



Navigating the Minefield of Contractual Indemnity Coverage and Additional Insured Issues

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**I. The Basics: Two Forms of Contractual Risk Allocation
Contractual Indemnification and Additional Insured
Coverage**

There are two primary methods of sharing and transferring risk: contractual indemnification and additional insured coverage. The party seeking to transfer the risk should ensure that both forms of risk allocation have been provided for in the contract and insuring agreement. Both contractual indemnification and additional insured status have limitations as contractual risk vehicles; thus if both are present in the contract, the party seeking to transfer the risk is more secure that the risk transfer has occurred. If the indemnity agreement is unenforceable, the party seeking coverage can turn to the policy. Likewise, if the policy is not available, the party seeking indemnification can look to the contractual indemnification provision.

Contractual indemnification and additional insured coverage operate independently. Indemnity is covered as a contractual liability. Additional insured coverage is determined by the insurance policy and the additional insured endorsement.

A. Contractual Indemnification

The primary limitation on contractual indemnification provisions is that some states by law do not allow indemnification for the sole negligence of the indemnitee and/or the concurrent negligence of the indemnitee and indemnitor. In some states, contractual indemnification is allowed if the contract clearly reflects an agreement by both parties to transfer liability. The reasoning behind the disfavoring of indemnification provisions is grounded in the fact that courts and legislators believe the indemnification provisions create unequal bargaining power and that subcontractors are neither prepared nor able to bear such potentially unlimited risk.

B. Additional Insured Status

Additional insured coverage provides benefits that the risk transferor does not get under contractual indemnification alone. First, the additional insured qualifies as an insured under the transferee's policy, meaning that the additional insured has direct rights as an insured under that policy.

Second, additional insured coverage can have broader benefits than contractual indemnification. Depending on the additional insured endorsement employed, coverage may be provided for the additional insured's own negligence, circumventing any state law prohibition against indemnification for the sole negligence of the indemnitee. Additional insured agreements are exempted from any anti-indemnification laws, either by way of statute or case law. However, the coverage an additional insured receives is only as good as the additional insured endorsement employed. (See page 5 for a discussion of the advantages and disadvantages of various additional insured endorsements.)

II. Hot Topics in Coverage Issues for Contractual and Additional Insureds

A. Horizontal and Vertical Exhaustion: Which policy pays first?

Many of the coverage issues tackled by courts recently involve the creation, scope and priority of additional insured coverage under insurance policies. Specifically, an analysis typically involves a determination of what policy provides primary coverage and the order in which any remaining policies are exhausted. The following cases suggest that the court should first look to the intent of the parties to the contract and not an "other insurance" clause analysis.

1. Rossmoor Sanitation v. Pylon Inc., 13 Cal.3d 622 (1975)

Held that where the owner was at most passively negligent, it could benefit from the general indemnity agreement; and that where the contractor's insurance policy was part of the consideration for the construction job, it would be viewed as primary insurance, and thus owner's insurer was subrogated to the indemnity rights of the owner for the full amount of the judgment, notwithstanding "other insurance" clauses in policies of owner and contractor.

2. J. Walters Construction v. Gillman Paper Company, 620 S.2d 219 (Fla. App. 1st Dist. 1993).

Held that, under Georgia law, “other insurance” provision in contractor's policy did not apply to claim against contractor as indemnitor under indemnification provision in construction contract.

3. Pecker Iron Works of New York v. Traveler's Ins. Co., 99 N.Y.2d 391(2003) Held that despite additional insured endorsement which provided subcontractor's insurer would be excess unless contracted to be primary, subcontractor's insurer was primary - the intent of acquiring the additional insured coverage was for it to be primary.

4. Maxwell v. Toys “R” Us-NY LTD. Partnership, 702 N.Y.S.2d 651 (2nd Dept. 2000) (required the two primary carriers to share)

5. St. Paul Fire and Marine Ins. Co. v. Lexington Ins. Co., 2006 WL 1295408 (S.D. Fla.) (2006).

Held that where right of indemnification exists between parties insured under policies of insurance, especially where one of the policies covers the indemnity obligation, controlling effect should be given to the indemnity obligation of one insured to the other over the “other insurance” or similar clauses in the policies of insurance.

**B. Additional Insured Endorsements:
Advantages and Disadvantages of Various Forms**

There are several different forms or endorsements that confer additional insured status on a party. These forms have various advantages and disadvantages. The following are typical examples of different forms and how they affect coverage.

1. ISO CG 20 10 11 85 (Attachment A)

Coverage is provided as an additional insured to “the person or organization shown in the Schedule, but only with respect to liability arising out of ‘your work’ for that insured by or for you.” This endorsement provides coverage

to the additional insured for any instance of damage or injury so long as the additional insured's *liability arises out of* the subcontractor's work. There is no restriction for "completed operations." ISO CG 20 10 11 85 form provides coverage for liability arising out of "your work" performed for or by that insured thereby extending coverage for any "bodily injury" or "property damage" linked to the subcontractor's work. However, all coverage under an occurrence-based policy requires that in order for the policy to be triggered, the alleged "property damage" or "bodily injury" must occur during the policy period. If the policy period is post-construction, then the additional insured has "completed operations" coverage for "property damage" and "bodily injury."

2. ISO CG 20 10 10 93 (Attachment B)

While ISO CG 20 10 11 85 extends coverage to the additional insured for liability arising out of "your work", ISO CG 20 10 10 93 limits the additional insured to coverage for liability arising out of the subcontractor's "ongoing operations." Coverage may still be provided for any "bodily injury" or "property damage" even if damage occurs after completion of the project, if the additional insured's liability can be traced to the subcontractor's "ongoing operations".

3. ISO CG 20 10 07 04 (Attachment C)

The "ongoing operations" endorsement has been modified recently. The primary changes in the new ISO CG 20 10 07 04 endorsement are:

- a. The replacement of the phrase "arising out of" with the phrase "caused, in whole or in part, by."
- b. The qualification of the term "[i]n the performance of your ongoing operations" with the addition of the preface "[t]he acts or omissions of those acting on your behalf."

While it is clear that the purpose of these changes is to preclude coverage when the named insured is not at fault, it is unclear whether these changes will achieve this result.

4. ISO CG 20 09 11 85 (Attachment D)

Under ISO CG 20 09 11 85, the endorsement contains an exclusion which provides that this insurance does not apply to:

2. B.(3) “Bodily injury” or “property damage” arising out of any act or omission of the additional insured(s) or any of their employees, other than the general supervision of work performed for the additional insured(s) by you.

This does not provide coverage for the additional insured’s acts or omissions unless they can be traced back to a general supervision claim. Further, there is no set definition for general supervision. Coverage is determined on a case-by-case situation.

This endorsement also specifically excludes “completed operations” coverage. This insurance does not apply to:

2. B.(2) “Bodily injury” or “property damage” occurring after:

(a) All work on the project (other than service, maintenance, or repairs) to be performed by or on behalf of the additional insured(s) at the site of the covered operations has been completed: or

(b) That portion of “your work” out of which the injury or damage arises has been put to its intended use by any other person or organization other than another contractor or subcontractor engaged in performing operations for a principal as a part of the same project.

5. Blanket Endorsement (see Attachment A)

In a blanket additional insured endorsement, the named insured is not required to list each additional insured by name. This is often used by subcontractors who have an abundance of additional insureds. In that

instance, the named insured's insurer might simply employ a blanket endorsement that would state: "WHO IS AN INSURED (SECTION II) is amended to include as an insured any person or organization (called hereafter 'additional insured') whom you have agreed in a written contract, executed prior to loss, to name as additional insured, but only with respect to liability arising out of 'your work' for that additional insured performed by you or for you."

6. "Arising out of" language

This language has been interpreted broadly by most courts, especially in comparison to "caused by" or "resulting from". When policies state that coverage applies to additional insureds for "bodily injury" or "property damage" "arising out of" the named insured's work, the additional insured will not be required to establish an unbroken chain of events evidencing their liability. All that must be found is a simple causal relationship between the accident or injury and the liability of the additional insured. The general trend evidenced by recent court decisions is that "arising out of" does not require a direct causal relationship between the named insured's conduct, work, or operations and the additional insured's liability. This provides broader coverage to the additional insured.

If the policy or endorsement states that the "property damage" or "bodily injury" must be caused by or result from the additional insured in order to invoke coverage, the additional insured must be able to show that there was a direct link between the additional insured's actions and the resulting "bodily injury" or "property damage." This wording restricts the likelihood of coverage being extended to the additional insured. Under the "arising out of" language, all an additional insured need prove is that the resulting "property damage" or "bodily injury" grew out of or had its origin in the contract or work performed by the named insured for the additional insured. For example, the First Court of Appeals in Texas interpreted the "arising out of" language broadly in the context of an additional insured provision in Admiral Ins. Co. v. Trident NGL, Inc., 988 S.W.2d 451 (Tex. App. Houston, 1999). In Admiral, a company hired to service an oil and gas facility named the facility's owner as an additional insured for liability arising out of the service company's operations. While one of the service company's

employees was unloading tools, a compressor on the property exploded. The injured employee sued the facility's owner and the owner sought a declaration that he was covered as an additional insured under the policy. The Court in Admiral, following the majority view from federal courts interpreting similar "arising out of" endorsements held:

. . . the majority view of these cases is that for liability to 'arise out of' operations of a named insured it is not necessary for the named insured's acts to have 'caused' the accident; rather it is sufficient that the named insured's employee was injured while present at the scene in connection with performing the named insured's business, even if the cause of the injury was the negligence of the additional insured.

Id. at 454.

Similarly, the Court in Aetna Casualty and Surety Co. v. Ocean Accident & Guaranty Corp., 386 F.2d 413 (3d Cir. 1967)(applying Pennsylvania law), reiterated this same rationale when it stated:

The policy language "arising out of" is very broad and vague . . . [It] means causally connected with, not proximately caused by. "But for" causation, i.e., a cause and result relationship, is enough to satisfy this provision of the policy.

C. Certificate of Insurance: What it does and does not do

Despite the fact that a certificate of insurance might name an entity as an additional insured, this alone is not enough to confer additional insured status on that party. In fact, the certificate of insurance usually contains a disclaimer that it has been issued as a matter of information only and confers no rights upon the certificate holder. What the certificate of insurance does do is provide a summary of information necessary should a claim arise, including the name of the insurer, limits, coverages, and durations of the policy.

Ideally, the party seeking additional insured status should request not only a certificate of insurance, but also a copy of the policy declarations and an additional insured endorsement naming that party as an additional insured. The party should also request a blanket additional insured endorsement that automatically provides additional insured status to anyone the named insured agrees to name as such in a contract or agreement. If a blanket endorsement is not possible, the party should ensure that the endorsement names the proper entity as an additional insured.

D. The Importance of Timely Notice

A common issue in insurance coverage litigation involves the timeliness of the insured's notice of an accident or claim. It is important that an insured provide notice of an incident to any and all insurers who may cover a claim, including the insurer under whose policy the party has been named an additional insured. A policy will generally state that an insured must give notice as soon as "practicable" of an occurrence that may result in a claim under the policy.

The "modern rule" adopted by the majority of the jurisdictions provides that an insurance company does not have to provide coverage only if the insurance company is able to show it has been substantially prejudiced by the insured's delay in notice. This is often referred to as the "notice-prejudice rule". Some jurisdictions have adopted a version of this rule, where a delay in notice is presumed to prejudice the insurer but where the insured can rebut this presumption. This is often referred to as the "prejudice presumption rule". A minority of states¹ continue to follow the "old rule," or a variation thereof, where an insured's failure to provide notice is automatically deemed to forfeit coverage under the policy. Even under the "old rule," however, an insured is given an opportunity to overcome forfeiture if it can prove that its delay in giving notice was "reasonable."

Some policies might distinguish the notice requirement of a first named insured and all other named insureds. In the 1986 and later CGL forms, it is the named insured or "you" who is obligated to give notice. It does not

¹ Generally, Alabama, Arkansas, Colorado, D.C., Georgia, Illinois, Nevada, New Hampshire, New York, Ohio, Virginia, and Wisconsin follow a version of the "old rule."

matter who notifies the insurance company provided that it is a named insured. Under the 1973 CGL policy, it is an insured (not merely a named insured) that has the obligation to provide notice. This provision could be problematic to the additional insured, as in some situations various employees of an insured who have notice of an occurrence might not recognize the significance of reporting it to an insurer. An endorsement stating that an insured is not considered to have knowledge of an occurrence unless specific employees have knowledge can alleviate this problem.

In general, it is best practice for the additional insured to give notice separate and apart from any other insureds who give notice under the policy. Although, “it has been held that timely notice by the insured can constitute notice by an additional insured where the two parties can be said to be ‘united in interest’”² the analysis of whether two parties are “united in interest” can be avoided by the additional insured’s providing separate, timely notice.

² City of New York v. Welsbach Electric Corp., 11 Misc.3d 1085 (A), 819 N.Y.S.2d 847 (N.Y. Sup.)