

ESSENTIALS OF CONTRACTUAL RISK TRANSFER:
INSURANCE ISSUES WITH CONTRACTORS, VENDORS, & SUPPLIERS

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TWO LAWYERS & A BROKER: THE DISCLAIMER

The information presented herein is intended to be educational and general in nature. Any thoughts, ideas, or suggestions contained herein **should not be considered as legal advice** or recommendations for specific business applications, as all businesses have unique characteristics which should be fully evaluated before implementing any of the ideas or strategies discussed herein.

The presenters recommend that utilities fully assess their specific risk management needs and objectives when considering the extent to which these techniques are appropriate for their companies, and incorporate the involvement of risk and insurance, legal, procurement and operations teams as appropriate when designing and implementing risk management strategies.

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SOME SUBJECTS WE WILL COVER

- Evaluating new contractors
- Contractual protections
 - Indemnity
 - Insurance requirements
- Typical contractor and vendor insurance requirements
- Common issues encountered along the way: “I can’t get that much coverage!”
- Discussion & questions

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CONTRACTORS: A NECESSARY PART OF YOUR BUSINESS

- Why use contractors?
 - Cost savings
 - Increased flexibility
 - Access to innovative construction methods
 - Labor qualifications and staffing issues
 - Reallocation of risk
- Contractors like working for us! Utility companies pay vendors in full, on time, and cautiously avoid liens on their assets.

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RISKS OF USING CONTRACTORS

- Wide variation in contractors' skill and expertise
- Risk that contractor does not understand your regulators' and customers' expectations
- Limited ability to direct and control contractor's work methods
- Not every contractor has the financial capability to fulfill its responsibilities in the event of injuries or damages that may occur as a result of its actions
- A utility is the classic "deep pocket," and must protect itself and its customers from liability for loss caused by others

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SELECTING A CONTRACTOR

- The utility must ensure that its contractors are financially responsible if the contractor's operations cause loss to the utility, its employees, or to the public
- Is the contractor qualified to perform the work?
- Does the contractor's commitment to **safety** mirror your own corporate values?
- Is the contractor financially able to meet its commitments to the utility?

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MUST HAVE: A WELL-DRAFTED, SIGNED CONTRACT

- Scope of work – who, what, when, where, and how often?
- Price terms – fair to both sides; easy to calculate and clear when payment is due
- Assignability – are you OK with the contractor assigning his duty to perform?
- Who bears the risk? The party with the greater control of the risk is in the better position to avoid risk, and should be responsible for the financial burden if a loss occurs
 - Insurance
 - Indemnity
 - Limitations of Liability
- Dispute resolution – choices of law, venue, and alternate dispute resolution procedures

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THE PEANUT BUTTER & JELLY OF RISK MANAGEMENT

Indemnity: The portion of the contract or agreement defining how one party will protect the other. This part of the contract describes to what extent the contractor / vendor must go to protect the company if the utility is faced with liability arising out of the contractor’s operations and activities.

Insurance Requirements: Portion of the contract or agreement stipulating the minimum types and amounts of insurance that must be maintained by the contractor or vendor in order to evidence a measure of financial responsibility for losses and legal liability. It is an independent verification of financial assets available to fund losses arising out of the contractor’s operations and activities.



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FIVE COMMON WAYS INDEMNIFICATION CAN OPERATE

1. Owner takes all liability (broad form favoring contractor)
2. Owner takes all liability except for sole fault of the contractor (intermediate form favoring contractor)
3. Comparative fault (limited / each responsible for its own fault)
4. Contractor takes all liability except for sole fault of owner (intermediate form favoring owner)
5. Contractor takes all liability (broad form favoring owner)

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BE WARY OF THE LEGAL DEFINITION OF AN INDEPENDENT CONTRACTOR

- The desire to manage your contractors' work activities must take into account the legal limits of doing so. Does your company conduct on-site inspections of contractors' work?
- The definition of "independent contractor" is a state law-specific analysis
 - South Carolina uses the "Right to Control" test
 - Direct evidence of the right to, or exercise of, control
 - The method of payment
 - The furnishing of equipment
 - The right to fire
- Federal and state agencies and plaintiffs' lawyers are trying to move from an "actual control" standard to a "potential control" standard

Note: This test looks not at the utility's **actual** control of its contractor, but rather at the utility's **RIGHT** to control the activities of its contractor. It is important to study your company's POs, terms & conditions, and other contract documents.

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ADDITIONAL CONTRACTUAL CONSIDERATIONS

- How long is coverage needed?
 - Contractor shall procure and maintain in effect during the term of the agreement, and for a period of ____ years thereafter for the following coverages. State Statutes of Limitations for contractor work?
- Require contractor's coverage to be "Primary and Noncontributory"
 - Contractor agrees to stipulate that such insurance is primary and is not additional to; or contributing with, any other insurance carried by on for the benefit of the owner
- Beware of the Limitation of Liability Clause – the fine print can hurt you
 - Evaluate the risk and understand how the limit of liability will apply before agreeing to the contract
 - Negotiate – even if it is part of a standard form
 - Limits of insurance is a possible compromise if the amount of the insurance reflects the amount of the risk

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CONTRACTOR / VENDOR INSURANCE COVERAGE

What it is.....

- It **IS** an independent and verifiable asset that provides a degree of financial assurance that will respond to claims for injuries and damages arising out of the contractor's activities
- It **IS** a certain degree of verification that the contractor's risks have been reviewed by an independent third party (an insurance company), which has agreed to assume the transfer of risk
- Where the **utility** is protected as an Additional Insured, it **IS** an independent source of potential financial protection, in the form of defense costs and settlements
- It **IS** good due diligence and business practice to assure that the contractor or vendor is able to be responsible for injuries and damages to the **utility**, its employees, third parties and the general public
- A policy of insurance **IS** the only document that grants, limits or takes away coverage – an insurance certificate can do none of that

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CONTRACTOR / VENDOR INSURANCE COVERAGE

What it IS NOT.....

- It **IS NOT** an indemnity agreement
- It **IS NOT** a substitute for a well-structured indemnity agreement
- It **IS NOT** an operative instrument of a contract or agreement – except to evidence protection of its insured contractor or vendor
- Except where the **utility** is protected as an Additional Insured, it **WILL NOT** be an independent source of potential financial protection, or act on its own to protect the **utility**
- It **IS NOT** a good idea to depend solely on the quality, effectiveness or the ability of contractor's / vendor's insurance coverage to protect the **utility**
- It **SHOULD NOT** be used only to protect the **utility's** out-of-pocket retention under its own insurance – it should also be sufficient to avoid your own insurers having to cover the contractor's problems

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COMMON PUSHBACKS

From contractors



“I can't get the coverage you require”



“I can't afford the premium to get the coverage you require”



“I'm a sole proprietor or only have a couple employees, so I'm not required to carry workers' compensation”



“I'll just add the cost of the coverage you require to my invoice”

From your own folks



“They're waiting at the plant gate right now – you're delaying the project!”



“If you won't approve them, it's supposed to be my responsibility then?”

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COMMON QUESTIONS – INSURANCE REQUIREMENTS

Should the utility be an Additional Insured on a contractor's or vendor's Umbrella / Excess Liability Policy too?

- **Yes.** While many Umbrella / Excess Liability policies will follow the terms of the underlying primary General Liability and Auto Liability policies that they are intended to provide additional limits over, there are a sufficient number of Umbrella / Excess Liability policies that do not follow form, and may not provide Additional Insured protection to the utility unless it is specifically stated in the contractor agreement that they must do so.
- Accordingly, it is recommended that your contracts and agreements specifically state that the utility (or your specific subsidiary) is to be included as an Additional Insured on the Commercial General Liability, Auto Liability and Umbrella / Excess Liability policies to be maintained by the contractor / vendor.

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COMMON QUESTIONS – INSURANCE REQUIREMENTS

Can the utility be included as an Additional Insured on the Professional Liability policy of a design or engineering vendor doing work for us?

- Generally **no** – but with some exceptions. Most Professional Liability or Errors & Omissions (E&O) insurers will not name you as an Additional Insured, as they only insure the contractor's professional liability. Providing Additional Insured status to the project owner could be interpreted as an agreement to insure the professional liability of the utility professionals involved in the project as well.
- That being said, some professional liability / E&O insurers may provide Additional Insured protection – limited to vicarious liability (only) for a third party that has been imputed to the utility due to the professional liability of its contractor (i.e., the utility held liable for the actions of the professional services contractor / vendor it hired).

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COMMON QUESTIONS – INSURANCE REQUIREMENTS

We require Contractual Liability – that covers the contractor’s breach of contract, or if they are unable to perform their obligations under the contract – right?

- **No.** The Contractual Liability coverage within a General Liability or Excess Liability policy only provides coverage for the utility’s assumption of the “tort” liability of another, for bodily injury or property damage to third parties. Despite the name of this coverage feature, it does not provide protection against breach of contract.

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COMMON QUESTIONS – INSURANCE REQUIREMENTS

What’s the difference between an Additional Insured and a Certificateholder?

- An **Additional Insured** is essentially as it appears. If the utility is named as an Additional Insured on a contractor’s or vendor’s liability policy, you are a protected insured party under the insurance policy in much the same manner as the contractor or vendor. The policy is extended to protect the utility for defense costs and settlements for injuries and damages to third parties, typically arising out of the activities of the contractor or vendor.
- A **Certificateholder** is the entity to whom a Certificate of Insurance is issued. For example, when the utility requires that a contractor or vendor carries certain types and amounts of insurance, you require that the contractor’s or vendor’s insurance agent or broker provide the utility with a Certificate of Insurance evidencing compliance with your insurance requirements. Since the certificate is issued to the utility, you would be shown as the Certificateholder on the certificate.

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COMMON QUESTIONS – INSURANCE REQUIREMENTS

ACORD CERTIFICATE OF LIABILITY INSURANCE

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, AUTHORIZED REPRESENTATIVE OF 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).

DESCRIPTION OF OPERATIONS, ETC.

CERTIFICATE HOLDER: [UTILITY]

CANCELLATION: SHOULD ANY OF THE ABOVE DESCRIBED POLICIES BE CANCELLED BEFORE THE OPERATION DATE HEREBY, NOTICE MUST BE DELIVERED IN ACCORDANCE WITH THE POLICY PROVISIONS.

Frequently, instead of specifically indicating the parties to be included as an Additional Insured, an insurance certificate may simply indicate that “the **Certificateholder** is an Additional Insured”

A better approach is for the certificate to include specific language in the “**Description of Operations, etc.**” area of the certificate as to who is an Additional Insured. Example: “[UTILITY], its directors, officers and employees are included as Additional Insureds under the Commercial General Liability, Auto Liability and Umbrella / Excess Liability Policies”.

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COMMON QUESTIONS – INSURANCE REQUIREMENTS

The contractor has inserted language into the contract that limits how and when the utility can be an Additional Insured on its liability policy – is that OK?

- **We’d try to avoid that.** Some contractors will try to redefine or direct how their insurance policy is supposed to work. Typically, this wording is inserted into the contract between the contractor and the utility, and not in the contractor’s insurance policy itself. Example:

“...the Utility is an Additional Insured on Contractor’s policy, but only to the extent of the actual negligence of the Contractor.”

- We suggest that such extraneous contract terms be avoided if possible, as they unnecessarily complicate the contract and create confusion, and may conflict with the way that the contractor’s own insurance company intends for their policy to work.

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COMMON QUESTIONS – INSURANCE REQUIREMENTS

We know what mutual indemnification is, but how does mutual Additional Insured status work?

- **Good Question!** Relatively little benefit has been demonstrated by this practice – but potentially much confusion.
- Disputed fault or negligence between the parties can typically render the benefits of Additional Insured status almost useless.

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“BELT & SUSPENDERS” PROTECTION

- The Indemnity Clause spells out the contractor’s or vendor’s contractual responsibility to protect the utility against liability and claims arising out of contractor’s or vendor’s products, services or activities
- The Insurance Requirements are intended to assure there is some form of independent financial capability to respond to contractor’s or vendor’s liabilities & its responsibility to protect the utility
- While the two provisions are complementary, they also need to operate somewhat independently from one another

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TYPES OF INSURANCE OFTEN REQUIRED BY CONTRACT

- **Commercial General Liability** – coverage for bodily injury and property damage to third parties arising out of operations, premises and products
- **Auto Liability** – coverage for bodily injury and property damage to third parties arising out of use of motor vehicles
- **Workers' Compensation** – coverage for medical costs and wage replacement arising out of injuries or disease to employees
- **Employer's Liability** – stop-gap coverage for employee injuries not otherwise covered by Workers' Compensation

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TYPES OF INSURANCE OFTEN REQUIRED BY CONTRACT

- **Excess Liability** – additional limits above primary limits of required General Liability, Auto Liability and Employer's Liability coverages
- **Professional Liability** – coverage for financial loss to third parties arising out of negligent errors or omissions in providing professional advice or services (e.g., design, engineering, etc.)
- **Pollution Liability** – coverage for environmental spills and cleanup to land and water
- **Cyber Liability** – coverage for loss and expense due to breach of private data / information

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ADDITIONAL INSURED STATUS

- Additional Insured status is not granted by contract alone; must have an endorsement to the contractor's insurance policies to confer status
- Aligns the contractor's insurance coverage with the obligation to protect the utility against liability arising out of the contractor's operations and activities performed on behalf of the utility
- Allows the utility direct and immediate access to and defense by the insurer and insurance policy(ies) that the contractor maintains for the protection of both the contractor and the utility
- Keeps both the contractor and the utility "on the same side of the table" vs. assuming an adversarial position against one another – the utility has the same rights and protections as the contractor
- Reinforces the intent of a Waiver of Subrogation – an insurer cannot attempt to force recovery from one of its own insureds

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ADDITIONAL INSURED VS. INDEMNIFICATION

Additional Insured

- Transfers the risk to insurer with financial means
- Defense coverage
- Insurer bound by duties of good faith and fair dealing

Indemnification

- Contractor may not have financial means to pay for the loss
- No defense coverage, fees probably not recoverable
- Contractor can litigate zealously

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EVALUATING CERTIFICATES OF INSURANCE

- Review for compliance with what was asked for in the contract with the contractor or vendor
- Check for accuracy of coverage dates, policy limits, and policy numbers
- Correct parties on Certificate?
 - Contractor / vendor properly identified? Same party as in the contract?
 - Utility company properly named as Additional Insureds?
 - Are parent / subsidiaries / affiliates of the utility named?
- Note: Certificates of Insurance do not in and of themselves confer coverage. Not a binding document.

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EVALUATING CERTIFICATES OF INSURANCE

- Remember – a Certificate of Insurance is only a representation of what is in the policy – it is not a legally enforceable instrument

While it is important that you are relying on an accurate Certificate of Insurance, regardless of how much effort is expended to have the Certificate completed a certain way or to your satisfaction – *only the actual terms and conditions of the policy itself will govern how coverage is determined*

If it's not in the policy, it can't be on a Certificate. If it's on a Certificate, it must be in the policy.

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YOU CAN LEAD A HORSE TO WATER, BUT.....

“Our insurance requirements are too strict and require too much!”

“Why does this apply to the small, local contractors we have always used?”

“If you don’t make an exception, the project will be delayed and it’s your fault.”

“Nothing is going to happen. This contractor is just doing [fill in the blank].”

“But, he used to work here. Our insurance should cover him.”

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