The Indemnity Loophole

When is the last time you woke up in the middle of the night worried about an indemnity provision? If you represent general contractors, chances are you never have. This is because indemnity provisions exist to provide contractors and their attorneys with the peace of mind that if or when problems occur, the subcontractor responsible will ultimately bear the cost of repairs.

If you represent subcontractors, on the other hand, you may suffer from long bouts of insomnia thinking about how to defend against claims for indemnification. In some cases, you will not have much evidence due to a lapse of time between the relevant events and when a general contractor sues your client. Typically, the statute of limitations protects defendants in these situations. But, due to the flexible time frame in which general contractors can initiate indemnity claims, statutory limitations may not adequately protect subcontractors against claims for indemnification.

In the typical construction defect case, an owner sues the general contractor, among others, and the general contractor, in turn, asserts claims against one or more subcontractors. The general contractor’s lawsuit against the subcontractors almost always includes claims for indemnification. For the purposes of this article, and to avoid confusion, we will assume that the general contractor is the indemnitee and the subcontractor is the indemnitor.

In this article we will first examine the use of indemnity provisions and statutes of limitation in the construction industry. We will then explore how general contractors use indemnity provisions to avoid statutes of limitation. Finally, we will make recommendations to attorneys defending subcontractors and will suggest ways to change the law that would allow subcontractors a fair opportunity to defend against claims for indemnification.

Indemnity Provisions in the Construction Industry

Construction projects are complicated, interdependent endeavors. Take a look at any construction work schedule and you will realize just how much general contractors depend on subcontractors to complete the majority of the work. When general contractors execute construction contracts with subcontractors, they want assurances...
that owners will not hold them responsible for a subcontractor's wrongdoing. Indemnity provisions provide such protection by imposing the cost of liability on the subcontractor that caused the problem.

Construction contracts generally use one of three types of indemnity provisions: limited form provisions, intermediate form provisions, and broad form provisions. Here, we will focus on limited and broad form provisions. A limited form provision requires a subcontractor to indemnify a general contractor only for the subcontractor's own negligence. A broad form provision requires a subcontractor to indemnify a general contractor for both the subcontractor's and the general contractor's negligence.

Statutes of Limitation in the Construction Industry


Statutes of limitation vary from claim to claim and from jurisdiction to jurisdiction. We see many different and often creative claims asserted in construction disputes, but the most common are negligence and breach of contract. The statutes of limitation for negligence vary from one year in Louisiana to 10 years in Rhode Island. La. Civ. Code Ann. art. 3493; R.I. Gen. Laws §9-1-29. The statutes of limitation for breach of contract vary from three years in Alaska to 15 years in Kentucky. Alaska Stat. §09.10.053; Ky. Rev. Stat. §413.090. In most jurisdictions, the limitations period for both negligence and breach of contract begins when the injured party knows or should have known of the damage or loss. See, e.g., *Dean v. Frank W. Neal & Associates, Inc.*, 166 S.W.3d 352, 357 (Tex. App. 2005, no pet.) *Gard v. City of Omaha*, 786 N.W.2d 688, 694 (Neb. Ct. App. 2010).

Construction disputes also typically involve an indemnity claim. A general contractor will almost always assert an indemnity claim against one or more subcontractors when it is sued by an owner. The statutes of limitation for an indemnity claim vary from 90 days in Colorado to 10 years in Illinois. Colo. Rev. Stat §13-80-104(I)(b)(II); Ill. Stat. §5/13-206; *Travelers Cas. & Sur. Co. v. Bowman*, 893 N.E.2d 583, 593 (Ill. 2008). The accrual date for indemnification differs from other claims. In some jurisdictions, an indemnity claim may accrue when the injured party discovers or should have discovered the construction defect or when an owner files a lawsuit against a general contractor. Mich. Comp. Laws. §600.5839(b); Minn. Stat. §541.051(c). In most jurisdictions, however, the statute of limitation for an indemnity claim against a subcontractor will not accrue until a general contractor becomes liable for damages to an owner. Colo. Rev. Stat §13-80-104(I)(b)(II); Conn. Gen. Stat. §52-598a; Utah Code §70-2a-506.

In the messy world of construction litigation, a general contractor will often bring in a subcontractor and assert a cause of action for indemnification against the subcontractor before the general contractor has paid damages to the owner. Even though the indemnity claim may not have accrued, courts generally will allow a general contractor to assert the claim early in the interest of judicial economy. *Ingersoll-Rand Co. v. Valero Energy Corp.*, 997 S.W.2d 203, 209 (Tex. 1999); *Burns & McDonnell Engineering Co., Inc. v. Torson Const. Co., Inc.*, 834 S.W.2d 755, 758 (Mo. Ct. App. 1992).

Importantly, an action for indemnification cannot exist against a subcontractor when the subcontractor is not liable to the owner. See, e.g., *Nassif v. Sunrise Homes, Inc.*, 739 So.2d 183, 185 (La. 1999); *ECC Parkway Joint Venture v. Baldwin*, 765 S.W.2d 504, 513 (Tex. App. 1989, writ denied). Therefore, an indemnity claim also differs from other claims because it cannot be asserted when a viable “underlying claim” does not exist. For the purposes of this article, we refer to claims such as negligence and breach of contract as the “underlying claim” because they form the basis of the claim for indemnification in construction-related indemnity disputes.

When Indemnity Provisions and Statutes of Limitation Collide

So, what happens when a general contractor has brought in a subcontractor and asserted an indemnity claim, but a statute of limitation bars the underlying claim? We find that if the subcontractor can prove that it is not liable for the underlying claim, the general contractor cannot maintain the indemnity claim. See, e.g., *Nassif*, 739 So.2d at 185; *Hunter v. Fort Worth Capital Corp.*, 620 S.W.2d 547, 553 (Tex. 1981). Does this same analysis apply when a subcontractor is not liable for the underlying claim because a technical defense such as a statute of limitation bars the underlying claim? If the underlying claim is time barred, surely the indemnity claim would also be time barred. To the dismay of attorneys representing subcontractors, this result is not likely.

The majority of courts have concluded that when a statute of limitation bars liability for the underlying cause of action, the party is deprived of the right to assert the claim, but this does not negate the liability. *Fleeger v. Wycelt*, 771 N.W.2d 524, 528 (Minn. 2009) (quoting *City of Willmar v. Short-Elliott-Hendrickson, Inc.*, 512 N.W.2d 872, 875 (Minn. 1994); *Amoco Chemicals Corp. v. Malone Service Co.*, 712 S.W.2d 611, 614 (Tex. App. 1986, no writ)). Extending this analysis, most courts conclude that a general contractor can pursue an indemnity claim against a subcontractor even though a statute of limitation would bar the underlying claim because the liability for the underlying claim remains. Those courts that have adopted this analysis view indemnification as a purely contractual agreement: if the language in the contract is clear, a court should enforce the obligation to indemnify regardless of other considerations. See, e.g., *Prince v. Pacific
Gas & Elec. Co., 202 P.3d 1115, 1120 (Cal. 2009). But this analysis ignores the purpose of statutes of limitation and forces subcontractors to defend against stale claims.

At least one court has disagreed with the majority position. A federal court in Virginia found that when a statute of limitation bars the underlying claim, the plaintiff in the indemnity action cannot maintain the indemnity claim. Smith-Moore Body Co. v. Heil Co., 603 F. Supp. 354, 359–60 (E.D. Va. 1985). In Smith-Moore, the defendant argued that the plaintiff could only recover for indemnification if it could maintain a cause of action for the underlying liability claim. Id. at 359. Because the underlying claim was barred by the statute of limitations, the defendant argued, the plaintiff had no cause of action for indemnity. Id. The court agreed, holding that the running of the statute of limitations extinguished liability and therefore an indemnity cause of action could not exist. Id. at 359–60.

**Practical Advice: How to Handle an Indemnity Claim When a Statute of Limitation Bars the Underlying Liability Claim**

For most readers, the legal landscape in which you practice does not take the Smith-Moore position. 603 F. Supp. 354, 359–60 (E.D. Va. 1985). Most subcontractors will remain liable for indemnification even when statutory limitations bar the underlying claim. With that in mind, we have some suggestions that may help you persuade your court or state legislature to change course regarding indemnity and statutes of limitation.

**Take It to the Courts**

File a motion for summary judgment on the indemnity claim against your client. To support your motion, it may be helpful to create a timeline showing when the owner knew or should have known of the alleged problems, when the owner filed the original lawsuit, when the limitations period started and ended for the underlying liability claim, and when the general contractor ultimately filed its claim for indemnification against your client. A timeline will illustrate the ample opportunity the general contractor had to bring your client into the lawsuit before the statute of limitation for the underlying claim elapsed. On a more substantive level, a few legal arguments may help you convince a court to dismiss the indemnity claim against your client.

**Urge the Court to Apply Principles of Due Process (Laches)**

In your motion for summary judgment, you should argue that laches precludes the general contractor from maintaining the claim for indemnification. This may be a novel argument in this situation, but equitable principles are not new concepts.

**Take It to the Legislature**

In recent years, legislatures have shown a willingness to change statutes relating to indemnity and limitations. We propose that changing the law to require general contractors to bring indemnity actions within the same time frame as the underlying claims for liability would give subcontractors a meaningful opportunity to present evidence and refute the claim. Consequently, when a statute of limitation bars the underlying claim, the subcontractor is deprived of its right to be advised of the claims against it in time to gather and preserve evidence to refute the claim. The right to due process “encompasses the individual’s right to be aware of and refute the evidence against the merits of his case.” Vining v. Runyon, 99 F.3d 1056, 1057 (11th Cir. 1996). Due process requires a meaningful opportunity to present evidence and have it considered in explanation or rebuttal.” Gaytan v. Workers’ Comp. Appeals Bd., 109 Cal. App. 4th 200, 219 (Cal. Ct. App. 2003). A statute or court order that denies a party the opportunity to defend against a case violates the basic principles of due process. U.S. Const. amend. V; Armstrong v. Manzo, 380 U.S. 545, 550 (1965). When a subcontractor must defend against an indemnity claim after statutory limitations bar the underlying claim, the subcontractor is deprived of its right to be advised of the claims against it in time to gather and preserve evidence to refute the claim. Consequently, when a statute of limitation bars the underlying claim, due process requires barring the claim for indemnification as well.
mote efficiency and encourage contractors to bring all potential parties into a lawsuit as soon as practicable.

**Legislatures Address Abuse of Indemnification Provisions**

Over time, business savvy general contractors began using indemnification provisions for more than an assurance that the responsible party would bear the cost: they used broad form indemnity provisions to shift liability for their own negligence to their subcontractors. Widespread use of broad form indemnity provisions led to massive inequities in the construction industry. Subcontractors that wanted work were, in essence, forced to sign contracts containing these provisions.


Interestingly, the courts first began to limit the use of broad form indemnity provisions in many states before the legislatures stepped in. Once ample case law existed, the legislatures acted. This should encourage our readers to assert equitable arguments in trial courts and on appeal. Who knows, your case may be the one that finally convinces your state legislature to act.

**Legislators Address Abuse of Limitations**

Until recently, a unique situation existed in Texas where, with the assistance of a willing defendant, a plaintiff could bring a lawsuit against a party even when the statute of limitation would otherwise bar the suit. Under the responsible third-party statute, a plaintiff was afforded 60 days after a defendant designated a responsible third party to add that party as a named defendant even though the statute of limitation for the claim had expired. In 2009, the Texas legislature removed the 60-day language and closed this loophole.

Use this example to show that legislatures in other states have changed the operation of a statute of limitation to avoid inequities, and encourage your legislature to do the same.

**Conclusion**

We are not suggesting that the statutes of limitation for indemnity claims should be so restrictive that they effectively prohibit general contractors from asserting indemnity claims against subcontractors. This would upend the proportionate responsibility system found in most states and probably create more problems than it would solve. Instead, we suggest that the law should bar an indemnity claim when a statute of limitation would bar the underlying claim.

The changes that we have proposed in this article follow in the footsteps of other recent statutory amendments that close loopholes in the law and bring some equity to the process when statutes of limitation and indemnity provisions collide. After reading this article, those of you who represent subcontractors may find yourselves sleeping even less; however, our hope is that you will have some useful information to consider while you are lying in bed awake.