Contract Confusion: Clearing up the differences between risk transfer concepts in construction agreements.

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Two popular means of risk transfer in construction agreements are often confused, and can lead to disputes in interpretation when legal issues arise. The first method is the procurement of "additional insured" status on your contractual partner's insurance. The second is the obtainment of insurance coverage for the contractual indemnifications set forth in your contract. As with all risk transferring devices, it is imperative to understand the parties' intentions and to know what language best communicates these intentions. Before embarking on any risk analysis, one must understand from the outset that additional insured status and contractual indemnity are distinct concepts.

An "additional insured" is one who becomes a party to another's liability insurance policy. As an additional insured, a party has direct and independent rights against another's insurance company—as an insured. The scope and breadth of coverage, in this instance, will be determined by the language of the insurance policy and the "additional insured endorsement." On the other hand, "contractual indemnity" is created by a clause contained in a contract which is distinct from the policy. Accordingly, a party's obligation to indemnify another is completely independent of an insurance policy or additional insured endorsement.

Additional insured endorsements

For many years, insurers have viewed issues involving additional insureds with rather narrow tunnel-vision, due to the long held industry belief that additional insured coverage applies only to coverage for any vicarious liability that might be imposed on it for the liability of the named insured. Indeed, that perception led to the practice of most large insurers to provide additional insured coverage for no additional premium, and to the industry's often sloppy communication and recording practices regarding the issuance of additional insured endorsements.

The issue which most frequently arises under additional insured endorsements, particularly in relation to the construction industry, is the scope of coverage and whether the additional insured is entitled to coverage for claims arising from their own negligence. Although case law in differing states established opposite boundaries on the issue, courts analyzing the standard ISO Additional Insured Endorsement (CG 20 10) have generally concluded that the additional insured need show only a *broad* causal relationship to obtain coverage. For example, where the additional insured endorsement provides:

> The "persons insured" provision is amended to include as an insured the person or organization named below

> but only with respect to liability arising out of the operations performed by the named insured.

Courts have determined that, so long as there was some causal connection between the named insured's work and the loss in question, the additional insured was entitled to coverage for claims arising out of their own negligence. Where the injured party is an employee of the named insured, most courts would find that the mere employment relationship was sufficient to satisfy the causal nexus and conclude that the injury arose out of the named insured's work "for" the additional insured regardless of the cause of the injury.

Courts have therefore employed this liberal construction of the phrase "**arising out of**" in the context of insuring agreements so as to require only "but for" causal connection in such agreements.

More recently, and perhaps in response to this broad interpretation, newer versions of the CG 2010 form utilize language making additional insured coverage subject to bodily injury or property damage being **caused, in whole or in part,** by the acts or omissions of the named insured in its performance of ongoing or completed operations for the additional insured. Courts interpreting these additional insured endorsements have concluded that the insurer does not owe a duty to defend the additional insured when the complaint fails to allege that the injuries were in fact caused in whole or in part by the named insured's negligence. Based on consideration of cases and their drafting history, the courts have generally determined that these additional insured endorsements must demonstrate that the named insured's acts or omissions were a proximate cause of the alleged injuries in order to trigger additional insured coverage.

As such, it is important to know what kind of additional insured you are. Do you have additional insured status by virtue of the injury at issue "arising out of" the named insured's work? Or must it be caused, in whole or in part, by the named insured's work for you?

Despite these differing standards of causation, where such causation is demonstrated, most courts have concluded that an additional insured has all the rights under the named insured's policy as the named insured itself. New amendments to CG 2010 in 2013 are intended to limit the scope of additional insured coverage to only that which is required in the underlying contract. Whether the court's will enforce these new terms remains to be seen. Regardless, additional insured coverage remains considerably broader coverage than that provided by an "insured contract" as discussed below.

Contractual indemnity and insured contracts

Simply stated, "indemnity" is a fancy word for "protect." When one agrees to indemnify someone else for a particular risk of loss, that person (the "indemnitor") is agreeing to protect the other (the "indemnitee") from a financial harm or loss should a future event, usually involving bodily injury or property damage, occur. As such, an indemnity agreement reflects nothing more than an agreement between two persons or entities as to which should bear the financial risk of harm or loss should a particular incident or category of incidents occur.

Where the controversy begins is where parties seek to obtain financial protection from others (or shift the financial risk and responsibility to others) for harm which results from their own wrongdoing, i.e., from

their own tortious conduct. Viewed in that fashion, where the courts justifiably have a public policy concern that people may not do things as carefully as they should if they are going to be immune from financial responsibility for the harm they might carelessly cause, contractual indemnity agreements are viewed with a measure of judicial disfavor. Consequently, they are generally subject to strict construction, with any ambiguities construed against the party seeking indemnity, and to be effective must be expressed in clear, unequivocal and explicit terms. That rule of specificity is particularly applicable where a party (the indemnitee) is seeking protection for claims arising from his own negligence. In that instance, the contractual indemnity provision must explicitly state that it includes claims arising from the indemnitee's own negligence, and words of general import alone (such as "any and all claims"), no matter how broad, will not suffice. Many jurisdictions also, or alternatively, have statutory limitations on indemnification provisions which seek to pass on one party's own negligence to another.

Indemnity agreements

Many courts employ strict construction of the language of contractual indemnity provisions for public policy reasons. However, there are also cases which recognize indemnity clauses to be a commercially acceptable risk shifting mechanism, which is usually both accounted for in the contract bid price and protected against by insurance.

Standard Commercial General Liability (CGL) policies anticipate that these indemnification agreements will be covered by the policy, assuming certain conditions are met. The "insured contract" coverage is itself an exception to the broader exclusions in the standard CGL for contractual liability and employer's liability. As such, where the policy presumptively excludes coverage for the insured's contractual liabilities, it provides an exception for indemnification agreements. The conditions can be different from policy to policy, but generally require that the indemnification agreement be part of a written contract that was executed prior to the date of the injury at issue. Further, the indemnification provision must seek to transfer "tort" liability. An insured cannot seek coverage for its duty to indemnify another party for purely contractual obligations. As such, a bodily injury claim, which arises from tort, will be acceptable, whereas an agreement to pay specified damages in the event of a contractual default, would not be covered.

A particularly thorny issue arises when an indemnity clause in a contract may not be enforceable in the jurisdiction in which the contract is litigated. Does the mere existence of the indemnification provision trigger insured contract status, or must the indemnification provision be legally enforceable in order to be insured? Must the enforceability of the indemnification clause be litigated prior to a proper tender as an insured contract? This issue is frequently encountered, particularly in jurisdictions that do not regulate indemnity agreements by statute. However, it is rarely litigated, and those courts facing the issue have not ruled with any consistency.

Distinguishing additional insured status from insured contract

This takes us full circle to the issue of distinguishing additional insured status from insured contract. If the contract at issue requires the named insured to name the putative additional insured as such, then the additional insured is presumptively an insured on the policy. The named insured's carrier would presumably bear the burden of

showing that the causality requirement has been met to trigger the endorsement. This is significantly broader coverage than the putative additional insured tendering its right to contractual indemnity to another party's CGL insurer, and expecting that the terms of the indemnification clause are both enforceable and insured.

There are also distinctions as to the rights of a putative additional insured to defense coverage. If there is additional insured coverage in the contract and a causal link, then the additional insured is entitled to a full "dollar one" defense in the underlying action, generally outside of the policy indemnity limits. If, however, a party seeks to be defended pursuant to an insured contract, it must demonstrate that the terms of the contract provide for that defense, and often the defense obligations are not ripe until fault has been established in the underlying action. Further, an insurer's agreement to pick up the defense of another party pursuant to an insured contract may have additional conditions, such as the requirement that the indemnitor's defense and the indemnitee's defense can be consolidated.

Additional issues

Additional insured endorsements raise a host of other issues, such as whether the injury was in the course of ongoing or completed operations, and whether the additional insured is entitled to have the named insured's CGL assume a primary position over the additional insured's own CGL policy. Indemnification and insured contract analyses are similarly complex and unpredictable from jurisdiction to jurisdiction. However, some broad conclusions can be made to begin the process of sorting out the priorities and availability of coverage in these risk transfers. First, additional insured coverage is generally broader than insured contract coverage. If your contract provides for this status, particularly on a primary basis, then you may not even need to proceed to make a tender of an indemnity provision under the insured contract coverage. Second, "insured contract" status is very dependent on the terms of the indemnification provision in the contract at issue, and also subject to any number of complex conditions.

Determining the appropriate means of risk transfer in construction agreements begins with reviewing available options. A proper analysis will begin with: (1) a complete copy of both the named insured's and the additional insured's CGL policies, preferably certified, with all endorsements; (2) a complete copy of the any contracts between the parties; and (3) a complete copy of all pleadings among the parties to the litigation which gives rise to the risk transfer. With these materials in hand, you should be in a position to begin the process of sorting out the obligations of the parties and insurers to effectively—and efficiently—achieve risk transfer.

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