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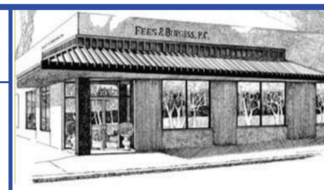

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Insurance Basics for Companies Contracting to Buy Goods or Services

This article attempts to set out some of the basic terms you might want to include in a contract when you are purchasing goods or services from a supplier or contractor. This is not meant to be a comprehensive discussion of the role of insurance in contracts or all of the potential forms of coverage, endorsements, and exclusions from coverage. Instead, our goal is to discuss some of the basic concepts we look for when drafting and reviewing terms related to insurance in contracts involving the purchase of goods or services. Below, we lay out a four-step process for considering what insurance terms you may want to include in a contract with a seller/contractor.

Step 1 - Types of Policies

Commercial General Liability (CGL) Insurance: This form of policy provides broad coverage that protects a business from claims based on personal injury or property damage arising from a variety of causes, including persons injured on your premises, injuries or property damage due to your operations or those of independent contractors you hire, and injuries or property damage arising from products you sell. Another important feature of this kind of policy is that it provides coverage that will back up most kinds of indemnities contractually agreed to by the insured. As a buyer, if you are going to require that a supplier/contractor maintain some form of insurance coverage, this is probably the bare minimum coverage you should require.

Automotive Liability Insurance: CGL insurance does not provide coverage for liabilities associated with the operation of an automobile. If you have a supplier/contractor that will be operating automobiles in connection with furnishing your goods or services, it is advisable to require that company to maintain this kind of coverage for "all autos."

Worker's Compensation/Employer's Liability Insurance: These forms of insurance provide coverage for injuries suffered by the insured's employees. Worker's compensation insurance covers the employer's insurance obligations under state worker's compensation laws. Employer's liability insurance provides coverage for employee injuries falling outside of the worker's compensation coverage. Most states are going to have laws in place requiring that employers provide these kinds of coverage. Still, if you are going to hire a contractor, you may want to require the contractor to carry these forms of coverage and state in the contract that the contractor has to provide you proof that it carries this insurance before starting work under the contract. This is particularly good advice if the contractor will be performing work on your premises. Just because contractors are supposed to have this insurance under state law, it does not mean that all of them do. Verifying that they have the required coverage should be part of your due diligence when hiring a contractor.

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Environmental Impairment Liability Insurance (sometimes called Pollution Liability Insurance): CGL and automotive liability policies contain broad exclusions for liability relating to pollution, and, even when they do provide some coverage, it often excludes clean-up and remediation costs. In order to provide coverage for this kind of risk, a separate form of coverage called environmental impairment liability insurance is needed. As a buyer of goods, you might want to require this kind of coverage if the goods you are buying pose a risk of exposing people or property to some hazardous substance. This could apply if the goods themselves are potentially hazardous (e.g., toxic chemicals) or if the goods are something that could be used to store or transport hazardous substances (e.g., railroad tank cars). More often, this kind of coverage is requested by a buyer when hiring a contractor to perform work on the buyer's premises if the contractor will be working near hazardous substances that are already on site, or if the contractor will be bringing such substances on the buyer's property. Many sellers and contractors do not routinely carry this kind of insurance, so, if you demand that they obtain it, they may insist upon pushing some or all of the cost for this coverage back to you in their pricing.

Professional Liability/Errors and Omissions Insurance: Professional liability or errors and omissions insurance protects an insured from claims based on errors made in the performance of professional services. Examples would include things like medical, legal, or engineering services. This kind of coverage is meant to protect against financial losses, not personal injury or property damage, which would be covered by a CGL policy. If you are hiring a contractor to provide professional services, it would be wise to require the contractor to maintain this form of coverage.

Builder's Risk Insurance: This is a special form of property insurance that provides coverage for a building while it is under construction and protects against a wide range of risks. It is a good idea to require this form of coverage anytime you hire a contractor to perform construction work on new or existing buildings.

Step 2 – Setting Appropriate Minimum Coverage Limits

In addition to making sure you contractually require the person or company selling you goods or services to obtain and maintain the right forms of insurance, it is also important to specify appropriate minimum coverage limits in your contract. There is no one-size-fits-all answer to what level of coverage should be requested. You have to do your best to gauge the maximum amount of exposure you might encounter from the business relationship involved and balance that against what level of coverage you can reasonably expect the seller/contractor to carry or purchase at your request. If you demand more coverage than the seller/contractor normally carries, you may be hit with a price increase to cover the cost of any additional insurance that has to be purchased.

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You should also keep in mind that liability policies usually have coverage limits that apply on a per-occurrence basis and an aggregate basis. For example, a policy might have coverage limits of $1 million per occurrence and $5 million in the aggregate. That means, if there is a $3 million liability associated with a single occurrence, the insurer will only pay $1 million, even though the aggregate limit is $5 million. If there were six claims of $1 million each, the insurer would pay $1 million on the first five, but would not pay anything on the sixth, because the aggregate coverage limits would have been exhausted. It is a good idea, when drafting a contract that requires the other party to obtain insurance, to specify the minimum per-occurrence limits for the policy and the minimum aggregate limits.

Step 3 – Additional Terms to Consider

Additional Insured Endorsement: If you are going to require sellers/contractors to carry insurance, you should also insist that they name you and your affiliated companies as additional insureds under those insurance policies. This is done through an additional insured endorsement, which provides the additional insured many of the same rights under the insurance policies that the named insured (i.e., the seller/contractor) has, including the ability to make a claim on the policy directly.

Primary and Non-Contributory: It can be beneficial to contractually require the seller/contractor to make its insurance policies primary and non-contributory with respect to any insurance carried by your company or any of its affiliates. This means, if there is a claim, the seller's/contractor's insurance has to step in before your insurer, and your insurance only comes into play if the other party's insurance coverage is exhausted. This helps protect your coverage limits and keeps you from having to make a claim that could raise your premiums, unless there is a catastrophic loss.

Waiver of Subrogation: This waiver keeps the other party's insurer from paying out a claim and then coming after you to recover some or all of what it had to pay. This situation might arise if there is a situation where both you and the seller/contractor are partially at fault for a loss. These endorsements are routinely given without any real objection, and it is always smart to request one if you are going to touch on the topic of insurance in your contract with a seller/contractor.

Exclusion Regarding Punitive Damages: Most insurance policies are going to exclude any coverage for punitive damage awards. If you are awarded punitive damages against a seller/contractor, you want to have some confidence that those damages will be paid. In some states, an insurer can waive this exclusion. To take advantage of this option, your contract can state that, where allowed by applicable law, the insurance policies of the seller/contractor will be endorsed to remove the exclusion for punitive damages.

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Step 4 - Evidence of Required Coverage

At a minimum, you should contractually require that the seller/contractor provide you with a certificate of insurance evidencing the insurance coverage and endorsements required under you contract, and you should further require that the certificate be sent to you and approved before any goods or services are provided. However, a certificate of insurance is not an insurance policy, and we have seen insurance agents issue certificates that are inaccurate. In order to make sure the seller/contractor actually has the insurance that your contract requires, the best practice is to have a contract clause stating that you will be provided a copy of the seller's/contractor's insurance policy upon request.

Insurance policies are usually long and wordy contracts with tons of exclusions, definitions, and conditions. In general, they are a headache to read. Still, the only way you can be certain that the other party has the required coverage is to read the policy and any applicable endorsements. For this reason, it is a good idea to have at least one person in your company or who services your company that can be called upon to read an insurance policy to verify coverage, if you have a high-risk relationship where you really want to make sure the required coverage is in place.

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