

Insurance professionals and risk managers alike often struggle with terminology involving contractual risk transfer. Discussions involving the differences between coverage as an additional insured and rights via contractual indemnification are particularly confusing. To help illustrate some of the concepts, including the importance of the differences, consider the following scenario.

Mary is an experienced chief financial officer with a CPA and over 20 years of experience. In her new position as CFO of Whitin Electrical Contractors, the responsibility for risk management and insurance is, by default, hers.

Joe's Injury Everyone at Whitin is pretty upset as Joe, a longtime employee of Whitin, was seriously injured at a construction site at which Whitin was a subcontractor for Spartan General Contractors. A few months after filing the workers' compensation claim on Joe's behalf, Mary receives a distressing letter from Spartan – demanding from Whitin contractual indemnification as well as protection as an additional insured – all resulting from Joe's injury. Apparently Joe has filed a lawsuit against Spartan for failure to maintain a safe workplace and, in turn, Spartan is alleging that Whitin was partly at fault for Joe's injury.

Contractual Risk Transfer While Mary has heard of contractual risk transfer, she is not sure how to handle this demand letter. In particular, she does not know why Spartan is seemingly pursuing two separate remedies against Whitin – contractual indemnification and protection as an additional insured. It was always her impression that being an additional insured was insurance purchased to “cover” demands of contractual indemnification.

CONTRACTUAL INDEMNIFICATION

After asking her insurance broker and attorney to Whitin's office to discuss the matter, Mary has found her understanding was mistaken.

Legal Advice Mary has learned from her attorney, Sarah, that Spartan's right to contractual indemnification is created by the indemnity agreement found in the construction subcontract between Whitin and Spartan. In that subcontract, Whitin had agreed to indemnify Spartan for injuries or damage that arose out of the work performed by Whitin, unless the injury was solely the fault of Spartan¹. The demand for contractual indemnification by Spartan actually constitutes a demand for Whitin to *perform* under the subcontract.

Further, Whitin's obligation to indemnify Spartan is completely independent of insurance or additional insured status – contractual indemnification is entirely separate from liability insurance (more on that later). If Spartan's allegations turn out to be true – that Whitin was partly at fault in causing Joe's injuries – Whitin will be obligated by the subcontract to indemnify Spartan for *all the damages* Spartan is legally obligated to pay Joe for his injuries².

ADDITIONAL INSURED

Mary's insurance broker, Claire, could see panic starting to set in when Sarah, Whitin's attorney, was describing contractual indemnification – particularly the part that states that including Spartan as an additional insured does not “insure” Whitin's obligation to contractually indemnify Spartan.

Agreement to Purchase Insurance In this instance, Claire explains, not only has Whitin agreed to indemnify Spartan, but in a separate insurance clause in the subcontract, Whitin has also agreed to purchase liability insurance that protects Spartan. Protecting Spartan is usually done by adding Spartan to Whitin's liability policy as an insured – and that is exactly what Claire had done at Whitin's earlier request. Spartan has been added as an insured; thus, Spartan is an additional insured under Whitin's liability policy.

As an additional insured, Spartan is actually a party to Whitin's liability insurance policy – Spartan has direct and independent rights against Whitin's insurance company – as an insured. Whitin's liability insurance company is now in privity with Spartan – the insurance company must act accordingly. The scope or breadth coverage afforded to Spartan is determined by the wording of Whitin's liability policy, most importantly the wording of the additional insured endorsement.

Defense of Additional Insured Claire explains that one of the advantages of being an additional insured is that the insurance company usually (but not always) is required to defend the lawsuit brought against the additional insured – and the cost of that defense is on the insurance company's dime. Sarah agrees – the indemnity agreement does not require Whitin to *defend* Spartan (as is sometimes the case), but the indemnity does require Whitin *reimburse* Spartan for its attorney's fees.

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CONTACTS

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Contractual Risk Transfer: Contractual Indemnification Versus Additional Insured

It becomes evident to Mary that “tendering” the lawsuit by Joe filed against Spartan to Whitin’s insurance company is important – Spartan needs to claim its status as an additional insured and demand Whitin’s insurance company defend it against Joe’s lawsuit. After some back and forth, Joe’s lawsuit is accepted by Whitin’s insurance company with an agreement to defend – but the insurance company also reserves its right to deny coverage based on a litany of reasons.

Insured Contract Despite the explanations, Mary is still very concerned with Whitin’s possible obligation to Spartan via contractual indemnification. If including Spartan as an additional insured does not cover Whitin for contractual indemnification, is Whitin without insurance? How does this work?

Claire was getting to that point. Whitin *does* have liability insurance for Whitin’s obligation to contractually indemnify Spartan – it is simply that having Spartan as an *additional insured* does not protect Whitin for its contractual indemnification obligation.

Instead of additional insured coverage, Claire explains coverage is found in a different part of the liability insurance policy. She specifically tells Mary that Whitin does have coverage for *liability assumed by contract* provided the liability is assumed in an “insured contract.” Mary begins to remember some of this terminology and it suddenly occurs to her: Doesn’t “insured contract” automatically give additional insured status to the other party?

Claire cannot say “no” to Mary’s question fast enough. She clarifies an insured contract has absolutely nothing to do with being an insured or an additional insured. Rather, insured contract is a defined term in the policy and includes a list of contracts or agreements in which an indemnity agreement may be found. If the indemnity agreement falls within an “insured contract”, then Whitin is covered for the liability it has *assumed in that insured contract* (subject to all other policy terms or conditions).

As Whitin has assumed liability in the subcontract with Spartan by virtue of the indemnity clause, and the subcontract is considered an “insured contract”, then Whitin does have liability insurance for its obligation to contractually indemnify Spartan relative to Joe’s injury.

Indemnitor and Indemnitee To further clarify, and with the help of Sarah, Claire tells Mary that in the context of contractual indemnification, Whitin is the indemnitor (the party owing contractual indemnification) and Spartan is the indemnitee (the party to whom contractual indemnification is owed). She explains that an indemnitee is not an additional insured. Unlike an additional insured, an indemnitee is not a party to the indemnitor’s liability insurance policy and thus does not have any rights against the indemnitor’s insurer. The indemnitee can only seek to enforce the indemnity clause, not the insurance policy of the indemnitor.

WHY PURSUE TWO SEPARATE REMEDIES?

Mary is relieved by Claire’s answer, but still does not know why Spartan is seeking contractual indemnification *and* additional insured protection simultaneously. Certainly Spartan cannot recover twice from Whitin for the same damages Spartan owes Joe.

Both Sarah and Claire respond; Mary is correct, Spartan cannot recover twice. But at outset, it is usually not clear which remedy – contractual indemnification or additional insured protection – will provide Spartan with the most favorable outcome.

It is possible that the additional insured coverage is very narrow. Remember, Whitin’s insurance company agreed to defend Spartan, but reserved its rights to later deny coverage. For example, the additional insured coverage provided to Spartan *may* provide coverage only for Spartan’s vicarious liability for the negligence of Whitin. If Spartan is found to have *any negligence* in causing Joe’s injury, Spartan would have no coverage under Whitin’s liability insurance.³

On the other hand, the indemnity clause in the subcontract agreement may be found to be in violation of state statute and thus void and unenforceable – leaving additional insured status as the only option.

Mary now understands that the contractual risk transfer methods of contractual indemnification and additional insured will likely both be required – and both may be pursued.

While the issues may seem complex, here are some points to remember to help distinguish between contractual indemnification and coverage as an additional insured:

Contractual Indemnification

- Contractual indemnification arises from liability assumed in a contract – it applies to liability not normally imposed by law – you are liable only because you have *agreed* to be liable;
- The extent of liability assumed in a contract is determined solely by the wording of the indemnity agreement, not by the scope of any liability insurance that might be available to the indemnitor;
- Contractual indemnification is not insurance and thus the indemnitee’s only right is against the indemnitor. The indemnitee is not an insured and thus has no direct rights under the indemnitor’s liability insurance.

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Additional Insured

- An additional insured is person or organization that is protected as an insured by liability insurance, usually someone else's insurance;
- The liability of an additional insured is typically imposed on that person or organization by law;
- The extent of the protection provided to an additional insured is determined by the wording of the additional insured endorsement (as well as the other terms of the insurance policy) and not be the wording of the indemnity agreement;
- An additional insured is a party to the insurance policy, giving them an independent right to enforce its rights under the insurance policy directly against the insurance company.

¹ Certain states' construction anti-indemnification statutes would render this indemnity void and unenforceable.

² Certain states' workers' compensation statutes exclusive remedy provisions may render such an indemnity unenforceable – some states will enforce the indemnity only if the indemnity expressly states that indemnitor is agreeing to assume liability for injuries to its own employees.

³ This is not standard Additional Insured wording, but some insurers do regularly use additional insured endorsements that provide coverage that is as limited in scope as noted in the example.

Editorial note: AmWINS has a dedicated construction practice with brokers who are well versed in the issues related to contractual risk transfer and additional insured status. Agents should contact their AmWINS broker with any questions.

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