Some Carriers Offer Broader Coverage, Or Can Be Persuaded to Do So

New ISO Forms Contract Contractual-Liability Insurance

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Many policyholders believe contractual-liability coverage provides protection against breach of contract. Obviously, such a belief is in error, and the knowledgeable agent or broker can correctly recite to the policyholder that contractual-liability coverage insures against the liability of another assumed by contract.

But does your understanding of contractual-liability coverage stop there? Do you know that since the Insurance Services Office radically changed the contractual-liability provisions in its commercial-general-liability policies about two years ago, a variety of different contractual-liability coverage provisions can be found from one CGL and umbrella-liability form to the next, depending on the insurer with which you place your client's coverage?

This article provides an abbreviated history of contractual-liability coverage, explains how ISO's newer form compares with historical provisions, and discusses what issues all agents and brokers should consider when placing CGL and umbrella-liability insurance for their clients. The amount of coverage afforded by the different contractual-liability provisions available in the CGL and umbrella-liability market varies dramatically from one form to the next.

Before ISO radically changed the contractual-liability provisions of its CGL policy, ISO's standard-form CGL policy did, indeed, provide coverage for contractual liability. Such coverage insured the policyholder against liability of another for property damage or bodily injury that the insured assumed under contract.

For example, if the policyholder entered into a contract with another party and agreed to defend, indemnify and hold harmless that other party for property damage or bodily injury, such an assumption of liability would be covered. However, the policy language did not expressly explain how, if at all, the defense costs incurred.by or on behalf of the policyholder's indemnltee were to be dealt with.

Were such defense costs treated as typical defense costs under the CGL policy, so that they were paid out under the "supplementary-payments" provisions and therefore in excess of policy limits? Or, in contrast, were such defense costs treated as "damages" that were covered, but were paid out under the limits of the policy?

Defense Costs Are 'Damages'

As a matter of practice, most insurers and policyholders agreed that such defense costs were "damages" that were covered under the contractual-liability coverage provisions of the CGL policy. Because the parties deemed such costs as "damages" and not defense costs, the parties also typically agreed that such coverage applied against and eroded the limits of the policy (i.e., they were not paid out under the "supplementary-payments" provisions of the policy).

About two years ago, ISO landed a bombshell of an interpretation on the policyholder community. ISO announced that its contractual-liability provisions were never intended to cover defense costs incurred by or on behalf of the policyholder's indemnitee.

what?! After decades of using the same form of Contractual-liability coverage provisions that almost everyone in the industry -- policyholder and insurer alike -- interpreted as covering defense costs, ISO said that everyone was wrong.

Instead, ISO issued new contractual-liability provisions that expressly delineated what, if any, coverage for such defense costs was provided. However, what used to be explained in a paragraph now was explained in a page of text. Why was so much text needed?

ISO created a complicated formula for determining whether, and to what extent, defense costs were covered. The provisions also provided, under certain circumstances, that the CGL insurer had a duty to defend the party the policyholder was contractually obligated to indemnify. A page of text was needed to explain this convoluted coverage.

I think you can gather what I think of ISO's newer policy provisions. I would throw them out of any policy I reviewed, because they are too complicated, problematic and "below market" with respect to what is available today.

Variations Proliferate

whether CGL and umbrella-liability insurers were using a variety of contractual-liability provisions before ISO radically changed the provisions in its standard-form CGL policy is hard to say. What can be said is that ISO's changes focused attention on these provisions like never before. As more professionals compared coverage provisions from one carrier's form to the next, and as the insurance market continued to remain soft, variations of contractual-liability provisions proliferated at an increasing pace -- some expanding coverage, some limiting it.

One of the most readily observable expansions of coverage came in the form of simple, straightforward provisions regarding defense costs incurred by or on behalf of the policyholder's indemnitee. Some carriers, in about two sentences worth of text, provided that contractual-liability coverage extended to defense costs, and that such costs were paid under the "supplementary-payments" provisions of the policy.

Another of the expansions of coverage was the extension of contractual-liability coverage to personal injury and advertising injury. If you go back and look at older forms of CGL and umbrella-liability policies, you will note that contractual-liability coverage extended to property damage and bodily injury only. But contractual-liability coverage is also needed for personal injury and advertising injury.

If you fend this hard to believe, ask for copies of some of your clients' contracts and look at the indemnity provisions in those contracts. I'll bet you will discover what I discovered when I did this exercise. I found that many of my clients were, indeed, agreeing to defend, indemnify and hold harmless other parties for offenses, liabilities and claims that fell within the coverage afforded by the personal-injury and/or advertising-injury provisions of CGL and umbrella-liability policies. They had no idea that their contractual-liability coverage extended to property damage and bodily injury only.

Not all carriers offer this coverage in their "off the shelf" forms, mind you; in fact, only a few do. But in today's soft market, many CGL carriers will extend contractual-liability coverage to personal injury and advertising injury if asked.

Coverage Limitations

While some of the variations proliferating in the market were expanding coverage, others were limiting it. Some carriers included in contractual-liability provisions the word "tort," so that coverage extended only to the "tort liability" of another assumed under contract.

When I first saw that language in a

policy, I asked myself why the carrier had inserted the word tort in front of liability. I noticed that the phrase "tort liability" was actually a defined phrase in the policy, namely liability imposed by law in the absence of contract. I said to myself, well, isn't that the exact essence of contractual-liability coverage?

I asked the underwriter to explain the reason for the limitation, stating my belief that the language rendered ambiguous the contractual-liability coverage afforded by the policy. He explained that the limitation did not bar coverage for the liability that the insured assumed by contract; rather, the limitation referenced the liability of the policyholder's indemnitee.

In other words, if the insured's indemnitee faces tort liability, that liability could be covered. If, however, the insured's indemnitee faces contractual liability-liability that the indemnitee assumed by contract--that liability would ***not*** be covered.

Therein lies the trap of the limitation! A little known fact, even for lawyers, is that a private-party indemnitor can, sometimes unwittingly, assume the contractual liability of an indemnitee, in addition to that indemnitee's tort liability.

Daisy Chain of Liability

Here is how such a daisy chain of contractual liability can be created by an insured. Assume the insured enters into a contract with another party -- a general contractor, for example -- and agrees to defend, Indemnify and hold harmless the other party for all liability arising out of the activities that are the subject of the contract. Let's call this other party the "Indemnitee."

Assume further the insured does not put any limitation on its contractual-liability obligations to the Indemnitee. Assume also that the Indemnitee enters into a contract with another party -- a subcontractor, for example -- to do some work in connection with the subject of the contract between the Indemnitee and the insured.

Assume finally that the Indemnitee agrees by contact with that other party to defend, indemnify and hold that other party harmless.

Depending on the facts and the state's law at issue, the contractual liability of the Indemnitee could well be liability that falls within the defense and indemnity obligations of the insured. If the insured's contractual-liability coverage is limited to the tort liability of another, the insured in this hypothetical faces liability it has assumed by contract that is broader than the contractual-liability coverage afforded by the insured's policy!

The resolution to this potential problem is to get the insurer to remove the limitation of "tort liability." In today's soft market, most CGL carriers are willing to eliminate the limitation. It would seem, though, that even if the market begins to harden, this limitation still could be removed if the insured can demonstrate that it uses indemnification provisions in its contracts that limit its contractual liability to the "tort liability" of the indemnitee.

Checklist of Considerations

There likely are variations in contractual-liability provisions in addition to those discussed in this article. It is important to realize that all "off the shelf' CGL and umbrella-liability forms must be independently examined so that the contractual-liability coverage afforded can be analyzed and, if need be, amended. To assist with an analysis of any policy form, here is a checklist of some of issues that should be considered:

> Coverage for defense costs should be provided by express provisions, and such coverage should be paid out under the "supplementary-payments" provisions of the policy, so that the coverage does not erode policy limits.

> The coverage should not be limited to property damage and bodily injury; it also should apply to personal injury and advertising injury.

> The coverage should not be limited to the "tort liability" of another; the insured's contractual liability could extend to the contractual liability of the insured's indemnitee, and the coverage should be coextensive with the insured's liability.

Agents and brokers should have a good understanding of the history and current variations of contractual-liability coverage available in the CGL and umbrella-liability markets. By knowing what to look for, and what to ask for, producers can maximize coverage for the client, avoid potentially uncomfortable situations where the client's liability is not covered by the insurance that was placed, and, perhaps, distinguish themselves from other agents and brokers who know nothing more about contractual-liability coverage than that it is not intended to apply to breach of contract.

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