

# INSURANCE BULLETIN

BULLETIN #2

## Risk Transfer Techniques

CNA and NESPA are proud to provide you with this information. We trust that you will find it useful in understanding the insurance and risk management issues associated with your business.

### Risk Transfer

Many firms frequently contract with other firms to provide services or perform some type of work. Examples range from contracting of janitorial services to installation of spas and swimming pools.

During the course of these operations, accidents may arise that cause bodily injury and/or property damage to the contracting firms, their employees, contracted workers or the public. Ideally, liability should be transferred to the party who has the most control over the exposures which could cause a loss. However, liabilities sometimes end up being transferred to the party who has the least leverage in contract negotiations. Owners usually try to transfer liabilities to general contractors. General contractors try to transfer liabilities to subcontractors. Subcontractors try to transfer them to sub-subcontractors, and so on.

Everyone knows that selecting qualified, reputable, safety oriented contractors is the key to maintaining a safe job site, but accidents can still happen. In the event of such a mishap, risk transfer mechanisms can prove invaluable. Risk transfer mechanisms allow a firm to shift its direct, contingent or vicarious liability to another party. **Since individual state laws as well as contractor operations will vary, be sure to consult your legal counsel on the validity of the risk transfer techniques discussed below and the approach that best meets your firm's needs and loss exposures.**

### Certificates of Insurance

A certificate of insurance is a form issued by the contractor's insurer (or agent), which lists the coverage(s), expiration date(s) and limits contained in the contractor's insurance policies. The certificate may also describe special endorsements that have been added to the policy (e.g., additional insured endorsements, waiver of subrogation endorsements, special notice of cancellation endorsements, etc.)

Spa and swimming pool companies should always include provisions in their contracts that require their subcontractors to obtain and maintain workers' compensation, general liability and automobile liability insurance and umbrella liability insurance.

**Certificates of insurance do not alter the terms or conditions of the policies listed on the certificate.** If a certificate misstates a key point, or lists a coverage that doesn't exist, the policies' actual terms and conditions are the ones which will prevail.

Spa and swimming pool companies should require proof of these coverages via certificates of insurance from all subcontractors prior to the start of the subcontractor's work. However, simply requesting and receiving a certificate of insurance from a subcontractor does not transfer the risk of losses, claims or lawsuits. The entity requesting the certificate of insurance should verify the subcontractor's existing:

- **Workers' Compensation Insurance** — In many states, if a subcontractor's employee is injured, and the subcontractor doesn't carry workers' compensation insurance, then the hiring contractor's workers' compensation coverage must respond to pay for the workers' injuries. Such payments can cause the hiring contractor's experience to worsen and premiums to rise.
- **Commercial General Liability Insurance and Umbrella Liability Insurance** — These liability limits carried by the subcontractor should match or exceed the spa and swimming pool contractor's or owner's limits. Without adequate insurance, payment of claims or lawsuits caused by the subcontractor are only backed by the net worth of the subcontractor and would most likely require the hiring contractor to sue the subcontractor.

- **Automobile Liability Insurance** — This insurance pays for liability resulting from the subcontractor's ownership or use of autos, trucks and trailers, and in some states, certain types of mobile equipment such as backhoes, graders and excavators. Here again, automobile liability limits carried by the subcontractor should match or exceed the spa and swimming pool contractor's or owner's limits.

Spa and swimming pool contractors should file subcontractor's certificates of insurance chronologically according to the soonest expiration date shown on the certificate, using a computerized diary system. Then, the spa and swimming pool contractor can request a renewal certificate before the existing coverage expires. Spa and swimming pool contractors should also require the subcontractor's insurer to provide 30 days notice prior to cancellation, non-renewal or material change of the subcontractor's coverage. Many insurance policies provide as little as 10 days notice.

### Hold Harmless Agreement

Spa and swimming pool contractors should require subcontractors to sign a hold harmless agreement, which is a non-insurance risk transfer technique.

Hold harmless agreements (sometimes referred to as indemnity agreements) are non-insurance provisions in contractual agreements used to transfer the risk of claims and lawsuits from one party to another. They often are incorporated into spa and swimming pool construction contracts, service job contracts, purchase order agreements, lease agreements, management agreements and consulting agreements.

In general, there are three types of hold harmless agreements: limited, intermediate and broad.

- **Limited** — Party A holds Party B harmless, but only for the sole negligence of Party A.
- **Intermediate** — Party A holds Party B harmless for negligent actions of Party A and for liability that arises from the joint negligence of both parties. However, Party A does not hold Party B harmless for Party B's own sole negligence.
- **Broad** — Party A holds Party B harmless for actions up to and including situations in which Party B is solely negligent.

#### Example of Broad Form:

Spa and Swimming Pool Subcontractor A signs a job contract with Contractor B. The contract includes a broad form hold harmless agreement favoring Contractor B. Contractor B negligently injures Passerby C. If the hold harmless agreement is successfully enforced, Spa and Swimming Pool Subcontractor A will have to pay Contractor B's liability damages (including legal defense costs) resulting from the injury to Passerby C. Contractor B won't have to pay anything.

- **Spa and Swimming Pool Subcontractor A** — the hold harmless grantor (indemnitor)
- **Contractor B** — the wrongdoer (indemnitee)
- **Passerby C** — the innocent victim

Industry standard contracts are often used as starting points by lawyers and others drafting construction job contracts. Two such standard contracts are:

- AIA Document A201, General Conditions of the Contract for Construction
- AGC Document No. 600, Subcontract for Building Construction, Associated General Contractors of America

Contractors and subcontractors should always consult their legal counsel when drafting a hold harmless agreement in a contract or before signing a contract containing a hold harmless agreement. Courts will generally uphold hold harmless agreements if they clearly reflect an agreement by both parties to transfer liability and if the transfer is not against public policy in the particular state. However, since there is always a chance that a court may strike down a contract's hold harmless provision, it's prudent to back up hold harmless provisions in contracts with other risk transfer techniques, such as:

- Additional Insured Endorsements
- Owner's and Contractor's Protective (OCP) Policies
- Wavers of Subrogation

### Additional Insured Endorsements

There are many ways that owners and hiring contractors can end up in litigation arising out of acts or omissions of subcontractors. Therefore, owners and hiring contractors should require subcontractors to add them as additional insureds on the subcontractors' commercial general liability and umbrella liability policies. This must usually be accomplished by adding an additional insured endorsement to the subcontractor's policy.

Commercial general liability (CGL) policies can be endorsed to add companies that do business with the named insured (policy holder). A company that is added as an insured by endorsement to a policyholder's CGL policy is considered to be an 'additional insured' under that policyholder's policy.

An additional insured endorsement complements an existing hold harmless provision in a job contract and can protect a party from liability arising out of another party's negligence. In this way, the risk transferor is not solely dependant on the validity and ultimate enforceability of the hold harmless agreement for protection. Additional insured endorsements can cover the additional insured for accidents that are caused by the named insured's involvement with a job.

Additional insureds are usually only covered for operations and actions which involve the named insured (policyholder) in some way. In this respect, additional insureds receive narrower coverage than Named Insureds, since Named Insureds are automatically covered for any business activity which isn't specifically excluded by the policy. Policy exclusions apply equally to Named Insureds and additional insureds unless specifically noted otherwise in the CGL policy or on the additional insured endorsement.

#### Example:

Owner A hires Spa and Swimming Pool Contractor B, who accidentally injures Passerby C. Passerby C sues both the Owner and the Contractor. Since the Owner has been added as an additional insured under the Spa and Swimming Pool Contractor's CGL policy, the Spa and Swimming Pool Contractor's insurer must pay the Owner's legal defense costs and liability damages that result from Spa and Swimming Pool Contractor B's actions.

- **Owner A** — the additional insured
- **Spa and Swimming Pool Contractor B** — the wrongdoer (and Named Insured)
- **Passerby C** — the innocent victim

## Owner's and Contractor's Protective Policies (OCP)

OCP policies protect the interests of someone hiring a contractor, typically the owner of a project. They are purchased by the hired contractor, but actually insure only the party hiring the contractor, typically the project owner. OCP policies list the hiring entity as the policy's Named Insured. Owners may require contractors to purchase these policies for the owner's benefit. Contractors usually contemplate the costs of such coverage in their project bids. Subcontractors may also be required to buy these policies for general contractors. The hiring party (the named insured on the OCP policy) is covered for liability arising out of operations, acts or omissions of the contractor. In addition, the hiring party is covered for its general supervision of the contractor.

### Example:

General Contractor A hires Spa and Swimming Pool Subcontractor B to do some work. Spa and Swimming Pool Subcontractor B injures Passerby C. The injured Passerby sues both the Spa and Swimming Pool Subcontractor and the General Contractor. The OCP policy won't cover the Spa and Swimming Pool Subcontractor (the Spa and Swimming Pool Contractor hopefully carries their own CGL insurance for that). The OCP policy will cover the General Contractor's defense costs and liability damages, plus it will cover liability that results from the General Contractor's negligent supervision of the Spa and Swimming Pool Subcontractor.

- **Party A** — the General Contractor (and OCP Named Insured)
- **Party B** — the wrongdoer (Spa and Swimming Pool Subcontractor)
- **Party C** — the innocent victim

The coverage provided by OCP policies can be broader or narrower than some additional insured endorsements. Even if OCP coverage is narrower, OCP policies have two advantages, which might make them attractive to an owner versus additional insured endorsements:

- OCP policies have a separate limit of liability that doesn't have to be shared with the purchasing contractor. Additional insureds (the owner or hiring contractor) share policy limits with the Named Insured (the subcontractor).
- OCP policies are written in the name of the hiring entity, so the hiring entity will be notified if the coverage is canceled. Additional insureds sometimes aren't notified when the policy covering them is canceled.

One disadvantage of an OCP policy as compared to additional insured coverage under a subcontractor's policy is the lack of products/completed operations liability coverage for claims and lawsuits that may arise from the project years in the future. OCP policies often provide coverage for premises and ongoing operations only. Upon completion of the project, coverage under the OCP policy typically ends.

## Waivers of Subrogation

Owners and general contractors often include waivers of subrogation in construction job contracts, including spa and swimming pool job contracts. The waiver takes away a subcontractor's right to sue the owner or general contractor in certain (sometimes all) circumstances.

If a subcontractor waives its right to sue, it also affects the subcontractor's insurer. The insurer loses the right to seek recovery from the negligent party for insurance claims paid to or on behalf of the subcontractor.

Usually insurers have no independent right of their own to sue negligent parties for reimbursement of claims the insurer has paid to or on behalf of their policyholders. Insurers have to "subrogate" (take over) their policyholders' rights of recovery against wrongdoers. The process of using an insured's rights to sue a negligent party is called "subrogation". Any moneys an insurer obtains this way from a negligent third party is called a "subrogation recovery". In general, insurers cannot subrogate against their own insureds or policyholders.

To avoid litigation expenses down the road, beneficiaries of waivers (owners and hiring contractors) sometimes require that the waiver-giver (the subcontractor) endorse its policy with a Waiver of Subrogation endorsement. Such endorsements verify that the subcontractor's insurer is aware of the waiver, and won't initiate subrogation actions against the owner or hiring contractor.

**Example:**

General Contractor A injures Spa and Swimming Pool Subcontractor B, but neither Spa and Swimming Pool Subcontractor B nor its insurer, can sue General Contractor A, because Subcontractor B signed a job contract prior to the injury that included a waiver of subrogation against General Contractor A.

- **General Contractor A** — the wrongdoer (and holder of waiver)
- **Spa and Swimming Pool Subcontractor B** — the innocent victim (and granter of waiver)

**Conclusion**

Risk Transfer techniques are an important part of any risk management program. They allow a firm to shift its liability to another party. Let's review some considerations that owners, general contractors, and subcontractors should take into account when accepting or transferring liability.

When accepting liability (e.g., a subcontractor accepts liability from a general contractor; or a general contractor accepts liability from an owner):

- Pay special attention to the operations of the indemnitee (the party held harmless) or additional insured. What potential claims may arise from their operations? What type of liability may be assumed?
- Always review contract language, terms and provisions with legal counsel prior to signing to determine the extent of hold harmless and indemnification protection contained in the contract. If possible, negotiate to reduce the extent of liability assumed.
- Check the Insurance Requirements section of job contracts for embedded hold harmless and indemnification agreements. Not all hold harmless and indemnity agreements are separately labeled as such. They are sometimes embedded in the Insurance Requirements section of the job contract.
- Check the Insurance Requirements section of contracts for mandated coverages that aren't provided by your policies. Uninsured contractually assumed risks exposes the indemnitor to breach of contract suits and possible financial ruin. (Breach of Contract suits aren't covered by contractual liability insurance.) Missing coverages for contractually assumed risks should be purchased from insurers or negotiated out of the job contract.
- When granting an entity additional insured status, don't provide more coverage than intended. Consider whether you intend to offer complete coverage for sole negligence of the additional insured (e.g., to back up an indemnity agreement in a contract), or only coverage for the additional insured's vicarious liability resulting from your own negligent acts or omissions.
- Carefully consider all requests for waivers of subrogation. Sometimes contractors are faced with the choice of waiving subrogation or losing a job.

When transferring the risk of loss (liability) to another entity (e.g., a general contractor transferring liability to a subcontractor; or an owner transferring liability to a general contractor; or a subcontractor transferring liability to another subcontractor who will be working for them):

- Ensure that at a minimum, hold harmless agreements protect the owner or contractor from liability arising out of the negligent actions of subcontractors and that the agreement is drafted by an attorney experienced in contract law within the jurisdiction where cases will likely be tried.

- Ensure that hold harmless agreements specify who will pay for defense costs, and whether defense costs will be paid on behalf of the indemnitee (upfront) or reimbursed to the indemnitee.
- Back up any risk transfer provisions in the job contract by being named as an additional insured on the contractor's and/or subcontractor's policies.
- Request a certificate of insurance from the contractors and/or subcontractors, which indicates additional insured status and limits of liability insurance for all needed coverages.
- Request that the contractor or subcontractor sign waivers of subrogation with respect to workers' compensation, general liability and automobile liability.

For assistance with risk transfer issues, always consult your legal counsel and your insurance agent or broker.

**Through the SPLASH program, CNA can provide a business insurance program that offers comprehensive risk control (safety) services, expert claim handling and property/liability insurance coverages designed specifically for spa and swimming pool professionals. So when your business is insured with the CNA/SPLASH program, you'll have peace of mind knowing it's a program backed by a carrier with more than 60 years experience in the construction industry. Give us an opportunity to earn your business – ask your insurance agent to obtain a quote from CNA and discover how you can benefit from this partnership.**

**For more information, contact your local independent agent or visit [www.cna.com](http://www.cna.com).**

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