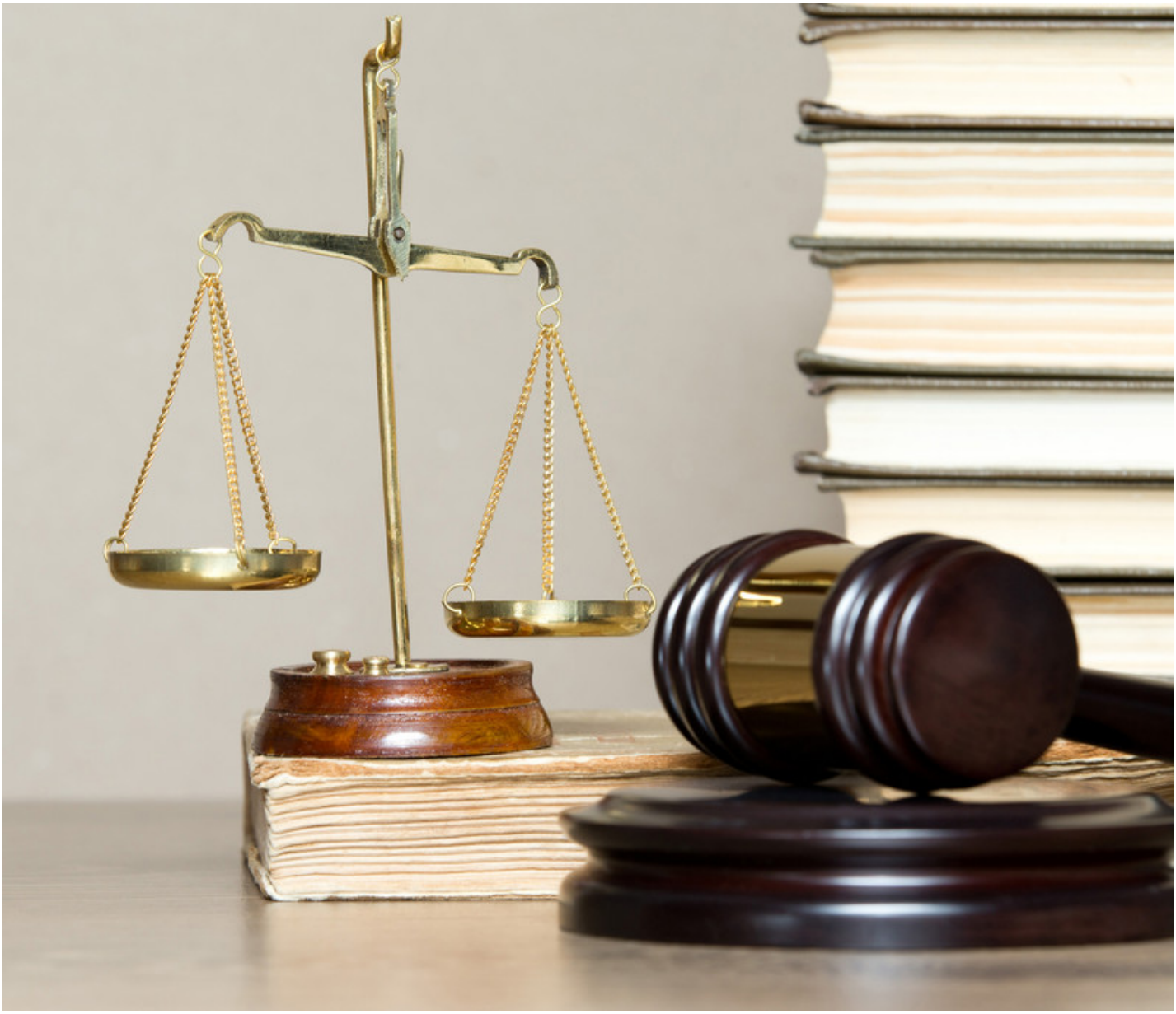
Expert Commentary

Additional Insured Issues 2016—Part Two



While use of additional insured coverage has been driven in large part by the proliferation of state construction anti-indemnity statutes, the scope of additional insured coverage, including Insurance Services Office, Inc. (ISO), changes promulgated in 2004, is still far from settled.

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December 2016

Liability Insurance

Part One of this article discusses today's heavy reliance on additional insured coverage as the prime contractual risk transfer approach in lieu of the historical reliance on contractual indemnification. This article discusses further changes promulgated in 2013 by ISO to its additional insured endorsements.

Additional Insured and Contractual Indemnity

Traditionally, additional insured coverage was considered independent of contractual indemnification. Therefore, as a general matter, anti-indemnity statutes did not affect the purchase and enforceability of insurance—even in circumstances when the scope of indemnity provided by the additional insured coverage was prohibited under the anti-indemnity statutes. In fact, some state anti-indemnity statutes expressly provide for an "insurance exception,"[1] which makes clear that the anti-indemnity statute is not to apply to insurance. A typical ruling that the anti-indemnity statute did not apply to insurance can be found in *American Cas. Co. v. General Star Indem. Co.,* 125 Cal. App. 4th 1510 (Ct. App. 2d Dist. 2005).

> Section 2782 [California anti-indemnity statute] expressly states that its "sole negligence" limitation "shall not affect the validity of any insurance contract." **As we read the clear import of that language, a provision in a liability policy providing coverage to an additional insured will not be deemed contrary to public policy or unenforceable merely because that additional insured party may have incurred claim liability due to its "sole negligence."** [Emphasis added.]

However, as contractual risk transfer moved away from contractual indemnification and to additional insured coverage, several states reexamined this general notion. In particular, downstream parties began to perceive additional insured coverage to be in conflict with the very the reason for anti-indemnity statutes.

Effect on the "Downstream" Party

Many lower-tiered contractors have viewed the use of additional insured coverage, including demands for additional insured endorsements providing coverage for the sole negligence of the additional insured (i.e., CG 20 10, 11/85 edition), as little more than a circumvention of the applicable anti-indemnity statute.

Consider the following news release from the American Subcontractors Association (ASA) in January 2005.

> Most states have so-called anti-indemnity statutes that regulate the use of hold harmless terms by general contractors in written subcontract agreements, but almost no states put a similar restriction on the use of additional insured contractual requirements. **In other words, anti-indemnity statutes in most states have a loophole, permitting upper-tier contractors to use additional insured arrangements to achieve the very same ends that are forbidden in the use of the hold harmless clauses**. Courts in most states have permitted the loophole even though the anti-indemnity legislation is designed to protect the public from the dangers and consequences of unsafe, or poor quality, construction. [Emphasis added.]

Anti-Indemnity Statutes Expanded

Today, there are 10 states that have passed legislation that restricts a party's ability to provide liability coverage to another party as an additional insured.[2] In its November 2016 news release, the ASA commented that "[o]nly six of the states prohibit a party from requiring another party to name it as an additional insured under a policy of insurance, but the trend is moving in this direction."

Oregon is one of the states not only with anti-indemnity legislation that restricts additional insured coverage, but whose highest court has ruled on the meaning of that statute.

> Whether the shifting allocation of risk is accomplished directly, e.g., by requiring the subcontractor itself to indemnify the contractor for damages caused by the contractor's own negligence, or indirectly, e.g., by requiring the subcontractor to purchase additional insurance covering the contractor for the contractor's own negligence, the ultimate—and statutorily forbidden—end is the same.

> In sum, the text of ORS 30.140, and its historic evolution, strongly suggests that the statute **prohibits** not only "direct" indemnity arrangements between parties to construction agreements **but also "additional insurance" arrangements** by which one party is obligated to **procure insurance for losses arising in whole or in part from the other's fault.** *Walsh Construction Co. v. Mutual of Enumclaw,* 104 P.3d 1146 (Ore. 2005) [Emphasis added.]

Expanded Anti-Indemnity Statutes and Additional Insured Coverage

As a result of statutes enacted in 2003 in New Mexico and Montana, 2006 in Colorado, 2009 in Kansas, and 2009 for residential construction in California, as well as Oregon's highest court ruling above in 2005, ISO began to promulgate *state-specific additional insured endorsements* to reflect in the policy forms the limited additional insured coverage allowed by each state's expanded anti-indemnity statutes. ISO's state-by-state approach to additional insured endorsements changed, however, shortly after major changes were announced to the Texas and California construction anti-indemnity statutes.

Texas and California

Here is a brief synopsis of the Texas anti-indemnity statute, as amended.

- House Bill 2093 revises Texas's anti-indemnity law. Agreements in construction contracts executed after **January 1, 2012,** are void and unenforceable to the extent that the agreement requires an indemnitor to indemnify an indemnitee for a claim caused by the *negligence or fault* of the indemnitee or any party under the control of the indemnitee. The bill contains an *exception* permitting an indemnitor to indemnify an indemnitee against a claim for "the bodily injury or death of an *employee* of the indemnitor, its agent, or its subcontractor of any tier."
- The bill also **prohibits** provisions in construction contracts that require the purchase of **additional insured coverage** to the extent that it provides coverage that is **void under the bill**. [Emphasis added.]

California passed Senate Bill 474 (to be effective January 1, 2013) that affected all private construction contracts. A section of SB 474 allowed construction contracts to continue to require additional insured coverage that "requires the promisor to purchase or maintain insurance **covering the acts or omissions of the promisor**, including **additional insurance endorsements covering the acts or omissions of the promisor** during ongoing and completed operations."

Once the highly populous states of Texas and California enacted construction anti-indemnity statute amendments within a period of a few months, ISO began to withdraw its state-specific additional insured endorsements. It is in this context that ISO's additional insured endorsement changes promulgated to be effective in 2013 should be viewed.

ISO's Additional Insured Changes—April 2013

ISO has maintained the coverage wording from 2004 in its April 2013 edition additional insured endorsement—any bodily injury, property damage, or personal, or advertising injury still must be caused in whole or in part by the acts or omissions of the named insured, or others acting on behalf of the named insured. In addition, ISO has *added* the following three major changes.

Only to the Extent Permitted by Law

> **1.** The insurance afforded to such additional insured *only applies to the extent permitted by law;* and

Coverage for the additional insured applies only if allowed by law. While policy wording can never be enforced if it is contrary to the law—for example, some state's laws prohibit insurance coverage for an insured that is found to have caused intentional harm—this new wording serves a more particular purpose.

The Purpose of "Permitted by Law"

ISO must file its forms for approval by the insurance departments of most states. Submitting a policy form that purports to provide coverage that is not allowed by state law will not be approved by the regulators. Considering the expansion of states' anti-indemnity statutes to additional insured coverage as noted above, ISO's standard countrywide additional insured wording would not be approved in certain states.

Thus, in lieu of filing state-specific additional insured coverage forms to coincide with that state's anti-indemnity statute, ISO apparently chose to simply incorporate the "only to the extent permitted by law" wording in its 2013 additional insured endorsements. While certainly this is not the express intent of ISO, it appears to be the most reasonable explanation for this change.

> An alternative and better reading appears to be that ISO is attempting to harmonize, without the need for state-specific endorsements, the scope of coverage where the state anti-indemnification law at issue extends to additional insured coverage.

> In this regard, some states have expanded their anti-indemnification statutes to void contract provisions that seek to transfer risk via additional insured coverage.[3]

Applying "Permitted by Law" to a Claim

How this wording will be interpreted in any claim scenario is another matter. At least one commentator has concluded that "these new endorsements explicitly limit additional insured status to the indemnity clause of the underlying contract."[4] While this interpretation appears to presuppose that the indemnity and additional insured requirements are inextricably tied together, this same presupposition may lead to the conclusion that the "permitted by law" wording will act as a "savings clause." If the additional insured requirement is tied to the indemnity clause, and if the indemnity clause is found to be unenforceable, the additional insured requirement may still be enforced and, thus, "saved."

Another commentator has concluded that the purpose of the "permitted by law" wording is to prevent an anti-indemnity statute, which is *silent* on how it applies to additional insured coverage, from negating additional insured coverage that is broader in scope than allowed by the anti-indemnity statute.[5] While it is

difficult to see how insurance policy wording can affect a court's application of a statute, it is conceivable that this argument may be made in those states whose anti-indemnity statutes do not have an express insurance exception.

No Broader Than Required by Contract or Agreement

> **2.** If coverage provided to the additional insured is required by a contract or agreement, the insurance afforded to such additional insured *will not be broader* than that which you are required by the contract or agreement to provide for such additional insured.

If the additional insured is being granted coverage pursuant to an underlying or extrinsic contract or agreement, then the scope of coverage afforded the additional insured will never exceed the scope of the additional insured endorsement wording or the underlying additional insured requirement—*whichever is less broad in scope*.

Applying "No Broader Than" to a Claim

The inescapable conclusion is that all coverage interpretations must take into account the underlying contract wording—a document that is extrinsic to the insurance policy. While it would appear the intent is to prevent the additional insured from gaining coverage that is broader than required of the named insured, in practice, this introduces a great deal of uncertainty.

> This increased focus on the trade contract presents substantial problems because the insurance requirements provisions are not crafted with the same level of detailed precision as an insurance policy (and they are not supposed to be).[6]

How will coverage be applied if the insurance requirements in the underlying contract states only that the party is to be added as an additional insured—with no further description? An argument may be put forth that the additional insured should receive what is usual and customary for that situation, but this view is far from definite.

Limit of the Lesser of the Policy Limit or the Limit Required by Contract

3. If coverage provided to the additional insured is required by a contract or agreement, the most we will pay on behalf of the additional insured is the amount of insurance:

1. *Required by the contract or agreement*; or

2. Available *under the applicable Limits of Insurance* shown in the Declarations;

whichever is less.

While the intent seems straightforward (the additional insured should not receive the benefit of a limit greater than requested) and this approach is not new (some insurers have been using similar wording for years), unintended consequences may result.

Applying "Lesser of" to a Claim

An illustration: If the underlying insurance requirement specifically requires a primary commercial general liability (CGL) limit of $1 million each occurrence supplemented by an excess liability policy of $5 million, problems may arise if the named insured has actually purchased greater limits—such as the CGL policy with a $2 million each occurrence CGL limit—and a $10 million excess liability policy.

The CGL insurer, following the "lesser of limit" wording, would afford the additional insured with only $1 million of CGL coverage. If the claim were to exceed the $1 million limit, a gap in coverage will result—the CGL insurer is not obligated to pay more than $1 million and the excess liability insurer would not drop down until $2 million has been exhausted. Of course, this could be avoided by matching exactly the limit structure in the insurance requirements with the actual policy limits. However, considering that some have dozens of projects going at the same time, this precise matching of limits could easily be overlooked and may not be a practical goal.

Conclusion

While ISO's 2013 additional insured endorsements continued to be further narrowed by providing coverage to the additional insured "to the extent permitted by law" but for "no broader coverage" than found in the underlying contract and for the lesser of the policy limit or the limit required by contract, substantial uncertainty as to the scope of coverage provided to an additional insured has been inevitably introduced.

Conceivably, a legal interpretation of the impact of any anti-indemnification statute that may apply is necessary, as well as an interpretation of the underlying contracts or agreements requirements for the scope and limits of coverage, also usually a matter of law. But until the full impact of the 2013 additional insured

endorsement wording has been judicially determined, the questions as to the effect of the 2013 additional insured endorsement changes will remain open.

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[1] The "insurance exception" in anti-indemnity statutes has been occasionally interpreted to mean that an otherwise *unenforceable* indemnity clause becomes *enforceable* (i.e., the anti-indemnity statute does not apply) simply because insurance may fund the indemnitor's contractual obligation to indemnify. Considering the overarching public policy reasons for anti-indemnity statutes, this view seems mistaken, as it would negate the very purpose of the anti-indemnity statute.

[2] See "Construction Anti-Indemnification Statutes," Rev. 6–2016, Saxe Doernberger & Vita, P.C., http://www.sdvlaw.com/wp-content/uploads/2013/12/Construction-Anti-Indemnity-Statutes.pdf.

[3] Roberta Anderson, American Bar Association Section of Litigation, Insurance Coverage Litigation, "ISO's 2013 'Additional Insured' Endorsement Changes Merit Close Attention," July 11, 2013.

[4] James J. Buldas, Pietragallo Gordon Alfano Bosick & Raspanti LLP, "Updating Your Additional Insured Endorsements: Avoid Nullification of Contractual Indemnity Protection," June 21, 2016.

[5] Suzanne C. Midlige and Rebecca A. Du Boff, Coughlin Duffy LLP, "Pushed Beyond the Limits—Reactions to the U.S. Judiciary's Expansion of Additional Insured Coverage," October 2013.

[6] Gregory Podolak, March 2015, IRMI.com, Expert Commentary, "Today's Additional Insured Endorsements: Revisiting the Impact of ISO Form Changes."

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