizing the question, what was the insured's implied in law indemnity obligation, while at the same time making an analysis of the cases determining the effect of contractual liability exclusion clauses, is *United States Fidelity & Guaranty Co. v. Virginia Engineering Co.*[10] The defendant, Fidelity, issued a general liability policy to the Engineering Company which contained a contractual liability exclusion clause. The Engineering Company's construction contract with International Harvester contained a limited indemnity provision. An employee of a contractor engaged by Harvester was injured when he brushed against exposed high voltage wires being installed by the Engineering Company and the employee recovered a judgment against both the Engineering Company and Harvester. The recovery against Harvester was sustained on the theory that Harvester owed the nondelegable duty to the injured, who was an invitee on its premises, of maintaining proper preventive measures against the danger of high voltage current.[11] Harvester paid the judgment and deducted the amount from money owed the Engineering Company under the construction contract. In the cited case the insured was suing on its policy to recover the amount of the judgment. The court in granting recovery stated:

"The indemnity clause in the construction contract did not assume liability with respect to any claim for which the Engineering Company would not itself be liable at law, but merely undertook to protect the Harvester Company against liability for which the Engineering Company was responsible. To construe the exclusion clause to relieve the Guaranty Company of liability for such claims would be to write into the policy a restriction which it does not contain, and which, we think, could not have been within the contemplation of the parties. It is not reasonable to suppose that, when the insured was taking insurance to protect against liability imposed by law, it was intended to exclude coverage of claims for which the law imposed liability on

9. Green Bus Lines, Inc. v. Ocean Acc. & Guaranty Co., 287 N.Y. 309, 315, 39 N.E.2d 251, 254 (1943).

10. 213 F.2d 109 (4th Cir. 1954).

11. See International Harvester Co. v. Sartain, 32 Tenn. App. 425, 222 S.W.2d 854 (1948).

the insured, merely because insured had agreed to protect another against secondary liability on account of such claims."[12]

The *Fidelity* case did recognize the distinction in the types of indemnity agreements and concluded that in effect the insured was liable for the judgment in the personal injury action regardless of the indemnity agreement. The court also placed due emphasis on what the parties intended when the policy was taken out. Thus, on a contractual basis it was possible to justify the non-application of the exclusion clause, where there was merely an implied in law indemnity obligation, by stating that there was no intention on the part of the insurer and the insured to exclude coverage in such a situation.

In *Union Paving Co. v. Thomas*[13] the opposite result was reached and the court held that the exclusion clause was operative. However, the case is distinguishable from the *Fidelity* case. Thomas entered into a limited indemnity agreement with the Paving Company and Thomas had a general liability insurance policy containing a contractual liability exclusion clause. One Downey was injured when his car crashed into an unlighted barrier where Thomas was performing part of the street repairing for the Paving Company. Downey sued and recovered from the Paving Company, in which suit the latter was determined to have breached a nondelegable duty it owed the public on the highways and could not defend on the ground that its independent contractor, Thomas, who was not a party to the suit, had been negligent.[14] The foundation of the Paving Company's suit against Thomas was the indemnity agreement, there being no claim made that Thomas had been negligent or that the Paving Company had been merely passively negligent. The court denied Thomas' effort to join the insurance company as a third party defendant holding that the terms of the policy explicitly excluded a liability based on an assumption of liability by contract.

The *Fidelity* case distinguished the *Union Paving* case on the basis that the court " . . . seems to have proceeded on the theory that the only liability of the insured for the injury . . . arose out of the indemnity agreement which it had executed. Here . . there was liability of the insured . . . without reference to the indemnity agreement."[15] Had the implied in law indemnity obligation, if there was one, been determined, then the case might have had a different result. If Thomas had been brought in as a defendant in Downey's action then the passive-active negligence rule might have been applied and Thomas deemed liable for the full amount of the judgment as an active wrongdoer, or at least as a tortfeasor jointly liable with the Paving Company. In such a case Thomas, if found to be actively negligent and the Paving Company merely passively negligent, would have incurred a liability arising out of an implied in law indemnity obligation and the exclusion clause could have in theory been held to have had no effect. In the indemnity suit by the Paving Company, had the court recognized the possibility of the insured being liable without reference

12. 213 F.2d at 112.
13. 186 F.2d 172 (3rd Cir. 1951).
14. Downey v. Union Paving Co., 184 F.2d 481 (1949).
15. 213 F.2d at 115.

to the indemnity agreement, then the insurer could have been properly joined as a third party defendant.

Another case where a contractual liability exclusion clause was held to preclude recovery because the insured had contracted to indemnify a third party was *St. Louis Police Relief Ass'n v. Aetna Life Ins. Co.*[16] The Association had rented a coliseum for a benefit circus and had agreed to indemnify the lessor for any liability incurred in relation to the premises during the term of the lease. The Association then took out a liability policy with the defendant containing a contractual liability exclusion clause. A spectator at the circus was injured when a bottle cap caught in her heel and she slipped and fell down a flight of stairs. Action was instituted against the lessor (on the theory that it had been negligent in failing to comply with a municipal ordinance requiring handrails) and against the lessee. The insurance companies of the lessor and lessee settled with the injured spectator. The lessor recovered the amount of its settlement from the Association. However, when the Association sued its insurance carrier the court held that the terms of the policy were applicable because the settlement of the lessor, which was based on the lessor's statutory negligence, was in no way based on a negligent act of the Association, and, therefore, was "the liability of another assumed by contract."[17]

Both the *Fidelity* and the *Union Paving* cases relied on the *Association* case and the reasons why each found that case applicable are consistent. The *Fidelity* case found that the Missouri decision did not deal with a liability imposed by law upon the Association, i.e., there was no implied in law obligation upon the lessee to indemnify the lessor for the loss it had suffered by reason of the ordinance violation.[18] The *Paving Company* case emphasized that the explicit character of the language in the policy when considered with the nature of the liability suffered by the lessor operated to exclude coverage.[19]

In *Board of Trade Livery Co. v. Georgia Cas. Co.*,[20] the Livery Company had contracted to transport passengers of a steamship company while they stopped over in Duluth. Under a city ordinance the Livery Company was required to have liability insurance. Its policy with the defendant excluded coverage for liability of others assumed by contract. The Livery Company reimbursed the steamship company for a judgment the latter had paid to persons who had been injured in one of the Livery Company's vehicles. The court in granting recovery to the insured on the policy stated:

"In reimbursing the Navigation Company . . . plaintiff was making good its own liability and its own wrong, and not a primary liability or wrong of the Navigation Company. . . . The case is analogous to those where one of two joint tort-feasors may compel indemnity from the other. That is allowed . . . where, as between themselves, only one is at fault, and his wrongful act or omission is a breach of a duty owed to the other, and the primary cause of the injury."[21]

16. 236 Mo. App. 413, 154 S.W.2d 782 (1941).
17. Id. at 416, 154 S.W.2d at 790.
18. See note 15 supra.
19. 186 F.2d at 175.
20. 160 Minn. 490, 200 N.W. 633 (1924).
21. Id. at 491, 200 N.W. at 636.

The *Livery Company* case, though it did not hold the exclusion clause inoperative in a situation where an express indemnity contract had been involved, does indicate what should be the effect of such a clause where the insured's liability is one resulting from an implied in law indemnity obligation. The *Fidelity* case cited the *Livery Company* case as being analogous to its situation in that the obligation incurred by the Livery Company was one imposed by law, i.e., an implied in law indemnity obligation.[22] The *Association* case, in noting that the liability of the Association was different in that it had been assumed by contract, stated that "when the livery company paid the judgment, it was making good its own wrong. It suffered a loss due to its own primary negligence."[23] These three cases may be summarized by stating that where the implied in law indemnity obligation of the insured has been established, a contractual liability exclusion clause will be inoperative whether the insured entered into an indemnity agreement or not.

The most recent case holding a contractual liability clause inoperative is *O'Dowd v. American Surety Co.*[24] The plaintiff was injured on the premises of a housing project being constructed by the insured for the Housing Authority of the City of New York. The policy of the insured contained a contractual liability exclusion clause. The insured and the Housing Authority were charged with active and passive negligence respectively and the Housing Authority cross-claimed against the insured on the theory that the insured was solely responsible for the injury and that since the insured had agreed to indemnify it against claims for personal injury, insured should pay the entire amount. The verdict was against both defendants and judgment was ordered over against the insured. The court denied the insurer's plea that it was liable under the rule of contribution[25] for only one half the judgment and held the exclusion clause inoperative. Though the *O'Dowd* case did not make it clear whether a limited or sweeping indemnity agreement was involved, it held that where the liability of the insured is attributable to his active negligence in relation to the indemnitee's passive negligence, an exclusion clause can not have the effect of prohibiting recovery. The court stated, "if the insurer's contention were to be upheld its consequences would be to relieve the active wrongdoer of a burden it has always borne and to place upon the passive wrongdoer a burden it has never had."[26]

CONCLUSION

To obviate the difficulties presented by a contractual liability exclusion clause, it is necessary that the principle be kept in mind that on the basis of the passive-active negligence rule a person may be held liable in the absence

22. 213 F.2d at 113.

23. 236 Mo. App. at 416, 154 S.W.2d at 790.

24. 135 N.Y.L.J. No. 81, p. 7, col. 8 (N.Y. Sup. Ct. April 26, 1956), aff'd, 2 A.D.2d 956 (1st Dep't 1956).

25. N.Y. Civ. Prac. Act § 211-a.

26. 135 N.Y.L.J. No. 81, p. 8, col. 1 (N.Y. Sup. Ct. April 26, 1956), aff'd, 2 A.D.2d 956 (1st Dep't 1956).