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Playing the Game of Risk Shifting

I. What Is Risk Shifting

Risk shifting also known as contractual indemnification, risk transfer or additional named insured insurance coverage is a contractual obligation undertaken by one party to assume the liabilities of another party under certain circumstances. The indemnitor promises to indemnify and/or hold harmless and protect the indemnitee from claims made against it. It is contractually negotiated. The provisions determine which party will bear the costs associated with the expenses arising out of accidents, liabilities, insurance coverage or other disputes involved in various areas such as constructions, trucking, professional relationships, franchise agreements, owner/operator controlled premises, equipment rental to name a few.

A. Understanding Risk Shifting

Risk shifting is a contractual obligation entered into by two (2) or more parties with the intent to create a legal assignment of each parties' responsibility. The contract should be in writing but need not be to be valid. It is governed by state law and should clearly set up the terms each to which each party agrees. Usually, "the plain meaning' standard to interpret the terms of the contract will be employed. The contract will be considered to speak for itself when the terms are clear and unambiguous. Normally, in situations where the terms are not clear a contract will be constructed against the drafter but in favor of coverage. There is an overall anti-indemnity basis in state law, but a high preference for additional named insured status.

1. What is Contractual Indemnification

A contract of indemnification requires the indemnitor to hold the indemnitee harmless from claims made by third parties against the indemnitee. Simply put, the contract places the legal tort responsibility of one party upon another under the terms and conditions contemplated in the agreement. The risk should be clearly identified in the agreement, be it tort liability, contractual liability, property damage, personal injury or both. The risk which is transferred is the risk of loss and the cost of defense.

2. A Matter of Plain Meaning

Since risk shifting is a matter of contract, success is in the details. The agreement should clearly state the party or parties to be indemnified or who are to be protected. The contract should also clearly outline the terms which are covered such as "completed operations", the meaning of "arising out of "and the covered conduct. The contract should expressly state the conduct to be covered to the extent it is permitted by law. It should also provide for an exclusion of the "sole negligence" of the indemnity.

3-The parties to the agreement can vary. This could include contractor and subcontractor. Owner, Contractor and all subcontractors. Owners and operators of premises and landlords and tenants. Owners and operators of pieces of leased equipment. Homeowners and contractors performing residential repairs or construction.

B. How to Shift the Risk

1. Types of Indemnity

There are many ways to provide for indemnification and a defense. There are three (3) widely recognized ways in the industry:

Limited Indemnity-This method provides that the indemnitor will save and hold harmless the indemnitee only from the indemnitor's own negligence. Clearly, this is limited in scope as it covers only the indemnitor's actions and not the actions or any other party. Essentially, it will not prevent the aggrieved party from looking only at one party for recovery and forces each party to argue that its actions were not the in any way related to injury or damages alleged.

-Intermediate Indemnity-This type of indemnification provides that the indemnitor will save and hold harmless the indemnitee from all liability excluding that which arises from the indemnitee's sole negligence. This type provides broader protection as the indemnitee is protected from claims but will need to demonstrate it was not sole responsible for the injury or damages alleged.

Broad Indemnity-In this situation, the indemnitor will save and hold harmless the indemnitee from all liabilities arising for the project, act or occurrence regardless of which party was negligent or which party's negligence caused the damages or injuries alleged. This provides full protection to indemnitee at the expense of the indemnitor. Care must be taken in this situation as this agreement places the indemnitor at great risk and this agreement may be void in some states as a matter of public policy.

2. Types of Insurance Coverage

There are various types of insurance coverages which are available and may be often required by contract to be specifically procured. The "additional named insured" requirement is typically the most often requested type of coverage or endorsement requested. It requires a company or individual to obtain insurance naming another party as an additional named entity covered by the policy of insurance. The additional named insured gets no greater rights or

coverage than that of the policy holder virtue of the acquired coverage or any endorsements and is subject to any and all valid exclusions in the policy.

The Owners Contractors Protective Policy or Owners in Place Insurance Program provides those falling under the protection of that policy or coverage program with the same coverage as the owner of the that policy. This usually includes not only comprehensive liability insurance coverage but also workmen's compensation coverage. Generally, this applies to construction and maintenance projects subject to the typical exclusions in those types of policies. There is also the Contractor Controlled Insurance Program, which is essentially the same, but paid for by the lead contractor on the construction project which may be to the benefit of the owner and all of the subcontractors. There are also Builder's Risk coverage which protects a person's or organization's insurance interest in material fixtures and/or equipment being used in the construction or renovation of a building or structure. This is normally limited to physical loss or damage from a covered cause.

The Wrap Up Policy is usually used on large construction projects, 10 million dollars or more, and is set up by the owner of the site or project to provide coverage for all of the contractors and/or subcontractors working on the project. This type of policy provides sweeping blanket coverage which protects the owner, contractors and subcontractors. It is all encompassing and for the benefit of the project owner. Normally all contractors and subcontractors are listed on the policy. It avoids the need of every contract going out into the open market and purchasing insurance. It generally includes general liability coverage, worker's compensation coverage, builder's risk coverage, professional liability coverage, pollution coverage and excess coverage.

This option perhaps offers the least amount of protection for risk shifting. This option requires one party to procure insurance for a certain amount, potentially primary and excess coverage for the job or project at hand and to produce proof thereof. The covered party is required to produce a certificate of insurance indicating the coverage is purchased and in effect for the amount specified. The party is not asked to give additional named insured status to any other party, but merely to show it has coverage. What this does not show is if there are claims made against the policy or if there are claims paid against the policy and if those claims are potentially exhausting that policy.

3. Advantages to Risk Shifting

The advantages of risk shifting are clear. Liability is potentially moved from one party to another, from one pocket to another. This provides the parties with peace of mind and certainty while conducted complex and often expensive business transactions. In situations involving wrap ups or OSIPs costs are generally controlled and fixed as the coverage is often less expensive. It becomes part of the contract price as opposed to any long-term commitment by a subcontractor on a high premium policy which larger amounts of coverage than it may normally need or require. It also ensures that all working on the project have coverage, especially in times when insurance is difficult to obtain, or workmen's compensation coverage cost prohibitive. It is a simple and effective way to handle risk if properly understood. It may also provide a party with more coverage than it could otherwise afford and subject it to lower or no self-insured retentions.

From a carrier or broker's perspective, the insured's liabilities should be clearly defined whether the insured is an indemnitor or an indemnitee. Evaluating and providing guidance to the insured as long as the terms and conditions of the contract are clearly understood. From an underwriting perspective, the terms and conditions of contracts should be made known so that risk can be evaluated clearly as well. Counsel should be prepared to provide advice to clients entering into these types of agreements before the they sign these contracts.

II. Defending the Claim for Defense and Indemnification

As advantageous as it is to obtain a hold harmless and indemnify agreement for a client, it is equally important to know how to defend a tender of such a claim and to know how to deny coverage if such a claim is made.

A claim made for defense and indemnification by an indemnitee to an indemnitor should be made upon written notice by way of tender or by the terms provided for in the initial contract. The tender should be presented to the indemnitor and the insurance carrier or carriers timely, with a copy of the complaint or initial notification, writ of summons, notice of injury, breach of contract, incident report. The tender should include a copy of the contract, the policy of insurance and all relevant documents which the indemnitee intends to rely upon for the claim. Preservation of evidence on both sides is essential. Investigation immediately is warranted in order to set up defense or denials. The client or insureds should be instructed to treat the tender as it would any piece of litigation in so far as it should not discuss the matter, it should collect all documents, etc.

A. Claims Arising Out Of

An analysis of the claim presented by the party claiming indemnity should be conducted. It should be determined if the claim is one which is one which is 'arising out of" the indemnitor's liabilities or is another unrelated party responsible. Does the indemnitee have liability for the allegations or is the indemnitee solely responsible for the loss, damage or injury giving rise to claim? Is the claim made against public policy or state law? Is the party seeking indemnification at fault or partially at fault?

1. Additional Named Insured Status-Additional named insured status must be determined as well. The claims handler or counsel must assess if the party is truly an additional named insured or even a party to the original contract. Does that party have any standing to make the claim for contractual indemnification? Was there an amendment to the contract which added that party and if so, was the policy also amended? Was there a subcontract and notification given to the indemnitee who agreed in writing to the additional party's inclusion?

2. Legality-Analysis of state law or any applicable law must be completed before making a determination if coverage exists or if a defense and/or indemnification is owed. Does state law allow for the type of indemnification the party is seeking. Is it against public policy to provide for that type of relief? Is the contract itself null and void on its face.

Which state's law governs the interpretation of the contract itself? Is the contract ambiguous, and if so, how are ambiguities to be construed?

B. **Coverage**

A coverage opinion and analysis must be sought. The entire operation, claim, accident, project, etc. must first be deemed to fall within the policy itself. Are there other parties involved in the project or accident at issue which are necessary parties and whose coverage may also be triggered? Are other coverages available to the insured, the tortfeasor, the site owner. Is the policy at issue primary or excess Does coverage even apply in this case? Are there any exclusions which apply? Was there fraud? Has the policy itself otherwise been exhausted?

1 Statute of Limitations or Repose-There must be a timely claim filed. Was the underlying claim timely filed under state law? Was the claim for indemnity and a defense made timely? Is a defense under the statue of repose to the overall claim and thus potentially to the claim for a defense and indemnity?

Misc. Defenses-What other defenses are available to the tender. Is this claim made by an employee and thus does the employee liability exclusion apply? Is there a pollution exclusion in the policy for an environmental claim? Is there an asbestos exclusion in the policy for a claim arising out of exposure or asbestos property damage? Are there any hazardous operations which can be excluded? Is this a completed operations claim which was not provided for in the original agreement?

C. Strategy

It is clear risk shifting provides great opportunity to protect your client, your insured or your company. The key however is understanding the risk and translating that understanding into a successful contract negotiation to benefit your client, policy holder or company. Paramount is reading and understanding the agreement reached and reaching and understanding the terms of the policy of insurance which is being purchased or which is provided to you. Additionally, understanding which states law will apply is essential as some state disfavor indemnity agreements but will uphold policies which provide for additional named insured status.

Conversely, when faced with a tender for a defense and indemnification from another party, it must be view timely and seriously. For carriers where additional named insured status is at issue, coverage counsel should be retained, and a coverage position issued. The additional named insured gets no greater rights than the insured. For counsel, if you are tendering on behalf of a client it is best practice to tender to the party with whom your client had the contract as well as the carrier, if applicable. You should include all of the appropriate documentation. If you are representing a corporate successor, who was not an original party to the contract, it is highly recommended that you provide all corporate transactional documents which you claim provide your clients with contractual rights to the indemnity and to the coverage, if any. Make your tender as soon as those facts which form the basis of the tender are known to you or your client.

In house counsel should be prepared to not only participate in contractual negotiations involving risk shifting and understand the ramifications of the terms of the agreements but should also be prepared to defend against these claims. This is especially important in cases of high self-insured retentions or self-insured situations. Also, in house counsel should be prepared to discuss these issues with the company's insurance departments and to educate those individuals who are negotiating or pricing contracts on behalf of the company.

Claims Analysts must be fully prepared to discuss these issues with their insureds and make appropriate coverage determinations. They must also be prepared to answer questions from broker and underwriters concerning the insured's business practices, and to work with counsel when litigating these matters. Decisions will need to be made, if it is determined that an additional named insured is owed coverage such as if that entity requires separate counsel, how the strategy for defending that entity if at odds with the strategy for defending the actual insured, etc.