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Wrap Your Head Around ISO's Additional Insured Revisions

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It is common among parties to sophisticated construction projects, service agreements, leases and many other types of projects and transactions to assess the risks associated with their contractual activities and allocate those risks through a combination of contractual indemnification provisions and insurance requirements. In the construction setting, for example, project owners, general contractors and developers ("upstream" parties) typically require their subcontractors and sub-subcontractors ("downstream" parties) to indemnify them for claims arising from the contract work.

In addition to the contractual indemnification provisions, upstream parties frequently require that they be provided with "additional insured" status on the downstream indemnitor's or named insured's general liability insurance policy.

This provides a number of benefits to the upstream indemnitee. It effectively gives the additional insured or indemnitee direct coverage rights under the indemnitor's insurance policy, preserves the indemnitee's own liability coverage and may protect the indemnitee in the event the contractual indemnification provision in the parties' contract is determined to be void and unenforceable.

Of course, the extent of the benefit of additional insured status hinges on the actual terms of the insurance policy and applicable law. With respect to policy terms, theInsurance Services Office (ISO) commercial general liability coverage forms provide the basis for many general liability policies. Accordingly, familiarity with the ISO forms is important.

With respect to applicable law, the indemnity/insurance scheme has precipitated frequently conflicting judicial decisions on numerous and complex issues. A number of these decisions, based upon the fact that the underlying agreement and the insurance policy are separate contracts, have held that the scope and validity of the contractual indemnification provisions have no impact upon the scope and validity of the additional insured coverage — with the effect that additional insureds sometimes enjoy broader protection under the insurance policy than under the contractual indemnification provisions.

By way of example, although anti-indemnification statutes in many states prohibit the transfer of an indemnitee's sole (and/or concurrent) negligence through contractual indemnity provisions, some courts have construed the terms of the insurance policy as encompassing and covering the additional insured's negligence even where the underlying contractual indemnification provision was void and unenforceable.

In addition, some courts have held that while the underlying contract may expressly limit the named insured's indemnification and insurance obligations to the additional insured, the scope of additional insured coverage is not so limited but rather is governed solely by the terms of the insurance policy.

Presumably in response to developing law impacting the scope of additional insured coverage, the ISO has recently revised its standard CGL forms and endorsements (effective April 1, 2013), including 24

of its 31 standard additional insured endorsements. Although the true scope of their effect will remain unclear until clarified by the ISO or by judicial decision, the new endorsements clearly have the potential to further complicate an already complex area of law and may potentially negatively impact both additional and named insureds.

The new endorsements and developing law warrant the attention of named insureds, additional insureds, indemnitors and indemnitees alike.

Revised Additional Insured Endorsements

The revised ISO endorsements contain three significant modifications of particular concern to contracting parties. These revisions impact 24 additional insured endorsement forms that cover a broad range of transactions and generally attempt to tie, and thereby limit, the scope of additional insured coverage to the underlying contract provisions.

1. Coverage Is Provided "to the Extent Permitted by Law"

The revised additional insured endorsements now state, "The insurance afforded to [an additional insured only applies to the extent permitted by law." Although it is not entirely clear what the italicized language is intended to accomplish, it clearly is attempting to address state anti-indemnification laws in some manner.

At least 45 states have enacted anti-indemnification statutes that restrict, modify or invalidate indemnification agreements in construction and certain other contracts. These statutes frequently prohibit the transfer of an indemnitee's sole and/or concurrent negligence through indemnification provisions.

Even where the anti-indemnification statute would render a contractual indemnification provision unenforceable, however, a number of courts have upheld additional insured coverage — even with respect to the additional insured's sole negligence.

Through the 2013 language, the ISO could be attempting to address circumstances in which prior ISO endorsements may provide broader coverage than is allowed under the anti-indemnification laws of certain states.

Alternatively, a better reading appears to be that the 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.

The italicized language also could be intended as a "savings clause" to preserve additional insured coverage in circumstances in which the contractual indemnification provision is determined to be void and unenforceable under the state anti-indemnification statute. This may be in response to the fact that some courts have voided contractual additional insured provisions where, for example, such provisions were "inextricably tied" to the indemnification provisions.

Whatever its intent, there are likely to be disputes over the meaning of this wording, and when

judicially tested, this language could have broad and negative implications for additional insureds. There also could be negative repercussions for indemnitors who may face breach-of-contract claims from indemnitees who thought they had bargained for and obtained broader additional insured coverage.

At a minimum, the language in these new forms underscores that contracting parties are well-advised to pay attention to, among other things, potentially applicable law, the terms of the underlying contract and the specific insurance policy terms so that they can most appropriately structure risk transfer provisions.

2. Coverage "Will Not Be Broader Than" the Contract Requires

The additional endorsements now state, "If coverage provided to [an] additional insured is required by a contract or agreement, the insurance afforded to such additional insured will not be broader than that which [the named insured is] required by the contract or agreement to provide for such additional insured."

The ISO has not provided guidance regarding the intent of this new language. However, it seems likely that the new language is intended to incorporate into the insurance policy any express limits on additional insured coverage that the parties have specified in the contract, e.g., where the contract specifies that additional insured coverage will only extend to vicarious liability.

Whatever its intent, reference to the terms of the underlying contract documents to determine the scope of coverage afforded to additional insureds may well create areas of significant disagreement.

Again, the additional language underscores the need to carefully review the terms of the underlying contract and the specific insurance policy language to be used to satisfy additional insured requirements. To the extent the 2013 endorsement is used, contracting parties should ensure that the underlying contract language clearly reflects the parties' intent regarding the scope of additional insured coverage.

3. Limits Are the Lesser of the Contract Requirement or the Policy Declarations

The additional insured endorsements now state that the most the insurer will pay on behalf of the additional insured is either the amount of insurance: "[r]equired by the contract or agreement"; or "[a]vailable under the applicable Limits of Insurance shown in the Declarations[,] whichever is less."

It seems clear that the intent of the italicized language is to limit the insurer's exposure to the lesser of the policy limits or the amount agreed to by the contracting parties. And at first glance, this may seem reasonable. This may come as an unpleasant surprise to contracting parties, however, because additional insureds often have access to the policy's full limits of liability — sometimes in cases in which the underlying contract or agreement requires that the named insured provide an amount less than the policy's limits.

Unanticipated changes may leave both parties exposed. To the extent an additional insured has insufficient insurance to cover a loss, it may look to the named insured for indemnification for any amounts in excess of the insurance limits.

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Conclusion

The important takeaway to contracting parties is to pay close attention to potentially applicable law, including potentially applicable anti-indemnification statutes and the underlying contract provisions setting forth the scope of contractual indemnification and additional insured requirements.

In addition, contracting parties are well-advised to review the specific terms of the insurance policy under which additional insured protection is to be afforded, including all endorsements, to confirm the coverage terms and to understand the interplay between the underlying contract provisions and the additional insured coverage.

Importantly, there are many different additional insured forms, and there can be significant discrepancy in the breadth of coverage provided to additional insureds under the wordings of the various forms. By paying close attention to potentially applicable law, in addition to the specific contract and insurance policy terms, contracting parties may avoid potentially negative surprises, such as unexpected gaps or potential loss of insurance coverage.

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