

“INSURING” THE RAILROAD’S GENERAL LIABILITY RISKS:

PRACTICAL CONSIDERATIONS WHEN NEGOTIATING WITH OUTSIDE CONTRACTORS

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Risks associated with railroads are unique. Because railroad rights-of-way intersect thousands of non-railroad-owned properties and thoroughfares, there are endless potentials for liability. Risks associated with railroad properties which do not involve rights-of-way are only slightly less due to the unique nature of the industry.

The risks are compounded when a railroad allows contractors to access railroad property. This access can occur when the contractor performs work for the railroad, or when a contractor must access or traverse railroad properties or rights-of-way in order for those contractors to perform work for others. Once a loss occurs, it is not uncommon to see a contractor’s employee sue the Railroad, a third party sue the Railroad, or even the contractor itself bring suit against the Railroad.

Railroads are, for the most part, self-insured, and thus highly motivated to offload liability in as many ways as possible. *Commercial Liability Insurance* (International Risk Management Institute, Inc.), at VI.R.1 (July 2002). Railroad risk management is most effective when it can prospectively offload its risk to another. Through insightful risk management, Railroads have effectively utilized the following strategies to either offload or avoid potential liabilities:

- Indemnification agreements with the Contractor’s Commercial General Liability (“CGL”) policy insuring the obligation:

¹ These materials address contractor and insurance considerations which relate to Commercial General Liability issues. Therefore, the scope of these materials does not include additional considerations for the Railroad in regards to additional risks such as Commercial Automobile issues.

- This protection insulates the Railroad against claims brought by others to, at a minimum, indemnify the Railroad for the Contractor’s fault in causing injury to a third person, or, if permissible, to indemnify the Railroad for the Railroad’s own fault in causing the loss.
- Additional Insured status under the Contractor’s CGL policy:
 - This protection is intended to provide the Railroad with direct insurance coverage for the loss at issue.
- Purchasing Railroad protective liability policies:
 - This protection provides direct primary occurrence coverage to the Railroad for risks which may otherwise be excluded under commercial general liability policies.

These materials overview each of these risk management tools, discuss how each separate tool provides maximum (and many times duplicative) protection to the Railroad, and address some practical considerations for use in the Railroad’s negotiation with Contractors. In addition, these materials outline a series of clauses and endorsements the Railroad should look for in Contractor policies once they are obtained.

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INDEMNIFICATION AGREEMENTS

Indemnification agreements contractually obligate one party to indemnify, and many times defend, another against losses arising from the subject matter of the contract. Most jurisdictions interpret the construction and effect of indemnification agreements as a matter of law. See e.g., Art Goebel, Inc., v. North Suburban Agencies, 567 N.W.2d 511, 515 (Minn. 1997). “A party may

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contract to indemnify another for damages or injuries caused by the negligence of the indemnitee and beyond the control of the indemnitor.” Christy v. Menasha Corp., 297 Minn. 334, 211 N.W.2d 773, 777 (1973). Most courts will enforce the scope of an unambiguous indemnification agreement even if it indemnifies for the indemnitee’s own negligence unless it runs afoul of public policy or statutory considerations. Therefore, it is important to understand how the state law of the jurisdiction involved will interpret the provision before it is proposed in a Contractor Agreement.

Typically, some form of nexus or connection between the liability and the project is required in order to enforce the indemnification agreement. Minnesota, for example, requires that there be a temporal and geographic nexus, or a causal nexus, between the contractor’s work and the injuries or damages at issue. Anstine v. Lake Darling Ranch, 305 Minn. 243, 249, 233 N.W.2d 723, 727 (1975), overruled on other grounds, Farmington Plumbing & Heating Co. v. Fischer Sand and Aggregate, Inc., 281 N.W.2d 838, 840 n. 4 (Minn. 1979). A temporal nexus exists between the contractor’s work and the injury where the worker’s injury occurs while the worker is preparing for work, or in the process of working, but not after the completion of the work. Fossum v. Kraus-Anderson Const. Co., 372 N.W.2d 415, 418 (Minn. App. 1985). A geographic connection exists between the injury and the contractor’s work if the injury is sustained on the job site, regardless of its cause. Id. at 417-18. Alternatively, a causal nexus exists when, “but for” the work, the injury would not have occurred. National Hydro Systems v. M. A. Mortenson, 528 N.W.2d 690, 693 (Minn. 1995).

As noted above, indemnification agreements, and especially those which seek to indemnify a Railroad for its own negligence, may be void or unenforceable either because of public policy or

statutory considerations. The most common statutory prohibition against indemnification for an indemnitee's own fault are the Construction Anti-Indemnification Statutes now in place in well over 40 states. 3 Bruner and O'Connor on Construction Law, § 10:77, p. 917 (2002). Specific statutory prohibitions vary from state to state, and therefore the jurisdiction's statute should be consulted if the Contractor will be engaging in construction activities. The statutes generally either prohibit the indemnitee from assuming the indemnitor's sole negligence, limit the indemnitee's protection to only the amount of fault of the indemnitor, or contain atypical or miscellaneous limitations. *Id.* Minnesota's statute, for example, is uniquely formatted to prohibit a Contractor from indemnifying a Railroad in a construction contract unless the Contractor obtain a policy to insure the indemnification obligation. Minn. Stat. Ch. 337.

Some jurisdictions may void an indemnification contract under various public policy reasons. An ambiguous clause may limit the scope of an indemnification agreement. In addition, some courts look to whether, at the time of contracting, there was a great disparity of bargaining power between the parties. For example, in Cook v. Southern Pacific Trans. Co., 623 P.2d 1125 (Or. App. 1981), a court invalidated an indemnification clause where the agreement was on a form prepared by the railroad, did not specifically allocate risk of third-party negligence (the cause of the injury to the railroad's employee), and the railroad was under a broad duty of care pursuant to the Federal Employers Liability Act ("FELA"). Despite these "legal" reasons, it appears what motivated the court was the fact the Contractor was financially unable to actually perform the indemnification obligation as he was a single individual who took on a job to demolish and remove an abandoned

station house for the sum of \$1,500. Assuming what in effect was the railroad's liability under FELA was just too great of a disparity to allow the court to enforce the agreement.

Despite careful drafting, many indemnification agreements do not fully detail the scope of the obligation imposed on the Contractor, and therefore may be considered ambiguous by a later-reviewing Court. For example, typical indemnification agreements impose an obligation for the Contractor to "defend" or "fully defend" the Railroad. These words, however, may only obligate the contractor to defend the Railroad for the claims actually indemnified. This scope of defense, as discussed below, is a much more narrow than that provided by an insurance policy. These obligations also raise the question of which party, the Contractor or the Railroad, will control the defense of the claim or suit. In addition, it may be unwise to have an indemnitor "defend" a Railroad in situations where the Contractor is also a party to the lawsuit.

Another concern about indemnification agreements typically utilized in Railroad/Contractor Agreements is that the scope of the type of injury indemnified may not be as broad as the Railroad requires. Typically, indemnification agreements require "bodily injury" and "property damage" to be the basis for the damages sought and for which the Contractor indemnifies the Railroad. However, especially in an age where security concerns predominate the industry, the Railroad may have additional exposures beyond physical injury to a person or property. There may be situations where a person may claim a more intangible injury such as those alleged in false arrest, detention or malicious prosecution matters. There may well be other matters involved with a project which potentially involves a constructive eviction of a property owner adjacent to the project, or some type

of libel or slander. Indemnification Agreements should be looked at to determine if the scope of the injury involved needs to be expanded to include protection from claims of personal injury or advertising injury such as these.

Finally, indemnification agreements raise collectability issues in that the Contractor may not be in a position later to deliver the bargained-for right of the Railroad.

INSURING THE INDEMNIFICATION OBLIGATION

The Railroad's indemnification right is only as valuable as the Contractor's balance sheet, or the Contractor's ability to insure the obligation. Since many contractors' balance sheets are not attractive to a railroad, the latter option is the only viable means of assuring the railroad that the obligation will be performed if needed.

Normally, the Contractor's CGL Policy will contain some form of coverage for indemnification agreements. However, the coverage may not be sufficient to insure the agreement with the Railroad. Therefore, the Railroad should insist that the Contractor procure contractual liability coverage which is sufficient to protect the obligation provided to the Railroad. This duty to procure clause may also assist the Railroad in defeating a state's Anti-Indemnification Statute. See e.g., Minn. Stat. § 337.05, Subd. 2; *Holmes v. Watson-Forsberg Co.*, 488 N.W.2d 473 (Minn. 1992).

The indemnification obligation running in favor of the Railroad (unlike other parties) often runs afoul of the Contractor's CGL Policy's Contractual Liability Exclusion. Specifically, typical CGL coverage for bodily injury or property damage is excluded if "the insured is obligated to pay

damages by reason of the assumption of liability in a contract or agreement.” See e.g., Insurance Services Organization (“ISO”) Commercial General Liability Form CG 00 01 10 01 at p. 2.² Therefore, unless an exception to the exclusion applies, the main provision of this exclusion bars coverage for the Contractor’s liability to indemnify the Railroad.

The Contractual Liability Exclusion does contain an exception which restores coverage for liabilities “assumed 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 standard insurance form’s definition of an “Insured Contract,” however, does not include indemnity obligations which would arise in most scenarios where the Contractor would either be doing work for the Railroad, or be accessing Railroad property to perform work for another. Specifically, while an indemnification agreement taken on in a sidetrack agreement would be covered, similar obligations in an easement or license agreement are not covered when the agreement is “in connection with construction or demolition operations on or within 50 feet of a railroad.” Id. Also, the indemnification obligation in favor of the Railroad is not insured when the “‘bodily injury’ or ‘property damage’ aris[es] out of construction or demolition operations, within 50 feet of any railroad

² The Insurance Services Organization (“ISO”) publishes “standard” insurance forms which are promulgated from time to time by the industry. “CG” forms address commercial general liability risks. Each CG form is designated by a set of four two-digit numbers. The first two sets of numbers (here 00 01) describe the type of form involved (here, the commercial general liability base coverage form). The second two sets of numbers describe the edition date of the form (here 10 01 (October 2001)). It is absolutely imperative that ISO forms be identified, not just by the form number, but by the edition date as significant changes have taken place to all forms in the years since each form was originally issued.

property and affecting any Railroad bridge or trestle, tracks, road beds, tunnel, underpass, or crossing.”

The insurance industry recognizes that Railroads require coverage for the indemnification set forth in its Contractor Agreements. Therefore, insurers will usually agree to have the Contractor’s CGL Policy endorsed with a standard ISO Form, number CG 24 17 10 01 (“Contractual Liability – Railroads”), to eliminate Railroad-related limitations to Insured Contract coverage discussed above. Form CG 24 17 10 01 is a scheduled form which requires the Railroad to be listed on the form, as well as a description of the “Designated Job Site.” The “Designated Job Site” description should be sufficiently broad to encompass all potential areas which might be impacted by the Contractor’s operations or work.

However, simply because the “Contractual Liability – Railroads” form is available does not mean that the insurer will automatically add the Endorsement to the Contractor’s policy. As more fully discussed below, in 2004, the insurance industry modified several of its “Additional Insured” standard endorsement forms to potentially severely limit the scope of coverage available under a Contractor’s CGL policy. This modification has also been implemented in the industry’s revisions to the “Insured Contract” definition in the endorsements addressing a Contractor’s contractual liability to a railroad. In conjunction with these changes, ISO issued a new form CG 24 26 07 04 designed to limit an indemnitee’s contractual liability coverage to only bodily injury or property damage that “is caused, in whole or in part, by [the Contractor] or by those acting on your behalf.” Id. This restricts a Contractor’s coverage for its indemnification obligation in two respects. First,

the standard form Insured Contract definition did not contain any nexus requirement between the Contractor's acts or omissions and the injury or damage. Therefore, so long as the contract was an Insured Contract, there was coverage, even if the Contractor was not at fault. This Endorsement requires that there be a causal link between the bodily injury or property damage and the (negligent?) acts or omissions of the Contractor. Second, coverage designed to protect a Contractor from its indemnification obligation is now lost if the indemnitee is solely at fault for the injury or damage at issue.

For some reason, when the ISO changes to the Additional Insured forms and the Insured Contract definition were implemented in 07 04, ISO failed to revise the "Contractual Liability – Railroads" form discussed above. ISO sought to remedy this problem with the issuance of a new form, CG 24 27 03 05, which is designed to replace CG 24 17. This new form mirrors the changes discussed in regards to the 07 04 Amendment of the Insured Contract Definition. The Contractor's contractual liability coverage for bodily injury or property damage only applies if the injury or damage is caused in whole or in part by the named insured or those acting on behalf of the named insured. This restricts a Contractor's coverage for its indemnification obligation to the Railroad in the same two respects as discussed above. First, Form CG 24 17 10 01 did not contain any nexus requirement between the Contractor's acts or omissions and the injury or damage. Therefore, so long as the contract was an Insured Contract, there was coverage, even if the Contractor was not at fault. Second, indemnification coverage for the Contractor is now lost if the Railroad is solely at fault for the injury or damage at issue.

Limited Contractual Liability Coverage for Personal and Advertising Injury

Endorsement: If the Railroad expands the scope of the indemnification involved in the agreement to include personal and advertising injuries, an additional ISO Form may be of interest. The Contractor's CGL Policy, if it follows standard language, will likely include coverage for personal injury and advertising injury. However, this protection contains a broad exclusion to bar coverage for personal injury and advertising injury "for which the insured has assumed liability in a contract or agreement." Form CG 00 01 10 01 at p. 6. Therefore, even if the Railroad bargained for indemnification of these additional liabilities, there would not usually be coverage available for the Contractor for the obligation.

The insurance industry has recognized that contractual liability coverage for at least some of these liabilities is marketable. ISO has issued a Form CG 22 74 10 01, entitled "Limited Contractual Liability Coverage for Personal and Advertising Injury" to address this issue. This is a scheduled form which requires the designated contract or agreement to be listed on the endorsement. If the endorsement is attached to the Contractor's policy, the Contractor would have coverage for an indemnification agreement which assumes the Railroad's liability for personal injury related to false arrest, detention and imprisonment.

Because the insurance industry has this limited endorsement, it may well be that the Contractor's CGL carrier would reject attempts to expand the exceptions in this endorsement on a manuscript basis to have the Contractor covered for all contractually-assumed personal injury and

advertising injury liability. However, this limited indemnification coverage for some personal injury and advertising injury offenses is better than nothing.

Defense Fees and Costs Payment: Even if there is Insured Contract coverage for settlements or judgments under the Contractor's CGL policy for bodily injury, property damage or other injury, there is a question as to how the Railroad's defense fees, costs and disbursements will be paid. The Contractor's CGL policy contains two separate provisions which may be applicable to those amounts. The first provision is found in the standard CGL Policy's "Supplementary Payments" provision. This provision states that, so long as the following conditions are met, the Contractor's CGL carrier will defend the Railroad in an action where both the contractor and the Railroad are named as defendants:

- a. The "suit" against the Railroad seeks damages for which the insured has assumed the liability of the Railroad in a contract or agreement that is an "insured contract";
- b. The Contractor's CGL policy applies to the liability assumed by the Contractor;
- c. The obligation to defend, or the cost of the defense of, the Railroad has also been assumed by the Contractor in the same "insured contract";
- d. The allegations in the "suit" and the information the Carrier knows about the "occurrence" are such that no conflict appears to exist between the Railroad's and Contractor's interests;
- e. The Railroad and the Contractor each ask the Carrier to conduct and control the defense of the Railroad, and further agree that the Carrier may assign the same counsel to defend both the Contractor and the Railroad; and
- f. The Railroad:

