

## Keep The Risk Where It Belongs

### I. Introduction

There are two very important questions you should ask when seeking to hire any type of contractor or subcontractor. The first and very obvious question is whether or not your contractor is licensed and qualified to do the work you're hiring him or her to do. The second and often the most important question is if your contractor has insurance.

Many times, the second question is not asked because we automatically assume that if the contractor is licensed then they must have insurance. Or, even if we ask and are assured that they do, we fail to verify that coverage is in place or determine if the coverage is adequate for the risk to which we are exposed. By failing to ask the question directly and verify the answer, you may find yourself with greater loss exposure and potentially even a lawsuit.

There are at least two types of insurance that a contractor should have: Liability and Workers Compensation Insurance.

### II. Managing the Exposure

The key to managing your loss exposure is not merely obtaining certificates of insurance, but establishing a risk management/transference program. An effective transference program can not only protect your company, but may also result in cost savings on your insurance premiums.

As a general guidelines, an effective program should include the following elements:

- A. If you have any work performed on your premises by anyone other than a direct employee, you must ensure that the party performing the work is adequately insured to protect *your* interests. This means that you must:
- Obtain Proof of insurance (certificates of insurance) for both Workers Compensation and General Liability (GL). It is not sufficient to merely ask they have insurance; it is incumbent on you to verify this.\*
  - Ensure that they have adequate limits. As a general rule, their GL Limits of Liability should be equal or greater than your own. Failure to ensure that a contractor has adequate limits of liability may expose you to monetary loss when the contractor's policy limits are exceeded.

\* NOTE: Liability for Workers Compensation coverage is set by statute in the employer's jurisdiction. For Workers Compensation, proof that coverage exists is sufficient.

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- Have appropriate contractual provisions in place to ensure that you are notified in the event of cancellation or non-renewal of their insurance policy.
- B. If your company sells or distributes goods for others without altering the product, you should request to be named as a vendor or additional insured on the supplier's CGL/Products policy.
- C. If your company is having substantial work performed (new construction, renovation) or has long-term contracts with other parties, you should request additional insured status on the other parties' CGL policies.
- D. If your company has critical work performed by other parties, you should request additional insured status on the other parties' CGL policies. Examples would include:
- heat treating, other processing
  - suppliers of major/critical components
  - facility/equipment maintenance
- E. If your company uses temporary employees, you should request additional insured status on the temporary agency's GL policy.
- F. There should be a procedure in place for your attorney to review all contracts to protect your company from assuming liability (or obligation to assume the financial consequences) for the actions of others over which you exercise no control.

The review should target:

- Indemnification and hold harmless agreements (in whose favor?)
- Insurance requirements
- Additional insured status (in whose favor?)

**Your company should refuse to allow anyone to perform work on your premises or on your behalf if the contractor does not meet the above requirements.**

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### III. Risk Transfer / Additional Insured Status

Risk transfer involves an attempt to allocate potential legal liabilities that could arise in connection with the performance of a contract between the parties to the contract. The rationale behind these transfers is to make the party with the most control over the risk responsible for suffering the financial loss should it fail to prevent such losses from occurring. That is, to “**keep the risk where it belongs.**” The provisions used to affect such risk transfers are hold harmless and indemnification agreements and the extension of additional insured status on liability insurance policies.

**It is important for you to know whether your company takes on additional liability risk from others, or whether your contract transfers liability risk to others.** Transfer of risk can occur through hold harmless and indemnification clauses and/or through the extension of additional insured status on liability insurance policies.

Virtually all hold-harmless agreements contain an indemnification agreement under which at least one of the contracting parties agrees to **indemnify** another party, as well as **hold** that party **harmless**. The distinction between the terms "hold-harmless" and "indemnification" is not significant as the net effect is very similar. Also, it should be pointed out that such clauses in contracts do not eliminate the tort liability of either party to the contract.

**Additional Insured** – “Additional Insureds” are those individuals or entities who generally are not automatically included as insureds under the liability policy of another, but for whom the policyholder provides a certain degree of protection under its liability policies. An endorsement to the policy is typically required to affect additional insured status for these parties.

There are very valid reasons for one party to require another to add it as an additional insured on the other party's liability policies. The most important of these reasons is to give the additional insured direct rights in the policyholder's liability policies. This provides the additional insured with a right to an immediate defense by the policyholder's insurer. An additional insured is also assured that the policyholder's GL policy will cover the additional insured's defense costs in addition to policy limits.

Additional insured status does not provide the additional insured with coverage for all types of liability it might incur in connection with a project. Most additional insured endorsements contain restrictions and limitations with respect to the coverage they provide. The coverage provided to an additional insured should correspond to the scope of the contractual undertaking. For example, a product manufacturer may extend additional insured status as a vendor to one of its retailers. This would mean that the retailer is an additional insured on the manufacturer's liability policy only with respect to the retailer's operations as a seller of the manufacturer's product. No other manufacturer's products and no other operations of the retailer would be covered by the manufacturer's liability policy.

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### IV. Contract Considerations

In addition to utilizing the following contractual provisions, it is also crucial to:

- Maintain good housekeeping practices and facility maintenance, good tool/equipment/material control (maintenance, storage).
- NEVER allow others to use/borrow tools or equipment (especially ladders, work platforms – powered and non-powered, scaffolding, and material handling devices).

All contracts should contain an Indemnification and Hold-Harmless clause in which the other parties agree to defend, indemnify and hold harmless your company for claims, losses, lawsuits and causes of action arising from the other parties' activities under the contract.

**NOTE:** *In the indemnification/hold harmless clauses, look for two common errors:*

1. *One party assuming liability for the other party's sole negligence (this is typically inappropriate as risk allocation should generally aim to place the risk with the party with the greatest control of that risk, as mentioned above).*
2. *Use of the terms "personal injury" or "injury" rather than "bodily injury" (they should adhere to the precise language and terms that are defined in your General Liability policy; therefore, the term should generally be "bodily injury").*

The written contract should contain an Insurance Requirement Clause. At a minimum, this clause should contain statements:

- regarding the other parties' agreement to maintain current specified insurance coverages with "qualified" companies and with specified limits;
- indicating requirements to furnish proof of insurance (certificates of insurance), maintain coverage in force for the duration of the contract, and notify the insured of policy cancellation, non-renewal, or material changes in the policies; and
- indicating requirements for additional insured status where appropriate.

You must properly manage and enforce the contractual rights granted in the Insurance Clause. To do this you must:

- review certificates for proper coverages, limits, and effective dates;
- review certificates for additional insured status where required by contract;
- follow up when a certificate is not received in a timely fashion; and
- NEVER allow the other party to start work until they have satisfied the *Insurance Requirements* provisions in the contract.

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Where Additional Insured Status is required, you must:

- require that a copy of the additional insured endorsement be attached to the certificate of insurance; and
- assure that the additional insured endorsement language corresponds to the contractual requirements. (e.g., if the contract specifies that additional insured coverage will be provided on a primary basis, make sure that the additional insured endorsement provides coverage on a primary basis).

Some insurance carriers issue additional insured coverage on an excess basis. Such a carrier would provide no coverage until the additional insured's (your) carrier had exhausted its limits. This is not what most parties contemplate when they request additional insured status, and this is not what your company should agree to. Your policy should be excess over the other parties' additional insured coverage.

## V. Obtaining Certificates of Insurance

All legitimate, insured contractors will be happy to present their Certificates of Insurance. Obtaining certificates, however, is not all there is to the matter. As a certificate holder you should:

- Identify the **insurance company** that issued the certificate. Do they meet any rating requirements specified in the contract? It is also important to recognize the difference between an insurance company versus a holding company. A certificate showing the holding company is not correct.
- Verify the coverages and limits. Aggregate limits should be some multiple of the per occurrence limits.
- Verify the inception and expiration dates of the policies. Make sure all certificates are current, and that new certificates are received when policies are renewed.
- Be informed promptly whenever the policy is cancelled, non-renewed, or materially changed.

### For Additional Insureds:

- Request an actual copy of the additional insured endorsement with the certificate. (A certificate will not reveal that additional insured coverage is being provided on an excess, rather than a primary, basis.)
- Verify that the wording of the additional insured endorsement corresponds to the contractual requirements (e.g., if the contract specifies that additional insured coverage will be provided on a primary basis, make sure that the additional insured endorsement provides coverage on a primary basis).

*Please see the last page for a sample letter requesting Certificates of Insurance.*

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## VI. Assistance

For additional information or assistance in the development and implementation of a Risk Transfer Program to meet the needs of your organization, contact your Sompo International Risk Control Team or email us at: [GRSRiskControlQuestions@sompo-intl.com](mailto:GRSRiskControlQuestions@sompo-intl.com).

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### Sample Letter Requesting Certificates of Insurance

*(Name and Address of Company to Whom request is Being Sent)*

Re: Request for Certificate of Insurance

Dear \_\_\_\_\_:

Please consider this letter a formal request for a Certificate of Insurance indicating your current Commercial General Liability coverage.

The requirements for this certificate are as follows:

1. Verification that a Commercial General Liability Policy is in force *(if appropriate, add the words "and that it includes products liability coverage".)*
2. Renewal certificates will be required 15-days prior to the current policy's expiration date.
3. We must be given at least 30-days advance notice of policy cancellation.
4. Policy Limits: *(You should specify the limits of insurance that you are requiring. This should be stated in terms of the General Aggregate Limit, the Products/Completed Operations Aggregate Limit, the personal & Advertising Injury Limit, and the Each Occurrence Limit. The limits you request should be at least equal to the limits on your Commercial General Liability policy.)*

If your insurance policy is renewed on an annual basis, we require an updated certificate each year.

Please forward all documents within thirty days to:

*(Give your company's name and address and the name of the responsible individual)*

*If you are requesting that the other party lists you as an additional insured on their policy, add this item to the list above:*

5. We request that the certificate show (name of your company) as an additional insured on your policy. We also request that you attach a copy of the additional insured endorsement to the certificate.

*If you sell products manufactured by others, and you wish to be given protection by the manufacturer's policy, add this item to the list above:*

6. We request that the certificate indicate that (name of your company) is an additional insured under a vendor's endorsement to your policy. We also request that you attach a copy of the additional insured-vendor endorsement to the certificate.