

CONTRACTUAL LIABILITY COVERAGE

In a reversal of position, the Insurance Services Office (ISO) recently decided that the Commercial General Liability policy (CGL) does not automatically cover the defense costs of an indemnitee. This is important to public entities since contractors that do public works projects are usually insured under a CGL policy.

This interpretation means that the insurance carrier of an indemnitor (a contractor or sub contractor) does not owe a defense to the indemnitee (the City) when the indemnitee is sued by a third party injured from operations arising out of the contracted project.

Traditionally, one of the primary benefits of a City using a contractor has been that the indemnitor would indemnify and hold harmless the indemnitee from liability claims made against the indemnitee. This represents one of the cornerstones of risk management; e.g. risk transfer. The City transfers responsibility for liability to the contractor along with the work.

Insurance makes this process work since it helps to guarantee a source of payment for the indemnitee's defense and indemnity costs should it be sued.

The ISO's new position is not that the contract between the indemnitee and indemnitor is not binding between the parties. Rather, it is that the insurance contract between the indemnitor and carrier does not obligate the carrier to defend a suit against the indemnitee.

The ISO now takes the position that the indemnitee must be added to the policy as an "Additional Insured." Such an action will then assure that the insurance company owes a defense to the indemnitee.

The ISO has issued a new CGL policy in 1996 reflecting two significant changes:

- The defense obligation wording will be changed to read "...we will have the right and duty to defend the insured against any suit seeking those damages..." This change will include a defense obligation to any "additional insured." But an indemnitee relying on a hold harmless/indemnity agreement alone will not qualify.
- Even if the indemnitee does not have "additional insured" status, it may still be covered under the indemnitor's policy if the contract language includes not only coverage for damages but also for defense expense coverage. The ISO's exact working is "...liability to such party for or for the cost of that party's defense has also been assumed in the same insured contract."

The indemnitee must include language in the contract asking for coverage of damages and defense expense coverage. ISO's position is that if this language is present, then no alteration of the indemnitor's insurance is necessary; the coverage for defense costs is automatically there.

In the past, we have often relied on the insurance industry honoring "Certificates of Insurance." This was despite the fact that the certificate states on its face that it does not grant "additional insured" status to the "certificate holder." This may change with the issuance of the new CGL policy in 1996.

To cover all your bases in the future, you need to demand an "Additional Insured" endorsement (versus the "Certificate of Insurance"), as well as include defense expense coverage wording in the contract.

