

CONTRACTS AND INSURANCE PROTECTIONS

By

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Contracting and insurance issues are present everyday in the transportation industry. Risk shifting is the name of the game. The shippers want hold harmless clauses, waiver-of-subrogation clauses, and additional insured protections. The trucking companies want the shipper's business but not without "giving up the farm." The insurance companies want to insure certain transportation risks, but often find themselves fighting coverage battles over contractual liability coverage, additional insured endorsements and other contract issues which were unanticipated at the policy issuance stage. Now the heightened concerns about homeland security and terrorism have added another complexity to the risk shifting game. At the end of the day, negotiating the right contract terms -- no matter which interest you represent -- is a necessity for survival.

I. HOLD HARMLESS (OR INDEMNITY) AGREEMENTS

Hold harmless (or indemnity) agreements are common to nearly every contract entered into in the transportation business. Such agreements usually appear as indemnification provisions in larger contracts. The primary purpose of an indemnity clause is to shift risks from one party to the other. It is an all-or-nothing proposition--you retain all the liability or give it all to the other party. By stating the allocation of liability when entering into a contract, the parties are in a better position to anticipate their responsibilities and make prudent business decisions.

A. Legal Basis for Indemnity

As a general rule of law, a contract of indemnity is an engagement to make good and save another person harmless from loss on some obligation which he has incurred or is about to incur to a third party. A claim of indemnification is a form of derivative liability which is contingent upon a finding of liability or a loss from an underlying claim. The underlying claim can be anything from a bodily injury or death claim to a property damage claim or to governmental enforcement action for, say, an environmental spill.

1. Indemnity Against Liability Versus Indemnity Against Loss or Damage

An agreement of indemnity against liability requires the indemnitor (the party doing the indemnifying) to perform an act or pay money which will have the effect of preventing harm or injury to the indemnitee (the party being indemnified). Simply incurring a legal liability, without proof of having paid money, is enough for an indemnitee to be entitled to hold harmless protection from the indemnitor. The right is triggered, for example, when a claimant obtains a monetary judgment against the indemnitee and the indemnitee has yet to pay the judgment.

On the other hand, an agreement of indemnity against loss or damage requires proof of payment by the indemnitee or the suffering of an actual loss before the hold harmless right is triggered. This would be, for example, when the indemnitee satisfies the judgment by paying the claimant.

A broad indemnity clause covers both circumstances, such as the following:

Carrier agrees to hold harmless, defend and indemnify Terminal from and against any and all claims, liabilities, expenses (including reasonable attorney's fees), losses, damages, demands, fines and causes of action arising out of....

If you are the party seeking indemnity rights, you try to make the clause as broad as possible. If you are the party doing the indemnifying, you try to make the clause as narrow as possible.

B. Interpretation of Indemnity Contracts

Indemnity provisions are interpreted under general principles of contract construction. The primary rule is to seek to ascertain and give effect to the intentions of the parties. To do this, courts examine the entire contract, the language used in the indemnity provision, the objectives of the parties and the circumstances under which the contract was entered. The indemnity obligation may be imposed only on one party. Or it may be a reciprocal mutual indemnity obligation for the benefit of both parties – each party agrees that if its negligence causes the other to incur a liability or loss, the negligent party indemnifies the other (who is fault-free).

1. Indemnity Against The Other Party's Own Negligence

On public policy grounds, courts do not favor indemnity agreements that relieve the indemnitee from liability for its own negligence. It is a tough pill to swallow to have to pay for someone else's negligence. Accordingly, such agreements are strictly construed against the party asserting the indemnity right and the party has a higher burden to meet before the provision will be upheld. The provision requiring indemnity against one's own negligence must be clear and unequivocal. If it is, it passes the public policy test and will be enforced. Otherwise, courts will not read into such indemnity provisions those terms which are neither expressly nor reasonably inferable from the terms.

Courts disagree over what constitutes "clear and unequivocal" language. Some courts will only allow indemnity against one's own negligence by a specific reference in the indemnity clause to liability for the indemnitee's "own negligence." Other courts require a lesser burden of

proof, such as a general reference to indemnifying someone for “all liability” or “any liability however caused.”

Agreements to indemnify another for the other’s intentional misconduct are subject to even greater scrutiny by courts. The general rule is that they are void as against public policy.

2. Causal Link Between the Injury and the Act

As a corollary to this rule, the triggering of an indemnity provision does not necessarily require the negligence of the indemnifying party. If the provision clearly does not require a causal connection between the injury or damage being indemnified and the negligent act of the indemnitor, then no causal link is necessary. One example would be an agreement to indemnify for liability “sustained in connection with or arising out of the performance” of contract by the indemnitee. Thus, the indemnity obligation can be triggered (a) even if the indemnitor had no control of the act creating the injury, or (b) even if the indemnitor merely breached a contract term but committed no negligence, or (c) even if the injury did not result from the work undertaken by the indemnitee but resulted from a non-negligent act of a subcontractor for whom the indemnitee is responsible. As you can see, the devil is in the wording of the indemnity agreement.

C. Statute of Limitations

The statute of limitations for a civil action based on an indemnity contract is whatever the statute is for breach of contracts. In some states, it is three years, others are more, others are less.

The cause of action on an obligation to indemnify normally accrues when the indemnitee suffers actual loss such as the making of a payment (as with indemnity against loss), or when the event for which indemnity is due occurs such as being hit with a monetary judgment (as with

indemnity against liability) At a minimum, the indemnity cause of action does not accrue from the date of bodily injury or property damage of the claimant.

D. Damages Recoverable

An indemnity contract is construed to cover all losses, damages and liabilities which reasonably appear to have been within the contemplation of the parties when the contract was made. But the indemnity contract is not extended to cover any losses which are neither expressly within its terms nor of such character that it can be reasonably inferred that they were intended to be within the contract.

1. Attorneys' Fees

An indemnity agreement is often not limited to indemnity against liability but also requires indemnity for attorneys' fees, costs and expenses incurred by the indemnitee in defending himself in the underlying suit. Such a provision is generally upheld in the courts, but there typically is the requirement that the defense be made in good faith and with due diligence and that the indemnitor had notice and opportunity to defend the indemnitee in the litigation but failed so to do.

2. Selection and Control of Counsel

Seldom do indemnity provisions set forth which party selects defense counsel for the underlying suit and controls the litigation. The party being indemnified often argues that it is a named defendant in the underlying suit and accordingly has the right to determine defense counsel and case strategy. The party doing the indemnifying often argues with equal force that it is ultimately responsible financially for the outcome of the litigation and consequently has the right to pick counsel and decide strategy. There is no hard and fast rule.

3. Punitive Damages

Where a punitive damages award is entered against the party being indemnified, the right to indemnity from another party often turns on whether the award was based on gross negligence or intentional conduct, on whether the award was based on vicarious liability or direct liability, and on whether punitive damages are specifically mentioned in the indemnity clause. Tort reform throughout the country has raised the bar in a substantial number of states for recovering punitive damages – requiring intentional conduct and direct liability. In those instances, agreements to indemnify another for such willful misconduct are generally void as against public policy.

In summary, the drafter of the indemnity agreement needs to be aware of the importance of certain terms in the clause because those terms will either enlarge or restrict the scope of the indemnity obligation.

II. SUBROGATION AND WAIVER OF SUBROGATION

Subrogation inevitably works its way into nearly every claim involving trucking accidents and losses. The property insurer pays for the damaged equipment and seeks subrogation against the at-fault party. Or a shipper proposes an agreement requiring the trucking company to waive the subrogation rights of its insurers on various claims or waive the right of recovery for any loss to the extent the loss is covered by the trucking company's insurance.

A. General Rules of Subrogation

As a general rule, upon payment of a loss under a policy of insurance the insurance company is entitled to be subrogated to any right the insured may have against a third party who

caused the loss. This rule applies in the first party insurance context (as in a payment to the insured business on its property policy) and in the third party insurance context (as in a payment to a claimant on a company's general liability policy). In either situation the insurer then goes after an at-fault third party.

1. No Subrogation Against Additional Insured

As a general rule, the subrogated insurer has no right of subrogation against the at-fault party if the at-fault party is also an insured under same insurance policy. This situation often arises when the insurer pays the property loss of the named insured and attempts to seek recovery against another who happens to be an additional insured on the same insurance policy. If the at-fault party is an additional insured, the right of subrogation does not exist because an insurer may not subrogate against its own insured.

2. Derivative of Insured's Rights

The insurer's rights are derived from the insured and apply only to rights that the insured possesses. If the insured has no right against a third party, neither does the insurer. In other words, no right of subrogation exists if the insured's damages occurred through no fault of another. Similarly, any defenses of the wrongdoer against the insured are good as against the subrogated insurer. For instance, if the subrogated insurer filed suit against the wrongdoer after the expiration of the statute of limitations on the claim, the wrongdoer has a complete defense to the suit.

B. Waiver of Subrogation

An extension of this rule concerns waiver of subrogation. The waiver of subrogation issue always seems to surface in the drafting of a transportation contract. In negotiating an agreement, a shipper may want the trucking company to agree to waive its insurer's right of

subrogation on various claims or waive the right to recover for any loss covered by insurance.

The purpose of the request is to shift the risk of loss from the parties onto the insurer. Let's say the party agrees to the waiver terminology. When the party's insurer later pays the party's loss and seeks subrogation against the at-fault party, the insurer often has no right to do so because the party agreed to the waiver in the agreement.

1. Express Waiver

As a general rule, the terms of a contract are construed to achieve the intent of the parties at the time the contract was entered into. Parties may bind themselves as they see fit by a contract unless the contract would violate the law or is contrary to public policy. However, contracts which attempt to relieve a party from liability for damages incurred through negligence are discouraged under the law and narrowly construed by the courts. Any such clause attempting to do so must show that this is the intent of the parties by clear and explicit language.

Where in a contract a party clearly agrees to waive his right of recovery against a third party to the extent of insurance coverage or clearly agrees to waive his insurer's rights of subrogation, this express waiver is generally enforced in the courts. The subrogated insurer is bound by the waiver and may not recover against the other party to the contract. This is so even if the insured failed to get the insurer to include in the insurance policy a provision allowing the insured to release third parties to the extent of insurance coverage or to waive the insurer's subrogation rights in a contract with a third party. This rule is harsh from the insurer's perspective and is one reason why there has been much litigation over this issue. The outcome of the cases quite often turns on how clear and explicit is the waiver of subrogation language in the contract.

Of course, disputes are minimized if the insurance policy does allow the insured to release third parties from liability or waive the insurer's subrogation rights prior to the occurrence of the covered loss. This way the insured and insurer are on the same page from day one. Typically, the cost of including such a provision in the policy is reflected in the amount of insurance premiums charged. The cost can be fairly steep depending on the circumstances.

In sum, the negotiation of trucking agreements invariably involves a decision on whether to agree to waive subrogation rights of one party's insurer. The contractual language usually appears in the indemnity or insurance clauses of a larger contract. Knowing the significance of the waiver issue can go a long way toward reducing surprises when claims arise later on.

III. ADDITIONAL INSURED INSURANCE

Similarly, negotiating the indemnity and insurance clauses of a larger transportation contract nearly always involves a request to have one party named as an additional insured on the other party's insurance policies. This is another risk-shifting measure. It is accomplished through an additional insured endorsement to the insurance policy. For the party being added as an additional insured, this reduces its own insurance-related costs and policy premiums.

A. Endorsement to Insurance Policy

An additional insured endorsement is an endorsement to an insurance policy which adds to the definition of "insured" by naming entities or describing groups of entities which are to be accorded insured status, subject to limitations in coverage.

1. Specific Endorsement

The addition may be made by specifically listing in the endorsement the name of the

to-be-added entity. With the specific endorsement approach, the insurer is required to issue the endorsement each time an additional insured request is made.

2. Blanket Endorsement

Or the addition may be made by way of a blanket endorsement – such as whenever the insured agrees in a contract to have another party named as an additional insured. For instance, the endorsement may say, “This endorsement includes as an insured any person or organization whom you are required to add as an additional insured on this policy under a written contract.” Thus, the blanket endorsement requires no further action by the insurer after the insurance policy is issued.

3. Certificate of Insurance

Sometimes transportation contracts require a certificate of insurance be sent to the additional insured party to satisfy the party that it has been added to the insurance policy as an additional insured. For many people this is all they want to see in order to be assured of their additional insured status. Unfortunately, it is not enough to get the certificate to be assured of the desired additional insured coverage. The certificate does not explain or elaborate on the coverage provided by the insurance policy or the exclusions contained in the policy.

B. Scope of Coverage

The scope of coverage lies at the heart of nearly every additional insured coverage dispute. What is the coverage actually being provided? The simple answer is that the scope of coverage of the additional insured insurance is typically governed by the language used in the additional insured endorsement, the main policy, the certificate of insurance, and/or the contract requiring additional insured status. But with so many different documents involved and with complicated fact scenarios, there are often disputes over additional insured insurance.

The most prevalent problem is whether the insurance covers damages caused by the additional insured's own negligence or whether it only covers damages caused by the negligence of the named insured for which the additional insured is vicariously (and derivatively) liable.

The additional insured endorsement typically defines the scope of coverage this way:

The 'Persons Insured' provision is amended to include as an insured the person or organization named below, but only with respect to liability arising out of the operations performed by the named insured.

Or alternatively,

Any person or organization with which the named insured is obligated by virtue of a written contract to provide insurance such as is afforded by this policy, but only with respect to operations by or on behalf of, or to facilities used by, the named insured.

The common perception is that these endorsements only cover damages caused by the negligence of the named insured for which the additional insured is vicariously (or derivatively) liable. However, courts have often concluded that the endorsement language is ambiguous as to whose negligence is excluded from coverage. The "arising out of" and "with respect to" language is very broad. Some courts have interpreted the endorsement liberally in favor of insurance coverage for the negligence of the additional insured; other courts have gone the other way and ruled in favor of the insurer.

Another point of contention is the application of exclusions and other limiting terms within the main policy. Depending on the specific wording of the endorsement, policy, certificate of insurance, and/or the underlying contract, limitations on coverage through exclusions or other terms may or may not be enforced. There is no hard and fast rule, other than the rule that ambiguous policy terms shall be interpreted in favor of the additional insured.

C. Rights and Duties Running To and From the Additional Insured

One of the primary benefits of additional insured coverage to the additional insured is the insurer's duty to defend the additional insured in a claim. However, the duty to defend does not arise until the additional insured has tendered the defense to the insurer. An additional insured does not always remember to notify the insurer in a timely manner. Some courts state that simple notice to the insurer is enough to trigger the duty to defend, such as when the insurer has information of the truck wreck and the parties involved. Other courts require an explicit demand by the additional insured to the insurer before the defense obligation is triggered, such as a demand letter specifically naming the policy and stating the facts of the claim.

D. Conflicts of Interest

Quite often, the named insured and additional insured are both afforded coverage for an accident but their interests are directly adverse to one another. Each may be stating the other caused the accident. The insurer is caught in the middle. The insurer has a duty of acting in good faith toward each insured and not elevating the interest of one insured over the other. Accordingly, the insurer usually retains separate counsel for each insured. But when this is not done, conflicts can surface between counsel, insurer, named insured and additional insured.

E. Reservation of Rights

When notified of a claim where insurance coverage issues exist, an insurer will usually send the insured a reservation of rights letter whereby the insurer reserves its rights to deny coverage at a later date if the denial is supported by the policy and the facts of the claim. This is the insurer's way of preserving its defenses to coverage issues which may crop up in the future. Additional insureds are accorded the same status. They will get such a letter from the insurer just as the named insured will get such a letter.

F. Failure to Provide Additional Insured Status

One party's promise to procure additional insured coverage for another is quite often breached when the party fails to procure such coverage. This situation arises when the insurance policy has no blanket additional insured endorsement and instead requires notice to the insurer and a request by the named insured to have a specific endorsement issued for an additional insured. The result is that no additional insured endorsement is ever issued, and the party to be named as an additional insured has no recourse to the insurer for insurance coverage. The remedy for the purported additional insured is a breach of contract claim against the party who promised in the contract to procure additional insured coverage.

G. No Right of Subrogation Against Additional Insured

As stated in the waiver of subrogation section above, an insurer has no right of subrogation against an additional insured for payments made to the named insured for a loss. This is sometimes referred to as the anti-subrogation doctrine in the context of additional insureds. It is a common defense utilized by an additional insured when the insurer is seeking subrogation. The doctrine is a broad one. But it is not always applicable and the outcome is not always easy to predict. For instance, a party may be under the mistaken belief that it is an additional insured when in fact it does not meet the definition of such. Or a policy exclusion or limitation may eliminate coverage for the additional insured and leave it exposed to the subrogation claim.