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USING ADDITIONAL INSURED ENDORSEMENTS

This Letter takes a look at recent changes to standard additional insured endorsements, how the changes may affect coverage, and related concerns that may have an impact on your insurance program.

NARROWING USE OF ANOTHER'S INSURANCE

More restrictive additional insured endorsements filed by Insurance Services Office (ISO) began going into effect in some states last month. This filing continues a decade-old trend in which ISO and insurers have eroded the value of additional insured endorsements. More and more, insurers are making it clear that you cannot use an additional insured endorsement as your own insurance policy to cover costs unrelated to the negligence of the named insured.

In a related trend during the past several years, ISO also tightened provisions related to contractual liability coverage, particularly in connection with defense of an indemnitee. (See our October 2003 Letter discussing risk transfer and contractual liability issues.) The ISO filing includes an endorsement that underwriters can use to restrict contractual liability coverage in jurisdictions that enforce broad indemnification clauses.

LIMITATIONS OF ADDITIONAL INSURED ENDORSEMENTS

In our October 2003 Letter, we included an analysis of the advantages and limitations of using additional insured endorsements. As mentioned in that Letter, an additional insured needs to be concerned about issues such as potential erosion of policy limits ... lack of control ... limited scope of protection ... elimination of important coverage.

When a landlord is added to a tenant's policy, the additional insured endorsement will usually limit coverage to liability arising out of the ownership, maintenance, or use of that part of the premises leased to the named insured. Claims stemming from such activities as structural alterations, new construction, and demolition operations are not covered, nor are losses occurring after the lessee ceases to be a tenant.

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ISO additional insured endorsements for owners, lessees, and contractors exclude products-completed operations. To obtain that coverage, you need a separate endorsement, which is not offered by all insurers and may be expensive.

The named insured and additional insured may have conflicting interests in the defense of claims brought against them as a result of a single occurrence. In a few states, "anti-indemnity statutes," designed to protect weaker parties from the inequities of being forced to agree to overly broad indemnification provisions, may affect the viability of an additional insured endorsement.

NO COVERAGE FOR SOLE NEGLIGENCE

Although the specific wording varies according to the purpose of the endorsement, the ISO additional insured endorsements typically amend the "who is an insured" section of the policy to include the designated additional insured for liability "arising out of your ongoing operations" or "premises owned by or rented to you."

For example, CG 20 10, Additional Insured - Owners, Lessees, or Contractors - Scheduled Person or Organization, amends the "who is an insured" section of the policy to include the scheduled person or organization as an insured for liability "arising out of your ongoing operations performed for that insured."

Whether there is coverage depends on how a court applies the phrase "arising out of ongoing operations" to a particular set of circumstances. For example, in St. Paul Ins. v. American Dynasty Surplus Lines Insurance Company, 101 Cal. App. 4th 1038 (2002), a general contractor, named as an additional insured on a subcontractor's policy, was pressure testing a pipe connected to a fuel tank, causing an explosion that injured one of the subcontractor's employees. The employee was in the vicinity doing electrical work unrelated to the pressure testing.

The additional insured endorsement covered the contractor only with respect to liability arising out of the subcontractor's ongoing operations performed for the contractor. The court ruled against the general contractor and its insurer, noting that the claim must somehow be related to the insured's performance of the work under the subcontract beyond the mere presence on the job site of the subcontractor and its employees.

Some courts have held similar language to afford coverage for a claim arising out of the additional insured's sole negligence. The additional insured would be covered regardless of whether the named insured also is at fault. ISO and insurers contend that the

intent is to primarily cover the additional insured's vicarious liability.

The revised endorsements, which have an edition date of July 2004, cover the additional insured's liability for injury or damage "caused in whole or in part by your acts or omissions or the acts or omissions of those acting on your behalf"

For example, CG 20 26, Additional Insured - Designated Person or Organization, completes that statement with "... A. In the performance of your ongoing operations; or B. In connection with your premises owned by or rented to you."

CG 20 28, Additional Insured - Lessor of Leased Equipment, covers the additional insured for bodily injury, property damage, or personal and advertising injury caused, in whole or in part, by the named insured's maintenance, operation, or use of equipment leased to the named insured by such person or organization.

As long as the named insured is at least partially at fault, even though its negligence played only a minor role in causing the injury or damage, the additional insured should have coverage. The additional insured has no coverage for injury or damage caused solely by the additional insured's negligence.

Other additional insured endorsements affected by this filing are: CG 20 07, CG 20 31, and CG 20 32, additional insured endorsements for architects, engineers, and surveyors; CG 20 10, Additional Insured - Owners, Lessors, or Contractors - Scheduled Person or Organization; CG 20 15, Additional Insured - Vendors; CG 20 33, Additional Insured - Owners, Lessees or Contractors - Automatic Status When Required in Construction Agreement With You; CG 20 34, Additional Insured - Lessor of Leased Equipment - Automatic Status When Required in Lease Agreement With You; and CG 20 37, Additional Insured - Owners, Lessees or Contractors - Completed Operations.

VENDOR COVERAGE FURTHER CURTAILED

Retailers, distributors, and wholesalers commonly are named as additional insureds on the CGL policies of the manufacturers whose products they handle. The ISO endorsement CG 20 15, Additional Insured Vendors, affords coverage only for products of the named insured distributed or sold in the regular course of the vendor's business.

Claims arising from other products are not covered. The manufacturer's limits of insurance do not apply separately to the vendor.

In addition, a number of exclusions apply. There is no coverage for the following situations:

- assumption of liability under a contract or for an express warranty unauthorized by the named insured;
- any change intentionally made to the product by the vendor;
- repackaging, except when the product is unpacked solely for the purpose of inspection, demonstration, testing, or substitution of parts under instructions from the manufacturer and then repackaged in the original container;
- failure to make inspections, adjustments, or tests, or failure to perform servicing as the vendor has agreed or normally undertakes to make in the usual course of distribution or sale; or
- demonstrating, installing, repairing, or servicing operations, except on the vendor's own premises in connection with the sale of the product.

The endorsement also excludes products that have been labeled or relabeled after distribution or sale by the named insured or used by the vendor as a container, part, or ingredient of something else.

The revised CG 20 15 adds an exclusion for injury or damage arising out of the vendor's sole negligence for its own acts or omissions or those of its employees or others acting on the vendor's behalf. The exclusion does not apply to the repackaging and demonstration exceptions noted above nor to inspections, adjustments, tests, or servicing the vendor has agreed to make or normally undertakes to make in the usual course of distribution or sale of the product.

The point to note here is that a vendor's endorsement provides very limited, targeted coverage; a vendor must rely primarily on its own insurance program.

ENDORSEMENTS SOMETIMES LIMITED TO VICARIOUS LIABILITY

The revised ISO endorsements do not mention "vicarious liability," but the intent is to limit coverage to the additional insured's exposure to vicarious liability and liability from contributory negligence. Some insurers have taken this one step further, covering an additional insured only for its vicarious liability. In many situations, that very narrow approach could strip away most of the benefit of additional insured status.

Based on Relationship

Vicarious liability is based on a relationship between the parties and applies irrespective of participation or fault in connection with the conduct that caused the harm. The liability is imputed to one party for the acts or omissions of another. Its basis is largely one of public or social policy under which it has been determined that a party should be held responsible for the acts of another.

For example, an employer can be held vicariously liable for acts committed by its employees. As we discussed in our Letter last month, the U.S. Supreme Court has held that Title VII of the Civil Rights Act holds an employer strictly liable when a supervisor's harassment of an employee results in a tangible employment action – regardless of any fault on the part of the employer.

Under the vicarious liability laws, owners of automobiles are commonly held liable for injury or damage even though they were not operating or riding in their auto at the time of the injury or damage.

Limited Responsibility for Negligence of Contractors

Owners or general contractors may be held vicariously liable for workers compensation claims made by employees of a contractor or subcontractor that does not have workers compensation insurance or is not a qualified self-insurer.

Generally, though, a firm that hires an independent contractor, absent an act of negligence of its own, is not vicariously liable to others for the negligent acts of the contractor. Where its own negligence contributed to the loss, the hiring firm would be exposed to direct – not vicarious – liability.

There are exceptions to this rule, such as when the owner or general contractor supervises the contractor or subcontractor's work; when the work is inherently dangerous; or when the contractor has a nondelegable duty to take safety precautions imposed by statute or regulation.

For example, you hold your premises open to the public for business, and you hire an independent contractor to maintain those premises in safe condition. You may be subject to the same liability for injury caused by the contractor's negligence as though you had retained the maintenance of the premises in your own hands.

Note that a lawsuit could allege that you failed to adequately supervise the contractor you hired and that failure caused the injury or damage. In this situation, your potential liability would be direct, not vicarious.

This is a point to keep in mind when you are faced with an endorsement that covers only the additional insured's vicarious liability. Also, if you have a contractual obligation to arrange coverage on your policy for another party, such an endorsement may fall short of meeting that obligation. The ISO endorsements would cover such negligent supervision claims and other contributory negligence.

CONTRACTUAL LIABILITY COVERAGE

With these revised endorsements, it's possible that the policy's contractual liability coverage would apply to a claim the insured would not have coverage for as an additional insured. This could occur in the event the named insured had agreed to a broad hold-harmless clause, in which a firm agrees to hold the indemnitee harmless regardless of fault.

Because a few jurisdictions will enforce a firm's promise to assume liability for an indemnitee's sole negligence, ISO has introduced a new endorsement to rule out contractual liability coverage under those circumstances.

New endorsement CG 24 26 amends paragraph f. of the definition of insured contract so that coverage applies to that part of "any other contract or agreement pertaining to your business ... under which you assume the tort liability of another party to pay for 'bodily injury' or 'property damage' to a third person or organization, provided the 'bodily injury' or 'property damage' is caused, in whole or in part, by you or by those acting on your behalf." (Emphasis added.)

ISO filed CG 24 26 as an optional underwriting tool that insurers can use in those states that will allow for such recovery under a hold-harmless agreement.

Broad hold-harmless clauses, which make one party responsible for all liability regardless of fault, are increasingly being viewed as contrary to public policy. In most jurisdictions, the courts do not enforce this broad type of contractual risk transfer. This is a point to keep in mind when you are in a position to determine the terms of a hold-harmless clause.

HOW DOES SUBROGATION APPLY?

A related issue is subrogation – a term often misunderstood by insurance buyers. With respect to insurance transactions, it simply means that, after a loss for which the insurer pays, the insurer acquires any right of recovery you may have against some other party responsible for the loss. Typically, the common law principle is spelled out as a condition in property and liability policies.

Generally, an insurer cannot subrogate against the named

insured. That is not necessarily true for an additional insured, however. For example, the additional insured's officers or employees would not be considered insureds under standard additional insured endorsements. In order to overcome this problem, officers and employees could be included as insureds in the additional insured endorsement.

In addition, a "waiver of subrogation" endorsement can be added to a policy, eliminating the insurer's subrogation rights against specified parties.

CG 24 04 amends the CGL policy's subrogation provision by waiving any right of recovery the insurer may have against the designated person or organization because of payment of claims arising out of the named insured's ongoing operations or work done under a contract with that person or organization and included in the "products-completed operations" hazard.

Subrogation waivers are commonly provided with respect to all subsidiary or affiliated organizations of the named insured. However, liability insurers are likely to request an increase in premium for adding a waiver of subrogation clause applicable to other parties. The increased costs will likely be passed on to the additional insureds.

Under most property policies, the insured has the right to waive its rights to recover from another party prior to a loss. It is also common to obtain a waiver of subrogation endorsement from a property insurer with no additional premium charged. However, it is important that either of these actions be taken prior to the occurrence of any loss if they are to be effective.

JOHN LINER TIP — OCP ALTERNATIVE FOR PROJECT OWNERS

In connection with a construction project, an owners and contractors protective (OCP) liability policy in the owner's name offers an alternative to the owner's being provided insured status under the contractor's policies. The standard form under the ISO program is CG 00 09, Owners and Contractors Protective Liability Coverage Form — Coverage for Operations of Designated Contractor.

OCP liability insurance is written in the name of the owner of the described construction project. (A general contractor may also require OCP insurance from a subcontractor, in which case the policy would be written in the general contractor's name.)

If you are the named insured, the policy covers your liability for bodily injury or property damage arising out of operations performed by the contractor on your behalf as well as your acts or omissions

in connection with the general supervision of those operations. Personal injury coverage may be added by endorsement CG 28 05.

Even though the cost is passed on to you, an OCP policy has several advantages. For one thing, it solves the problem with respect to the potential depletion of limits when you are named as an additional insured under the contractor's general liability policy. It allows you to keep the liability insurance costs of the project separate, and claims incurred will not be reflected in your general liability loss experience and insurance costs.

Another advantage is that it gives you broader coverage than you would otherwise have under your CGL. Typically, an OCP form will not exclude losses stemming from automobiles, aircraft, watercraft, or transportation of mobile equipment, for example.

OCP insurance does not cover products-completed operations. The OCP "damage to property" exclusion is less restrictive than the one in the CGL. It excludes property damage to property you own, rent, occupy, or borrow ... personal property in your care, custody, or control ... work performed for you by the contractor.

These exposures should be covered under the owner's property and inland marine insurance. The "work" is the construction project itself and would be covered under the owner's builders risk policy.

The "damage to impaired property or property not physically injured" exclusion is similar to the one in the CGL, but is tailored for the OCP.

Another option is for the owner to require the contractor to purchase project management protective liability (PMPL) insurance ... at the owner's expense. PMPL insurance affords similar coverage to an OCP policy, except that it is designed to cover the architect, the owner, and the contractor. Normally, an OCP covers either the owner or the contractor, not both — and not the architect.

A PMPL endorsement, CG 31 15, Construction Project Management Protective Liability Coverage, is available under the ISO program. CG 31 15 contains a provision in which the insurer waives any subrogation rights it may otherwise have against a named insured because of payments it makes for bodily injury or property damage to which the insurance applies.