Insurance Requirements in Contracts: Common Mistakes & Misconceptions

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One of the biggest headaches for risk managers and procurement staff is the development of appropriate insurance language for contracts. While this may seem mundane, it is one of the most critical and proactive risk management strategies an organization can take to protect against unbudgeted losses. Some of the biggest misconceptions or mistakes made regarding insurance requirements in contracts include:

Using The Wrong Indemnification/Or Not Including Key Components - Every contract has two critical components: indemnification and insurance requirements. These sections are distinctly different, one being the agreement between parties and the other a promise to pay compensation for harm or loss. Both hold a crucial role in the risk transfer process. The indemnification (also called the "hold harmless") is the "promise," but the "promise" is only as good as the person making it. Therefore, what happens if the contractor cannot fulfill their promise, i.e., cannot pay the claim? The insurance requirements back up the indemnification and act as the guarantee the contractor can meet its obligations. Thus using the correct indemnification language is of utmost importance and this language should be reviewed and vetted by legal representatives. Even small changes to the hold harmless provision can weaken an organization's protection.

Choosing Limits Based on Project Values – Accidents of all kinds happen daily on job sites for projects of various scopes and sizes. It is known that freak things happen, often with no rhyme or reason. For example, a roofing contractor replacing broken tiles at a residential property could fall and suffer a brain injury, just as easily as a roofing contractor performing work at a large commercial building could. The project costs may be egregiously different, but the claim could be the same. For this reason, it makes no sense to relate the insurance requirements to the project value. Risk should be evaluated in a completely different context. When structuring the insurance requirements in a contract, staff must consider the risk involved and assume the worst-case scenario. One cannot take a cookie-cutter approach. Having the ability to increase limit requirements when a job is too risky is critical. After all, a small job doesn't necessarily mean a small risk.

Types Of Coverage Forms –Two primary coverage forms exist in the marketplace, and their coverage triggers are entirely different. If commercially available, it is always recommended that policies be written on an occurrence-based form. An occurrence policy is the broadest form because coverage ties back to the policy in force when the loss occurred. This means when the claim is reported, the policy in force on the date of loss shall respond. Under a claims-made policy, coverage is tied to the date the claim is reported. Coverage will not be triggered if there is no policy in place when the claim is reported (which could be years after the work has been done). The wrong coverage trigger could result in an entity not having the protection it thought was in place, leaving the entity stuck paying the claim.

Types of Coverage Requested in a Contract – Since each contract's risk differs, the coverage requirements will also be unique. As a result, entities must know the different types of coverage required for each project. In most every contract, one will want to have three coverages: commercial general liability, auto liability and worker's compensation. However, unique projects have unique needs. For example, a professional services contract may require professional liability, while a technology contract may require professional and cyber liability. Similarly, an

environmental contract likely needs environmental coverage. It is crucial to review not just the limit requirements related to the risk involved with a contract but also whether the type of work being performed requires special insurance requirements.

Additional Insured Status – Having additional insured status on a contractor's commercial general liability policy is vital. Without it, one may not be afforded any coverage if something happens, and the insurance is triggered. Unfortunately, we often see several mistakes made in this respect:

1. Most insurance companies will not provide coverage for an additional insured if there is no written contract

2. Most entities believe being a certificate holder makes them an additional insured, which it does not.
3. The additional insured requirement should have all the following added to the coverage: the entity, its officers, officials, employees and volunteers.
4. Additional insured status needs to cover the entity when the contractor is performing the work on-site and when it is completed. This is often accomplished with two separate endorsements and is why we always recommend getting copies of the Additional Insured endorsements as part of the certificate of insurance.

Every transaction has some risk attached to it, but carefully reviewing contracts can help protect an organization by passing on that risk to another party. Failing to understand some of the key components of hold harmless and insurance language could be detrimental. A proper appreciation of critical concepts and being conscious of common misconceptions will result in better contract language structure and ultimately preservation of the company. Additional information is available in the Alliant Insurance Requirements in Contract manual, a detailed guidebook for insurance contracts, available at no cost.