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Supply Agreements: Structuring Defense, Indemnity and Insurance Provisions

Mitigating and Allocating Risks Between Manufacturers, Suppliers and End Sellers; Maximizing Insurance Coverage for Losses

WEDNESDAY, JANUARY 6, 2016

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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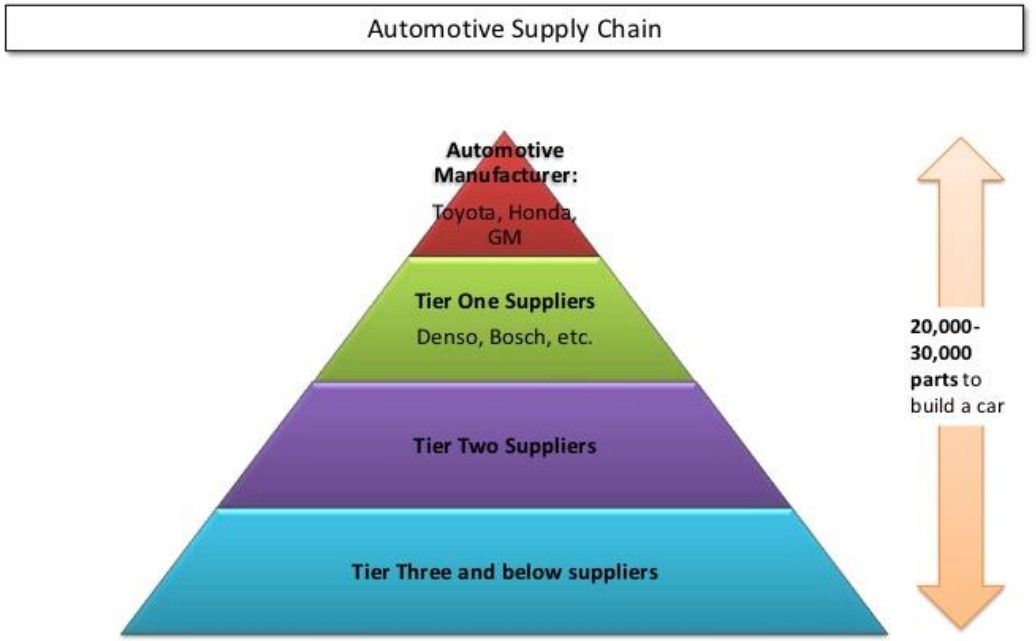
Supply Agreements: Structuring Defense, Indemnity and Insurance Provisions

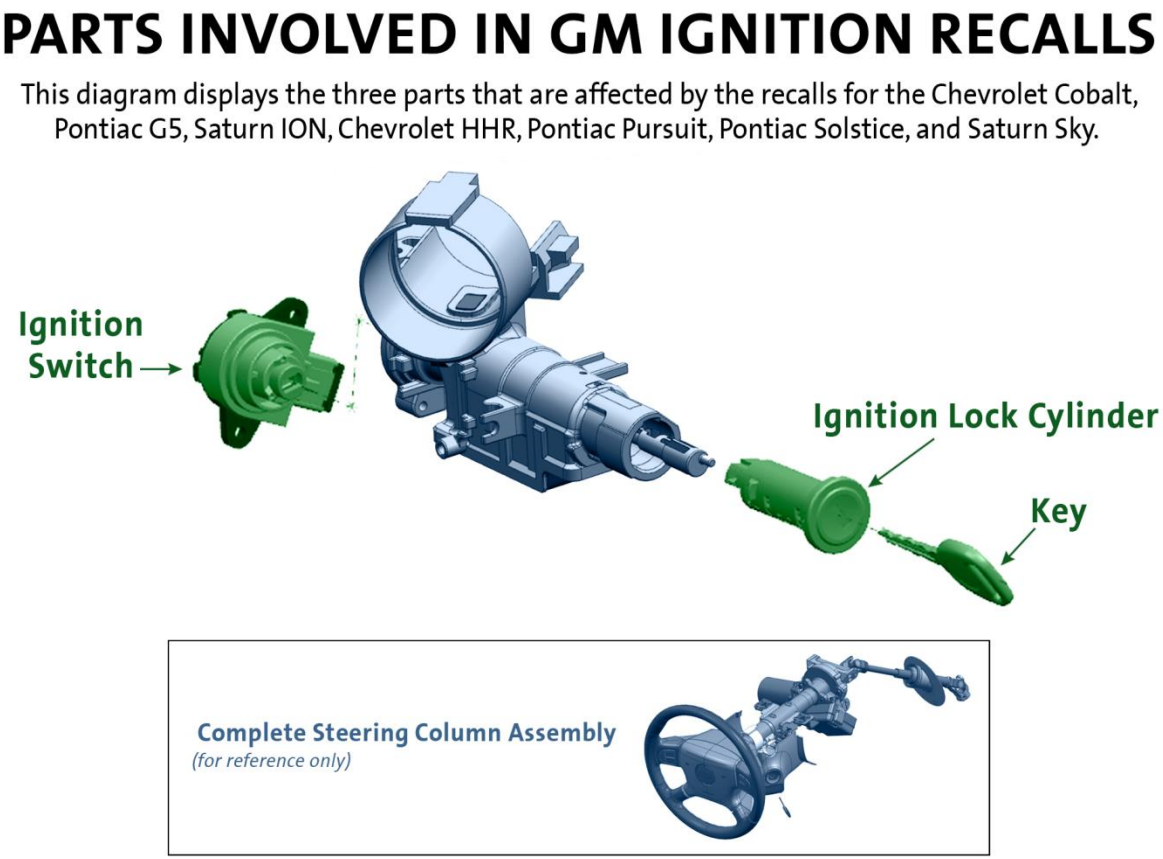
BACKGROUND: Manufacturing Environment

- The supply chain – Just In Time/Lean Manufacturing
  - Automotive example



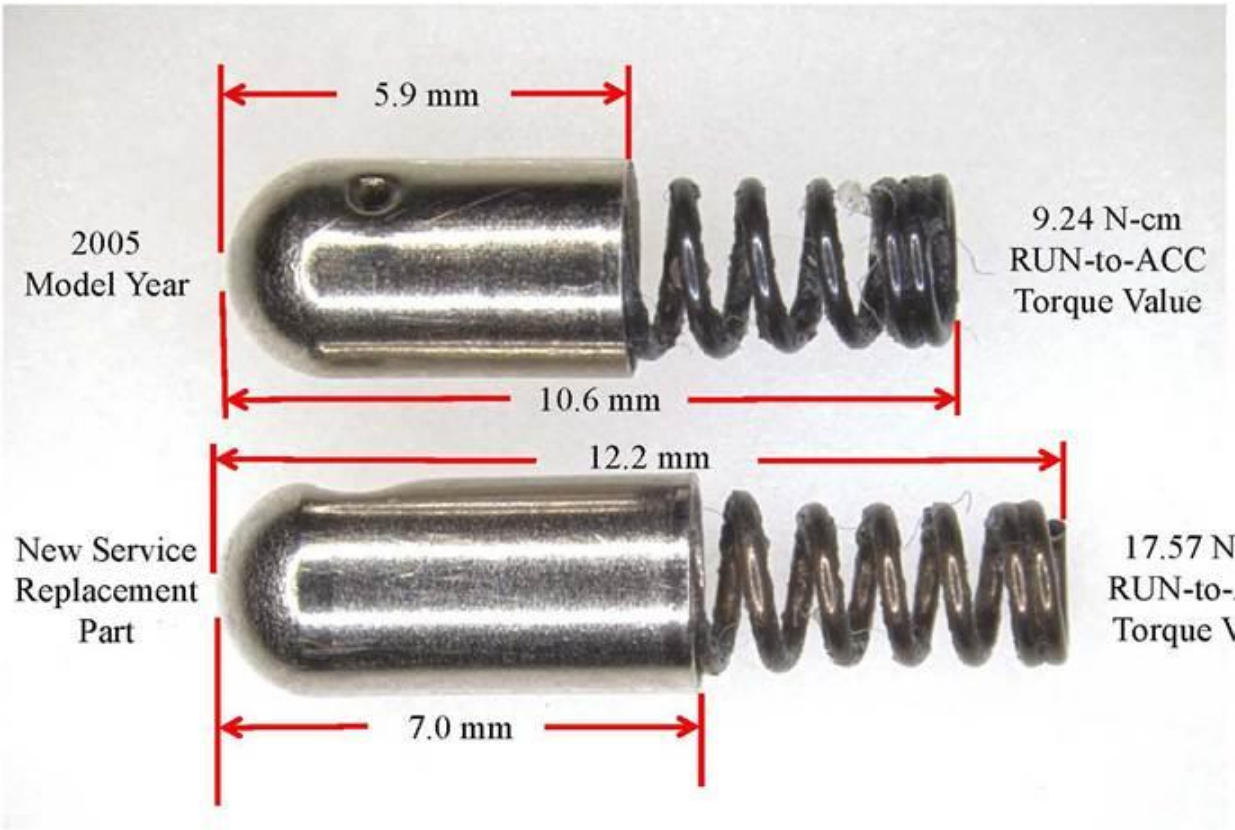
Smanagement http://smanagement.net

BACKGROUND:
Supply Chain Complexity and Liability



BACKGROUND: Example of Détente Plunger in Switch – GM Recall

Exemplar Chevrolet Cobalt Switch Detent Plungers



BACKGROUND:
Lack of Incoming QC

- Today's supply chain assumes perfect performance
- QC Sampling of incoming components is usually limited to select items
- Many components are not inspected at all before being moved to the production line

BACKGROUND: Component Supplier Doctrine

- Restatement (Third) of Torts: Product Liability, Section 5 (1998) (hereinafter "Restatement, Section 5"): Liability of Commercial Seller or Distributor of Product Components for Harm Caused by Products Into Which Components Are Integrated

BACKGROUND: Component Supplier Doctrine

- One Engaged in the business of selling or otherwise distributing product components who sells or distributes a component is subject to liability for harm to persons or property caused by a product into which the component is integrated if:
  - (a) the component is defective in itself, as defined in this Chapter, and the defect causes the harm; or
    - (1) the seller or distributor of the component substantially participates in the integration of the component into the design of the product; and
    - (2) the integration of the component causes the product to be defective, as defined in this Chapter; and
    - (3) the defect in the product causes the harm.

PRACTICAL ISSUES: BATTLE OF THE FORMS

Typical Transaction – Seller's acknowledgement is not a counteroffer

INQUIRY
- "Please quote price and delivery"

QUOTATION
- Generally not considered to be an offer, but instead an invitation to negotiate
- May contain Seller's T&C's

PURCHASE ORDER
- Usually considered to be the "offer" (First Strike)
- Typically contains buyer's boilerplate T&C's
- Usually says acceptance is limited to the terms of the offer and Buyer objects to any additional or different terms of Seller.

ORDER ACKNOWLEDGEMENT
- Typically considered to be the acceptance
- Not a conditional acceptance, but does contain additional and/or different terms
- Not a counteroffer

CONTRACT EXISTS UNDER 2-207(1)

MANUFACTURE & SHIP

DELIVERY AND ACCEPTANCE

THE BATTLE
- Battle of the forms over whose T&C's apply
- "Knockout rule" applies to Buyer's and Seller's different terms
- "Material alteration" rule applies to Seller's "additional terms"
- Net result – Buyer wins

PRACTICAL ISSUES: Combination of Products and Services

- UCC says that the dominant purpose governs whether the UCC or common law applies
- Consider 2 separate contracts – one for the goods and a separate one for the services
  - Example: engineering services to develop a product, followed by a manufacturing contract for the manufacture of the designed product.

PRACTICAL ISSUES: The Viewpoint of Purchaser's General Counsel

- Risk Management
  - Unforeseeable consequences
  - Getting many people to conform to process and procedure
- Use of standard agreements
- Restrict ability to deviate from standard agreement
- Psychology of the Purchasing Department

PRACTICAL ISSUES:
Seller's Process and Procedure

- Be prepared to reject a purchase order if no master purchase agreement
- Create a prioritized Checklist of what's most important
- Prepare specific descriptions of both the desired and acceptable outcomes
- Create your own Terms and Conditions of Sale
- Prepare list of negotiating options
- Understand what the customer needs vs printed terms of its form PO or contract

Example of Prioritized Checklist of Important Items

1. Warrant only that product will conform to specifications provided by Buyer and agreed upon by Seller.
2. Limitations of Liability to Buyer Notwithstanding Breach of Warranty within the 12 month warranty period
3. Indemnity/Defense by Seller
4. Quality Assurance obligations
5. Buyer's Indemnity/Defense of Seller
6. Government-mandated recalls
7. Elective recalls by customer/ultimate manufacturer
8. Order Process
9. Intellectual Property Rights/Indemnity

Example of Acceptable outcome and list of negotiation options

- Manufacture to specifications provided by Buyer and agreed upon by Seller.
  - Recommendations of Seller have been independently approved and adopted by customer
  - Clear description of "specifications" without any ambiguity or vagueness
  - Exclude "intended use" or "purpose" clauses
  - Avoid incorporation of unknown or overbroad documents
    - Incorporated documents are overbroad if they include language that goes beyond merely building to customer's specifications

Protecting Against Third Party Claims

- Indemnification/hold harmless provision
- Insurance requirements
- Additional Insured Coverage

Limits on Liability

- Include or exclude some obligations from a liability limit? E.g., fines.
- Include or exclude indemnity obligations from a disclaimer of consequential damages?
- Baskets and hurdles – Where a claim must exceed a certain amount before it is subject to indemnification.
- Caps - Where an indemnity has a financial cap the indemnified party may, depending on any other limitation clauses, still have an uncapped claim in contract law for any breach of contract.

Indemnification

- What liabilities are to be covered in the indemnity provision?
- Who is covered by the indemnity provision?
- What are the limitations of the provision? (Who and what are not covered?)
- What exclusions apply?
- Is indemnification the exclusive remedy?
- What are the procedures to invoke the provision (notice requirements, etc.)?
- Who controls the litigation?
- What are the requirements concerning the parties' cooperation in dealing with indemnification issues?

Indemnification

- It is important to note that an indemnity is a distinct right from the right to claim damages for breach of contract. Therefore any limitations under an indemnity will be for that indemnity only and will not operate to limit the common law right for damages for breach of contract. Conversely, if the indemnity is intended to be unlimited, then it is important that this is expressly stated in the contract so as to prevent any purported limitation of liability biting.

Defend, Indemnify and Hold Harmless

"Indemnify," "hold harmless" and "defend" are often used interchangeably, but actually have distinct and separate meanings:

- Indemnify. Indemnification is a contractual obligation by one party (the indemnitor) to pay or compensate for the losses, damages or liabilities incurred by another party (the indemnitee).
- Hold Harmless. In some states, this term only releases the indemnitee from liability to the indemnitor, not to third parties. An obligation to "hold harmless" may amount to nothing more than an agreement by the party giving the indemnity not to seek to counterclaim against the party receiving the indemnity, even if they have contributed to the event which gave rise to the indemnity being triggered.
- Defend. In many states, the obligation to indemnify does not occur until resolution of the case, when the indemnitee has had a judgment entered against it for damages, or has made payments or suffered actual loss—unless the contract requires such a defense. Also, in some states (like California and New York), the right to indemnify includes the reasonable costs of defense, but in other states (like Illinois), it does not, unless expressly stated.

What's The Difference?

- Most courts hold that "indemnity" and "hold harmless" are synonymous
  - *See, e.g.*, *Medcom Holding Co. v. Baxter Travelnol Labs., Inc.*, 200 F.3d 518, 519 (7th Cir. 1999); *Praetorian Ins. Co v. Site Inspection, LLC*, 604 F.3d 509, 515 (8th Cir. 2010) (citing Black's Law Dictionary); *Valhal Corp. v. Sullivan Assoc., Inc.*, 44 F.3d 195, 202 (3d Cir. 1995) ("an indemnity clause holds the indemnitee harmless from liability …"); *Mautz v. JP Patti Co.*, 298 N.J. Super. 13, 19 (App. Div. 1997) (using terms interchangeably).

What's The Difference? (cont.)

- Some courts disagree, finding that a "hold harmless" clause is an exculpatory provision releasing the indemnitee from liability to the indemnitor (as opposed to third parties)

  - *See. e.g., Exxon Mobil Corp. v. New West Petroleum, LP*, 369 Fed. Appx. 805, 807 (9th Cir. 2010*) Fernandez v. K-M Indus. Holding Co*., 646 F. Supp.2d 1150, 1160 (N.D. Cal 2009) (both citing *Queen Villas Homeowners Ass'n v. TCB Property Mgmt.*, 149 Cal. App. 4th 1, 9 (2007)).

Types of Indemnities

- Indemnities in commercial contracts are all about allocating risk between the parties. Indemnities come in all shapes and sizes. They can be:

  - a third party indemnity, whereby the indemnifier agrees to hold the beneficiary harmless from loss or damage arising from a claim by a third party; or
  - a party to party indemnity, where the indemnifier accepts responsibility for losses arising from certain failures or risks.
  - The nature of indemnities vary from contract to contract but examples of common indemnities include those relating to personal injury, property damage and intellectual property infringements.

Delineating Areas of Control and Fault

- Common types of losses subject to indemnification include breach of representation or warranty; breach of a covenant; losses incurred under specified conditions; and third-party claims against the indemnitee.
- Assuming equal bargaining strength, parties should only warrant and indemnify for things under their control. Likewise, in the indemnification provision, the types of fault that could reasonably occur should be defined and spelled out as attributable to a certain party.
- Factors to consider in allocating risk are as follows:
    - Who would be at fault for the loss? Who is in the best position to control/mitigate the risk? If the indemnities are delineated by areas of control and fault, as a practical matter, they should be easy for each party to accept.
    - What is the customary industry practice?
    - Who has the bargaining power?
    - Who is in the best position to insure against the risk?

Types Of Indemnity Provisions

- Three types
  - Narrow/Limited
  - Intermediate
  - Broad

Broad Form Indemnity

- Indemnitor indemnifies indemnitee for all liabilities, even those arising from indemnitee's sole negligence.
- Beware of anti-indemnity statutes or case law limiting or prohibiting broad form indemnity.
  - *See, e.g.,* N.J. Stat. § 2A:40A-1 (specific to construction): "A[n] … agreement … purporting to indemnify or hold harmless the promisee against liability for damages arising out of bodily injury to persons or damage to property caused by or resulting from the sole negligence of the promisee … is against public policy and is void and unenforceable …"
  - *See also* N.Y. Gen. Oblig. Laws § 5-322.1 (construction); § 5-321 (landlords); § 322 (caterers); § 5-323 (building maintenance contractors).

Sample Indemnification Clause - Broad

- "To the maximum extent permitted by applicable law and **whether or not caused, directly or indirectly, in whole or in part, by the negligence, willful misconduct or other fault of the party to be indemnified**, Supplier will indemnify and hold harmless Client and its respective officers, directors, employees and agents, from and against any and all claims, causes of action, suits, investigations, and administrative or other proceedings, and all related demands, damages, liabilities, fines, penalties, assessments, costs, expenses (including attorney's fees) of every kind and nature, **related to or arising out of** the sale of products by Supplier, any breach of this Agreement by Supplier and any act or omission of the Supplier."

Sample Indemnification Clause - Limited

- Service Provider shall defend, indemnify and hold harmless Client … from and against any and all claims, demands, suits, judgments, losses, liabilities, damages, costs or expenses of any nature whatsoever … caused solely by any: (i) negligent act or omission of Service Provider, its officers, directors, agents or employees; (ii) failure of Service Provider to perform the Services in accordance with generally accepted professional standards; or (iii) breach of Service Provider's representations and warranties, agreements, duties or obligations as set forth in this Agreement.

Indemnification For Injuries To Indemnitor's Employees

- Some states require that an indemnity provision specifically state that an Indemnitor is required to indemnify a third party for injuries to the Indemnitor's own employee.
  - *Bester v. Essex Crane Rental Corp.,* 619 A.2d 304, 308-09 (Pa. Super. 1993): "[C]ontracting parties must specifically use language which demonstrates that a named employer agrees to indemnify a named third party from liability for acts of that third party's own negligence which result in harm to the employees of the named employer.…"

Insurance

- Indemnification provisions should reflect the parties' insurance coverage. The indemnitor for a type of loss should be the one to obtain insurance for that loss and should name the indemnitee as an additional insured.
- Indemnity may only be as strong as the insurance the party has to back it up—especially where the indemnitor is a small company with limited assets.
- Conversely, where you are giving the indemnity, always make sure that doing so is permitted under your insurance.

Is The Indemnity Obligation Covered By Insurance?

- Standard ISO CGL policies contain an exclusion for liability assumed in a contract:

  This insurance does not apply to ...

  b. "Bodily injury" or "property damage" for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement.

ISO Insured Contract Exception

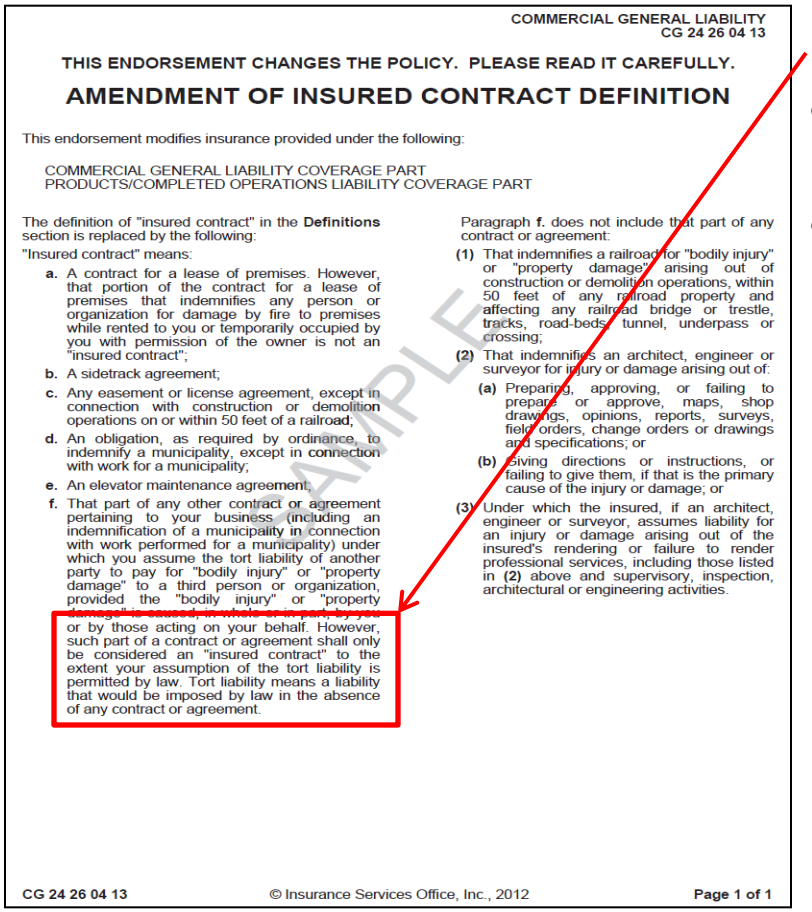
This exclusion does not apply to liability for damages:

(2) Assumed in a contract or agreement that is an "insured contract", provided the "bodily injury" or "property damage" occurs subsequent to the execution of the contract or agreement. . . .

Insured Contract Definition:

- "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. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement."

Amended Insured Contract Definition



COMMERCIAL GENERAL LIABILITY
CG 24 26 04 13

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

AMENDMENT OF INSURED CONTRACT DEFINITION

This endorsement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY COVERAGE PART
PRODUCTS/COMPLETED OPERATIONS LIABILITY COVERAGE PART

The definition of "insured contract" in the **Definitions** section is replaced by the following:

"Insured contract" means:

a. A contract for a lease of premises. However, that portion of the contract for a lease of premises that indemnifies any person or organization for damage by fire to premises while rented to you or temporarily occupied by you with permission of the owner is not an "insured contract";

b. A sidetrack agreement;

c. Any easement or license agreement, except in connection with construction or demolition operations on or within 50 feet of a railroad;

d. An obligation, as required by ordinance, to indemnify a municipality, except in connection with work for a municipality;

e. An elevator maintenance agreement;

f. That part of any other contract or agreement pertaining to your business (including an indemnification of a municipality in connection with work performed for a municipality) 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. However, such part of a contract or agreement shall only be considered an "insured contract" to the extent your assumption of the tort liability is permitted by law. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.

Paragraph **f.** does not include that part of any contract or agreement:

(1) That indemnifies a railroad for "bodily injury" or "property damage" arising out of construction or demolition operations, within 50 feet of any railroad property and affecting any railroad bridge or trestle, tracks, road-beds, tunnel, underpass or crossing;

(2) That indemnifies an architect, engineer or surveyor for injury or damage arising out of:

(a) Preparing, approving, or failing to prepare or approve, maps, shop drawings, opinions, reports, surveys, field orders, change orders or drawings and specifications; or

(b) Giving directions or instructions, or failing to give them, if that is the primary cause of the injury or damage; or

(3) Under which the insured, if an architect, engineer or surveyor, assumes liability for an injury or damage arising out of the insured's rendering or failure to render professional services, including those listed in **(2)** above and supervisory, inspection, architectural or engineering activities.

SAMPLE

CG 24 26 04 13 © Insurance Services Office, Inc., 2012 Page 1 of 1

However, such part of a contract or agreement shall only be considered an "insured contract" to the extent your assumption of the tort liability is permitted by law.

What Is Additional Insured Coverage?

- Risk transfer method that allows one party to a business relationship to obtain coverage under another party's policy

- Unlike coverage for liability assumed in an insured contract, which covers the sums the insured incurs pursuant to an indemnity agreement, additional insured coverage allows an additional insured to have direct access to the named insured's policy

Who Are The Players?

- **Named Insured** – the party whose policy is providing coverage to the Additional Insured.

- **Additional Insured** – the party seeking to take advantage of another party's coverage

  – Beware of using "Additional **Named** Insured"

How Does One Become An Additional Insured?

- Generally requires both contract between the parties and an additional insured provision in an insurance policy.

The Contract

- An obligation to indemnify does not confer additional insured status.
- Does the contract contain an insurance provision?
  - Does it require that the other party name your client as an additional insured?
  - Does it specify the type and amount of insurance coverage to be provided?
    - CGL, Umbrella?
    - Primary or Excess?
    - Limits?

Broad Additional Insured Provision

- Component Supplier shall, at its own expense, maintain in full force a policy or policies of commercial general liability insurance, including property damage, that will insure Component Supplier *and Purchaser and such other persons, firms or corporations as are designated by Purchaser,* against liability for injury to persons and property *arising from the Component Part*. The liability under such insurance shall be *not less than* $2,000,000 for bodily injury and $1,000,000.00 for property damage.

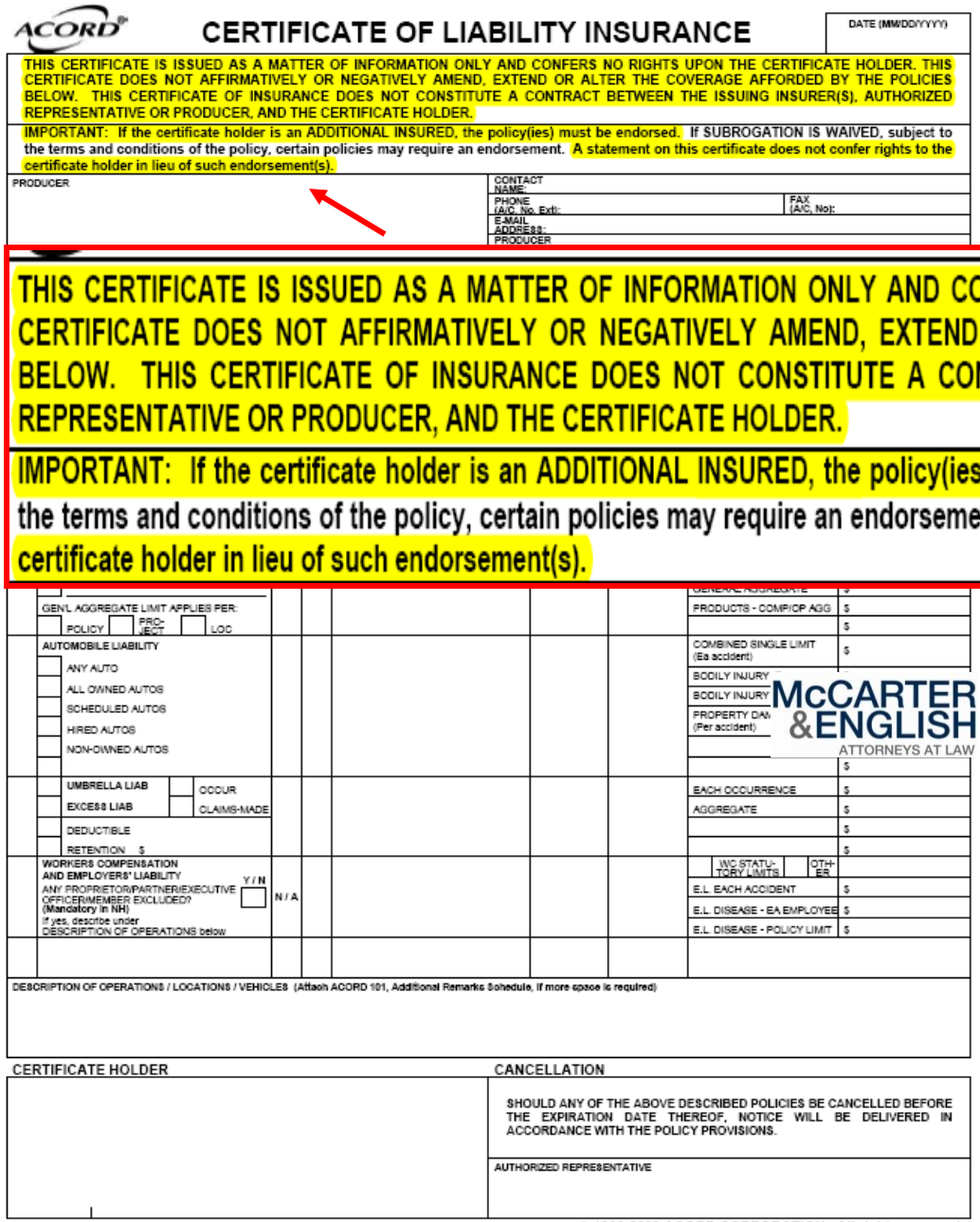
The Insurance Policy

- A contractual obligation to provide insurance is ineffective unless the Named Insured's policy contains an Additional Insured Clause.

- Usually in an endorsement.

Verifying Additional Insured Coverage

- A certificate of insurance is not proof of insurance
- The Acord form specifically states that additional insured coverage requires an endorsement



ACORD

CERTIFICATE OF LIABILITY INSURANCE

DATE (MM/DD/YYYY)

THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AFFIRMATIVELY OR NEGATIVELY AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW. THIS CERTIFICATE OF INSURANCE DOES NOT CONSTITUTE A CONTRACT BETWEEN THE ISSUING INSURER(S), AUTHORIZED REPRESENTATIVE OR PRODUCER, AND THE CERTIFICATE HOLDER.

IMPORTANT: If the certificate holder is an ADDITIONAL INSURED, the policy(ies) must be endorsed. If SUBROGATION IS WAIVED, subject to the terms and conditions of the policy, certain policies may require an endorsement. A statement on this certificate does not confer rights to the certificate holder in lieu of such endorsement(s).

PRODUCER

CONTACT NAME:

PHONE (A/C, No, Ext):

FAX (A/C, No):

E-MAIL ADDRESS:

PRODUCER

THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AFFIRMATIVELY OR NEGATIVELY AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW. THIS CERTIFICATE OF INSURANCE DOES NOT CONSTITUTE A CONTRACT BETWEEN THE ISSUING INSURER(S), AUTHORIZED REPRESENTATIVE OR PRODUCER, AND THE CERTIFICATE HOLDER.

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GEN'L AGGREGATE LIMIT APPLIES PER: POLICY PRO-JECT LOC

PRODUCTS - COMP/OP AGG $

$

AUTOMOBILE LIABILITY

ANY AUTO

ALL OWNED AUTOS

SCHEDULED AUTOS

HIRED AUTOS

NON-OWNED AUTOS

COMBINED SINGLE LIMIT (Ea accident) $

BODILY INJURY

BODILY INJURY

PROPERTY DAM (Per accident)

$

UMBRELLA LIAB OCCUR

EXCESS LIAB CLAIMS-MADE

DEDUCTIBLE

RETENTION $

EACH OCCURRENCE $

AGGREGATE $

$

$

WORKERS COMPENSATION AND EMPLOYERS' LIABILITY

ANY PROPRIETOR/PARTNER/EXECUTIVE OFFICER/MEMBER EXCLUDED? Y / N

(Mandatory in NH)

If yes, describe under DESCRIPTION OF OPERATIONS below

N / A

WC STATU-TORY LIMITS OTH-ER

E.L. EACH ACCIDENT $

E.L. DISEASE - EA EMPLOYEE $

E.L. DISEASE - POLICY LIMIT $

DESCRIPTION OF OPERATIONS / LOCATIONS / VEHICLES (Attach ACORD 101, Additional Remarks Schedule, if more space is required)

CERTIFICATE HOLDER

CANCELLATION

SHOULD ANY OF THE ABOVE DESCRIBED POLICIES BE CANCELLED BEFORE THE EXPIRATION DATE THEREOF, NOTICE WILL BE DELIVERED IN ACCORDANCE WITH THE POLICY PROVISIONS.

AUTHORIZED REPRESENTATIVE

ACORD 25 (2009/09)

McCARTER &ENGLISH ATTORNEYS AT LAW

ACORD 25 (2009/09)

McCARTER &ENGLISH ATTORNEYS AT LAW

Contractual Limitations On Additional Insured Coverage

- **Example**:
  - "Owner shall be included under Contractor's insurance as an additional insured with respect to claims and/or liability arising out of Work performed for Owner by Contractor, but only to the extent of Contractor's indemnity obligation in Section 13.b. herein**. In no event shall Owner be an additional insured with respect to claims and/or liability that do not arise out of the sole negligence or other actionable fault of Contractor.**"

Scope Of Additional Insured Coverage

- How broad is it?
- Does it essentially back-stop the Named Insured's contractual indemnity obligation?
  - Which clause appears first in the contract – indemnity or insurance?
- Does it cover more than the Additional Insured would be able to recover under the Indemnity Agreement?
  - What if the indemnity agreement contains a monetary cap?
  - What if the insurance provision states that the Additional Insured will receive coverage in the minimum amount of $_____?

In Re Deepwater Horizon, No. 13-0670, 2015 WL 674744 (Tex. Feb. 13, 2015)

- Additional Insured provision in Drilling Contract required Transocean to name BP "as additional insured in each of [Transocean's] policies, except Workers' Compensation ***for liabilities assumed by [Transocean] under the terms of [the Drilling] Contract."*** (emphasis added)
- Transocean agreed to indemnify BP for above-surface pollution, regardless of fault
- BP agreed to indemnify Transocean for all pollution risk not assumed by Transocean

In Re Deepwater Horizon, No. 13-0670, 2015 WL 674744 (Tex. Feb. 13, 2015) (cont.)

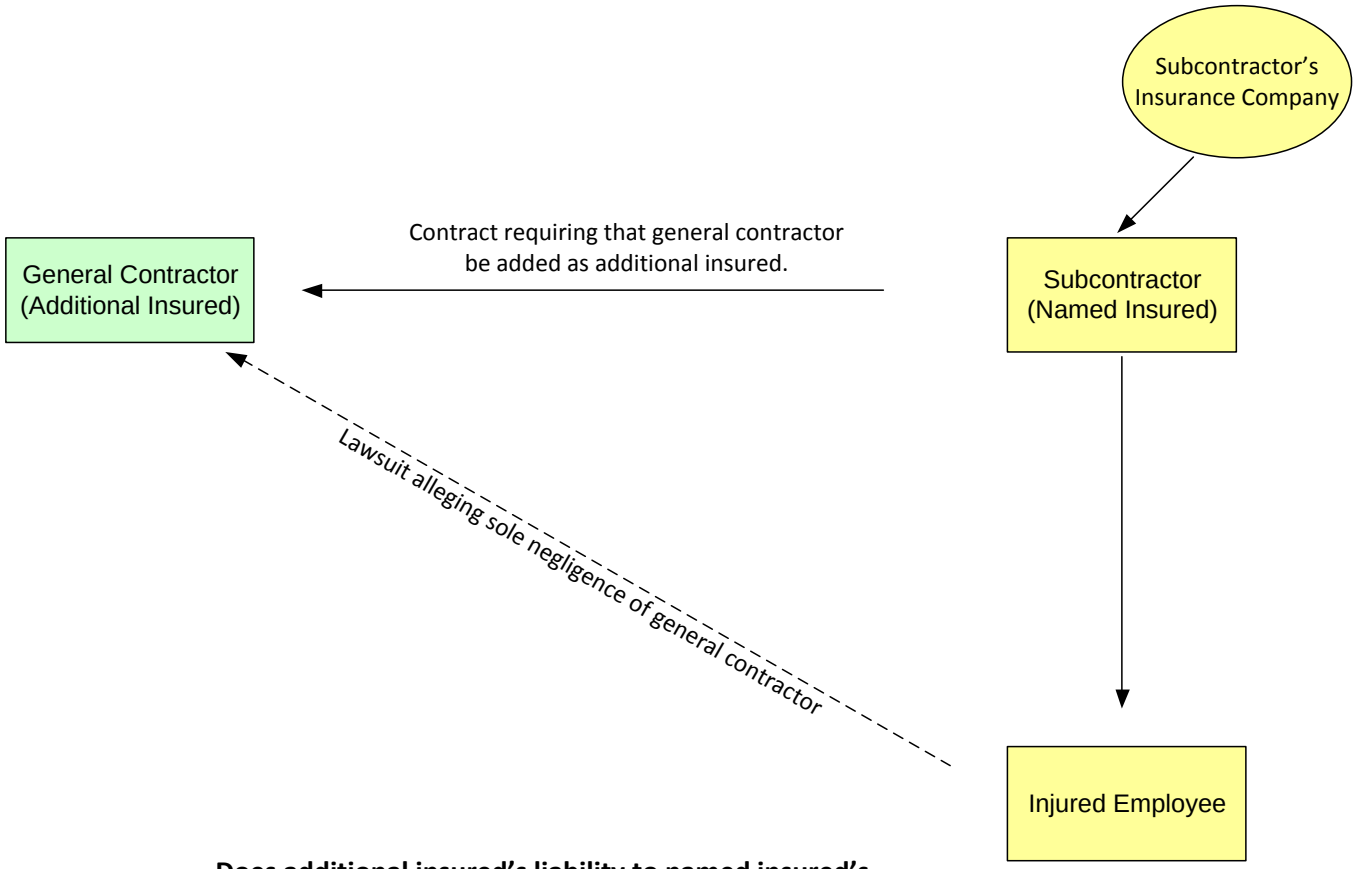
- Court held BP was an additional insured only as to liabilities assumed by Transocean under the Drilling Contract

- Because Transocean did not assume liability for subsurface pollution, BP was not an additional insured as to that risk

In Re Deepwater Horizon, No. 13-0670, 2015 WL 674744 (Tex. Feb. 13, 2015) (cont.)

- "[S]imply because the duties to indemnify and maintain insurance may be separate and independent does not prevent them from also being congruent; that is, ***a contract may reasonably be construed as extending the insured's additional insured status only to the extent of the risk the insured agreed to assume***." *Id.* at *12 (emphasis added)

Typical Additional Insured Claim



Does additional insured's liability to named insured's employee "arise out of" named insured's ongoing operations?

McCARTER &ENGLISH ATTORNEYS AT LAW

Gilbane Building Co. v. Empire Steel Erectors, L.P., 691 F. Supp. 2d 712 (S.D.Tex. 2010), *aff'd in part, rev'd in part*, 664 F. 3d 589 (5th Cir. 2011)

- Parr, an employee of Empire Steel, a Subcontractor, fell off a ladder at a construction site and sued Gilbane Building Co., the General Contractor.

Gilbane Building Co. v. Empire Steel Erectors, L.P., 691 F. Supp. 2d 712 (S.D.Tex. 2010), *aff'd in part, rev'd in part*, 664 F. 3d 589 (5th Cir. 2011) (cont.)

- Admiral Ins. Co. argued that because the indemnity agreement in the Trade Contractor Agreement was unenforceable under TX law, Gilbane was not covered as an additional insured.
- The District Court rejected this argument, finding that the indemnity and insurance provisions were separate clauses that do not reference each other, are not intertwined or interrelated, and on their face stand independently as separate obligations.
- The 5th Circuit affirmed.

Norfolk & Dedham Mut. Fire Ins. Co. v. Morrison, 456 Mass. 463(2010), aff'd, 79 Mass. App. Ct. 1128 (Mass. App. Ct. 2011)

- **Dr. Beverly Shafer rented office space from Cummings.**
  - The lease agreement required Dr. Shafer to indemnify Cummings against liability to third parties and to purchase insurance adding Cummings as an additional insured.

Norfolk & Dedham Mut. Fire Ins. Co. v. Morrison

- One of Dr. Shafer's patients tripped in the parking lot and sued both Dr. Shafer and Cummings.
  - Cummings (landlord) demanded that both Dr. Shafer and Norfolk (Shafer's insurer) indemnify it.
  - Norfolk refused, citing a Massachusetts statute voiding a tenant's obligation to indemnify a landlord.

Norfolk & Dedham Mut. Fire Ins. Co. v. Morrison (cont.)

- The Court held that the statutory prohibition against indemnity agreements did not apply to the insurance provision of the lease agreement:

  – "An agreement in a lease that the tenant indemnify or hold harmless the landlord is distinct from an agreement to purchase insurance on the landlord's behalf, which covers the liability of both in the event of a negligently caused injury."

Impact Of Anti-Indemnity Statutes On Additional Insured Coverage

- Recently, some states (e.g., California, Colorado, Kansas and New Mexico) have enacted legislation prohibiting coverage for the additional insured's own negligence where that negligence could not be transferred via an indemnity agreement.
- New York has pending legislation. *See* New York Senate Bill S2925.
- In states where additional insured status is within the jurisdiction of the anti-indemnity statute, an additional insured's coverage cannot be broader than its protection as an indemnitee

Kansas Stat. 16-121

- For example, KSA 16-121 in relevant part provides:
  - (b) "An indemnification provision in a contract which requires the promisor to indemnify the promisee for the promisee's negligence or intentional acts or omissions is against public policy and is void and unenforceable."
  - (c) **"A provision in a contract which requires a party to provide liability coverage to another party, as an additional insured, for such party's own negligence or intentional acts is against public policy and is void and unenforceable."**

New York Senate Bill S2925

- Provides that provisions in construction contracts with respect to requirements for certain additional insurance coverage are void and unenforceable.
- Seeks to amend New York's existing limitation on indemnification even further by precluding indemnitor from obtaining additional insured coverage where it could not provide indemnification.
- Status: Passed Senate in June 2015; in Assembly Committee (Assembly Bill A4259).
- Previous attempts to pass similar bills have failed.

Coverage For Additional Insured's Own Negligence

- *McIntosh v. Scottsdale Ins*. Co., 992 F.2d 251 (10th Cir. 1993) (festival patron injured on fairgrounds brought suit against township/additional insured. Festival operator's insurer obligated to cover township, even though township stipulated that it was 100% negligent, since injuries "arose out of" Festival's operations).
- *Allen-Stevenson School v. Burlington Ins. Co*., 2008 N.Y. Misc. LEXIS 10587 (N.Y. Sup. Ct. Mar. 31, 2008) ("The additional insured language…defines coverage…based on the scope of the named insured's work. As long as the claim against the additional insured arises out of the named insured's work, coverage is provided under the Endorsement.").
- *Mid-Continent Cas. Co. v. Swift Energy Co*., 206 F.3d 487 (5th Cir. 2000) (finding that injuries to named insured's employee "arose out of" named insured's operations, even if the cause of the injuries was the sole negligence of the additional insured).

The 2004 Amendments To ISO's Endorsements

- In response to these cases, in 2004, ISO amended some of its most commonly-used additional insured endorsements to make clear that the additional insured's sole negligence is not covered.
- Additional Insured only has coverage with respect to liability for BI or PD caused, in whole or in part, by the Named Insured's conduct.

Comparison Of Pre- And Post-2004 Versions Of ISO CG 20 10

PRE-2004 CG 20 10

A. Section II – Who Is An Insured is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of your ongoing operations performed for that insured.

2004 CG 20 10

A. Section II. Who Is An Insured is amended to include as an additional insured the person(s) or organization(s) shown in the Schedule, but only with respect to liability for "bodily injury", "property damage" or "personal and advertising injury" caused, in whole or in part, by:

1. Your acts or omissions; or

2. The acts or omissions of those acting on your behalf;

in the performance of your ongoing operations for the additional insured(s) at the location(s) designated above.

Did ISO's Amendment Resolve The Issue?

- Maybe not --
  - In *Gilbane*, Admiral argued that since the complaint contained no allegations of negligence on the part of Empire (the Subcontractor/Named Insured), or anyone acting on its behalf, the General Contractor, Gilbane, was not covered as an additional insured

Gilbane Building Co. v. Empire Steel Erectors, L.P., 691 F. Supp. 2d 712 (S.D.Tex. 2010), *aff'd in part, rev'd in part*, 664 F. 3d 589 (5th Cir. 2011)

Did ISO's Amendment Resolve The Issue? (cont.)

- The District Court speculated that the named insured's negligence had not been pled because of the statutory immunity of the Workers' Compensation bar, ***but***

- Concluded that the claimant's negligence could be presumed and imputed to the named insured, thus triggering Admiral's duty to defend.

Did ISO's Amendment Resolve The Issue? (cont.)

- The Fifth Circuit reversed the district court's ruling on the **duty to defend,** finding that Parr's negligence could not be presumed.

  – Applying the eight-corners rule, the Fifth Circuit concluded that Admiral was only obligated to defend the GC/additional insured "if the underlying pleadings allege[d] that Empire, or someone acting on its behalf, proximately caused Parr's injuries." 664 F.3d at 598.

Did ISO's Amendment Resolve The Issue? (cont.)

- The Fifth Circuit affirmed the district court's finding that Admiral was required to **indemnify** the additional insured:
  - A co-worker's recount of Parr's statement, immediately after he fell, that his "'feet got wrapped up in the extension cord'" was persuasive. 664 F.3d at 601.
  - The District Court properly "consider[ed] facts outside of those alleged in the petition in determining the duty to indemnify." *Id.*

Revised CG 20 10 Does Not Limit Coverage To Vicarious Liability

- **American Empire Surplus Lines Ins. Co. v. Crum & Forster Specialty Ins. Co**., No. H-06-004, 2006 U.S. Dist. LEXIS 33556 (S.D. Tex. May 23, 2006) (language of endorsement requiring that Additional Insured's liability arise, in whole or in part, out of Named Insured's conduct, does not limit coverage to vicarious liability, but provides coverage where both Named Insured and Additional Insured are negligent).

No Coverage For Additional Insured's Sole Negligence

- ***Smith v. Toys "R" Us, Inc*., 2012 WL 3822116 (N.J. App. Div. Sept. 5, 2012)**
  - Policy providing additional insured coverage for liability "caused, in whole or in part, by [the Named Insured's] acts or omissions. . ." did not cover additional insured's sole negligence.

Comparison Of 2004 And 2013 Versions Of ISO CG 20 10

2004 CG 20 10

A. Section II. Who Is An Insured is amended to include as an additional insured the person(s) or organization(s) shown in the Schedule, but only with respect to liability for "bodily injury", "property damage" or "personal and advertising injury" caused, in whole or in part, by:

1. Your acts or omissions; or

2. The acts or omissions of those acting on your behalf;

in the performance of your ongoing operations for the additional insured(s) at the location(s) designated above.

2013 CG 20 10

A. Section II – Who is An Insured is amended to include as an additional insured the person(s) or organization(s) shown in the Schedule, but only with respect to liability for "bodily injury", "property damage" or "personal and advertising injury" caused, in whole or in part, by:

1. Your acts or omissions; or

2. The acts or omissions of those acting on your behalf;

In the performance of your ongoing operations for the additional insured(s) at the location(s) designated above.

However:

1. The insurance afforded to such additional insured only applies to the extent permitted by law; and

2. If coverage provided to the additional insured is required by a contract or agreement, the insurance afforded to such additional insured will not be broader than that which you are required by the contract or agreement to provide such additional insured.

Whose Coverage Is Primary?

- Formerly a hotly-disputed issue.
- ISO attempted to resolve the dispute in the CGL policy itself.
- The 2001 and later versions of the ISO CGL Policy (CG 00 01 10 01) contain an amended Other Insurance Clause (Section IV).

b. If a claim is made or "suit" is brought against any insured, you must:

(1) Immediately record the specifics of the claim or "suit" and the date received; and

(2) Notify us as soon as practicable.

You must see to it that we receive written notice of the claim or "suit" as soon as practicable.

c. You and any other involved insured must:

(1) Immediately send us copies of any demands, notices, summonses or legal papers received in connection with the claim or "suit";

(2) Authorize us to obtain records and other information;

(3) Cooperate with us in the investigation or settlement of the claim or defense against the "suit"; and

(4) Assist us, upon our request, in the enforcement of any right against any person or organization which may be liable to the insured because of injury or damage to which this insurance may also apply.

d. No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without our consent.

3. Legal Action Against Us

No person or organization has a right under this Coverage Part:

a. To join us as a party or otherwise bring us into a "suit" asking for damages from an insured; or

b. To sue us on this Coverage Part unless all of its terms have been fully complied with.

A person or organization may sue us to recover on an agreed settlement or on a final judgment against an insured; but we will not be liable for damages that are not payable under the terms of this Coverage Part or that are in excess of the applicable limit of insurance. An agreed settlement means a settlement and release of liability signed by us, the insured and the claimant or the claimant's legal representative.

4. Other Insurance

If other valid and collectible insurance is available to the insured for a loss we cover under Coverages **A** or **B** of this Coverage Part, our obligations are limited as follows:

a. Primary Insurance

This insurance is primary except when **b.** below applies. If this insurance is primary, our obligations are not affected unless any of the other insurance is also primary. Then, we will share with all that other insurance by the method described in **c.** below.

b. Excess Insurance

This insurance is excess over:

(1) Any of the other insurance, whether primary, excess, contingent or on any other basis:

(a) That is Fire, Extended Coverage, Builder's Risk, Installation Risk or similar coverage for "your work";

(b) That is Fire insurance for premises rented to you or temporarily occupied by you with permission of the owner;

(c) That is insurance purchased by you to cover your liability as a tenant for "property damage" to premises rented to you or temporarily occupied by you with permission of the owner; or

(d) If the loss arises out of the maintenance or use of aircraft, "autos" or watercraft to the extent not subject to Exclusion **g.** of Section **I** – Coverage **A** – Bodily Injury And Property Damage Liability.

(2) Any other primary insurance available to you covering liability for damages arising out of the premises or operations for which you have been added as an additional insured by attachment of an endorsement.

b. Excess Insurance

This insurance is excess over:

(2) Any other primary insurance available to you covering liability for damages arising out of the premises or operations for which you have been added as an additional insured by attachment of an endorsement.

b. If a claim is made or "suit" is brought against any insured, you must:

(1) Immediately record the specifics of the claim or "suit" and the date received; and

(2) Notify us as soon as practicable.

You must see to it that we receive written notice of the claim or "suit" as soon as practicable.

c. You and any other involved insured must:

(1) Immediately send us copies of any demands, notices, summonses or legal papers received in connection with the claim or "suit";

(2) Authorize us to obtain records and other information;

(3) Cooperate with us in the investigation or settlement of the claim or defense against the "suit"; and

(4) Assist us, upon our request, in the enforcement of any right against any person or organization which may be liable to the insured because of injury or damage to which this insurance may also apply.

d. No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without our consent.

3. Legal Action Against Us

No person or organization has a right under this Coverage Part:

a. To join us as a party or otherwise bring us into a "suit" asking for damages from an insured; or

b. To sue us on this Coverage Part unless all of its terms have been fully complied with.

A person or organization may sue us to recover on an agreed settlement or on a final judgment against an insured; but we will not be liable for damages that are not payable under the terms of this Coverage Part or that are in excess of the applicable limit of insurance. An agreed settlement means a settlement and release of liability signed by us, the insured and the claimant or the claimant's legal representative.

4. Other Insurance

If other valid and collectible insurance is available to the insured for a loss we cover under Coverages **A** or **B** of this Coverage Part, our obligations are limited as follows:

a. **Primary Insurance**

This insurance is primary except when **b.** below applies. If this insurance is primary, our obligations are not affected unless any of the other insurance is also primary. Then, we will share with all that other insurance by the method described in **c.** below.

b. **Excess Insurance**

This insurance is excess over:

(1) Any of the other insurance, whether primary, excess, contingent or on any other basis:

(a) That is Fire, Extended Coverage, Builder's Risk, Installation Risk or similar coverage for "your work";

(b) That is Fire insurance for premises rented to you or temporarily occupied by you with permission of the owner;

(c) That is insurance purchased by you to cover your liability as a tenant for "property damage" to premises rented to you or temporarily occupied by you with permission of the owner; or

(d) If the loss arises out of the maintenance or use of aircraft, "autos" or watercraft to the extent not subject to Exclusion **g.** of Section **I** – Coverage **A** – Bodily Injury And Property Damage Liability.

(2) Any other primary insurance available to you covering liability for damages arising out of the premises or operations for which you have been added as an additional insured by attachment of an endorsement.

2013 Revision

no requirement of endorsement

b. Excess Insurance

This insurance is excess over:

(2) Any other primary insurance available to you covering liability for damages arising out of the premises or operations for which you have been added as an additional insured ~~by attachment of an endorsement~~.

Duty to Mitigate?

- Duty to mitigate can apply to either tort or breach of contract.
- Illinois Pattern Jury Instructions - 700.17 Determination of Damages--Mitigation of Damages
  - The law provides a party cannot recover damages [he][she][it][they] could have prevented by exercising ordinary care and diligence when [he][she][it][they] learned or should have learned of the breach. The burden is on [defendant's name] to prove [plaintiff's name] failed to minimize [his][her][its] damages and that the damages should be reduced by a particular amount as a result. In this case, [defendant's name] claim(s) and has the burden of proving that, with reasonable efforts and ordinary care, [plaintiff's name] could have avoided some losses in whole or in part, even though [his][her][its] losses originally resulted from the [defendant's name]'s(s') failure to keep [his][her][its] promise.
- To avoid confusion, it is advisable to make it clear whether the beneficiary is under a duty to mitigate or not.

Breach of Warranty/Representation

- In the sale of most goods it is necessary to negotiate the warranties and representations in conjunction with the indemnity provisions
- Effect of multiple design warranties in a product that includes multiple components from multiple suppliers
- Beware the warranty that the product will fulfill its intended purpose

Third Party Claims

- If the item supplied is a component of the ultimate product, much depends on the existence of/lack of cooperation between Buyer and Seller
- If the item supplied is the final finished product, who designed it?
- Failure to warn claims vs defective design vs defective manufacture

Recalls

- Government-mandated (safety/misrepresentation)
- Seller's decision to recall without any governmental requirement (reputation/customer satisfaction
- Effect on product liability claims

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Ed has been the Founding Member and Managing Partner of the Firm. Ed is heavily involved in various no-for-profit entities, and is a Trustee of Elmhurst College and the Elmhurst Memorial Hospital Foundation, a past Board Member of the Oak Brook Area Chamber of Commerce.
In his prior work as in-house counsel Ed had direct experience in being a member of senior management of several large publicly-held companies, covering the manufacturing, logistics and transportation fields. Among other things, he has been responsible for environmental compliance, product liability risk management, advertising compliance and complex financing coordination. Ed also has first-hand experience in entrepreneurial ventures as an owner and partner, including as a partner in a venture that developed one of the largest residential projects in Sedona, Arizona.

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Steven Weisman, Partner, **McCarter& English,** is a member of the Firm's Insurance Coverage Group and the Data Privacy and Cyber Risk Task Force. Mr. Weisman has a national commercial litigation practice, representing corporate policyholders in all types of insurance-related matters including complex coverage disputes, insurance broker disputes, and premium disputes in state and federal courts throughout the United States. Mr. Weisman advises his clients on and litigates a broad range of insurance issues concerning an array of underlying liabilities and first-party losses under a wide variety of insurance policies, including general liability insurance, directors' and officers' insurance, errors and omissions insurance, employment practices liability insurance, management liability insurance and first party property insurance. Mr. Weisman's guidance also extends to counseling clients on data privacy matters, including data breach notice requirements and cyber risk insurance coverage. Mr. Weisman's credentials also extend to providing advice on the scope of his clients' existing insurance coverage programs relative to their potential risks.

Drawing on his broad experience, Mr. Weisman counsels clients on and negotiates, among others, licensing and supply agreements.

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A seasoned courtroom lawyer for over 25 years, Mr. Fields has litigated, arbitrated and mediated commercial matters in numerous jurisdictions from inception through trial. He has a diverse background representing owners and developers in construction contracting and litigation, and financial services, telecommunications, insurance, Internet, real estate, and other commercial clients in business matters, arbitrations, and federal and state court litigations. In addition to his trial-level experience, he is a veteran appellate practitioner. Over the course of his career, Mr. Fields has successfully litigated a number of construction and real estate disputes, insurance coverage matters, civil RICO cases, high-level exposure toxic tort matters, reinsurance disputes, development disputes and telecommunications matters, among others.

Past and present experience includes litigating and settling multimillion-dollar Directors' & Officers' insurance coverage issues for Fortune 100 companies, recovering large sums under Errors and Omissions insurance policies, litigating multimillion-dollar casualty losses and large-scale environmental cost recovery matters, and representing financial institutions in high-stakes litigations.