Contractual Confusion—Assuming the Liability of Others

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It is not surprising, then, if we become easily confused and "misremember" how contractual liability insurance works. For many, the subtleties of this rather arcane topic simply cannot be gleaned from the superficial and infrequent contacts we have with it; for others, it may not rank high on the excitement meter. Either way, what follows is intended to assist in understanding contractual liability insurance by thrashing out some concepts and offering some observations you may find helpful.

Basis of Liability

Liability can be imposed by law or by contract. You can also assume the liability of another. These are discussed below.

Liability Imposed by Law

The law can impose liability on us for *our own actions*. If we are negligent, we are personally liable for the damages that result. We can also be held liable for the *actions of others*. For example, if our employee is negligent while acting in the scope of employment, not only is the employee personally liable, we are also liable *solely* because we are the employer. Our liability is based entirely on our relationship with our employee. Assigning liability to an otherwise blameless party (the employer did nothing wrong) for the acts of another (our employee was negligent) is called "vicarious" liability and is also liability imposed by law. Although these concepts are generally well understood, both are worth repeating—to establish a baseline of comprehension and also to use as a point of comparison to help gain insight into contractual liability.

Liability by Contract

Figuring out what risk is to be covered is central to grasping how any insurance works. With contractual liability insurance, the risk is a contract—but not just any contract. In fact, for the contracts involved, we usually don't mean the *entire* contract. We mean only a particular portion of certain contracts or agreements. That particular portion is generally known as the hold harmless or indemnity agreement. For the sake of discussion, we will refer to the clause simply as an indemnity agreement.[1]

Assuming Liability. By entering into an indemnity agreement, we have agreed to answer for what some else does; that is, we have agreed to be legally liable for the actions of others. In an indemnity agreement, our liability is based on *our promise* to be liable and not because the law

imposes the liability on us as illustrated above. In the jargon of insurance, this category of liability is often referred as "assumption of liability by contract."

Additionally, and this is important, indemnity agreements are *not* about failure to fulfill or perform the terms of a contract. To the contrary, indemnity does not relate to *breach* of contract but rather *performing* the terms of a contract—making good on your promise to "step up" and take financial responsibility for the liability of another.

Three People Involved. An indemnity agreement necessarily involves *three people*.[2] If three people are not involved, it is not an indemnity agreement. The first person is making the promise to indemnify and is called the indemnitor. The second person is accepting (or demanding) the promise to be indemnified and is called the indemnitee. While three people must be involved, only the first (indemnitor) and second (indemnitee) are actually parties to the indemnity agreement.

The third person is usually the one to whom the *indemnitee* is legally liable, usually due to negligence of the indemnitee. Because the third person is not a party to the indemnity agreement, the third person is not affected by the terms of the indemnity agreement. In other words, whatever the indemnitor and indemnitee may agree on is not binding on the third person. The third person retains all rights and remedies available under law against the indemnitee or indemnitor despite the indemnity agreement.

Workings of an Indemnity Agreement—An Illustration

A tenant agrees to "hold harmless and indemnify" the landlord for "any and all injury or damage that takes place on the premises of the tenant, unless the injury or damage is caused by the sole negligence of the landlord." In this example, the tenant is the only tenant in the entire building and the indemnity agreement is part of a 45-page commercial real estate lease between the landlord and the tenant.

What is most pertinent here is that the tenant (indemnitor) has agreed to indemnify the landlord (indemnitee) for "any and all injury or damage" that takes place on the tenant's premises. The only exception to the tenant's obligation to indemnify the landlord is if the injury or damage is caused by the *sole negligence* of the landlord. As a result, the tenant has agreed, in most instances, to "assume the liability" of the landlord and therefore the tenant has agreed to "step up" and be financially responsible for the landlord's negligence. The law would not usually impose liability on the tenant for any of the landlord's negligence; the source of the tenant's liability to the landlord is the tenant's promise to pay for the landlord's legal liability for "any and all injury or damage" taking place on the tenant's premises.

As a result of a small fire within the building, a patron of the tenant was seriously injured by burns and smoke inhalation. There was no damage to the building.

The patron sued both the landlord and the tenant for his injuries. Recall all of the rights and remedies at law are available to the third person, in this instance the patron, despite the indemnity agreement between the tenant and landlord. At trial, it was determined that the fire was caused by the tenant's employee's failure to properly extinguish smoking materials and, consequently, the tenant was found to be 20 percent negligent in causing the patron's injuries.

The trial also determined that the landlord's smoke alarm and automatic sprinkler systems had failed as the landlord had not maintained either in working order. Further, the patron had difficulty leaving the building because the landlord had not properly marked the exits and the exit doors were jammed and could not be easily opened.

The trial court determined the landlord was 80 percent negligent. In its judgment against the tenant and landlord, the court awarded the patron total damages of $500,000 for his injuries. The tenant was required by the court to pay 20 percent of the patron's damages or $100,000; the landlord was required by the court to pay 80 percent of the patron's damages $400,000. The combination of the payments by the tenant and landlord satisfied the judgment and award of damages to the patron.

An Indemnity Agreement in Action. Immediately after the trial, the landlord sought to enforce the indemnity agreement to recover from the tenant the $400,000 of damages the landlord had paid to the injured patron. As the tenant had "assumed the liability" of the landlord, the tenant was contractually liable to indemnify the landlord and therefore pay the landlord the $400,000 of damages assessed against landlord by the court for the injuries to the patron.

Remember, the indemnity agreement required the tenant to indemnify the landlord for "any and all injury or damage taking place on the tenant's premises, unless caused by the sole negligence of the landlord." The trial determined the landlord was *not* solely negligent (the tenant was found 20 percent negligent); presuming the indemnity agreement was not unenforceable because of statute or caselaw, the tenant is obligated to pay the landlord $400,000. Notice the indemnity involved three persons—the tenant (indemnitee), the landlord (indemnitor), and the third party—the injured patron.

Purpose of Contractual Liability Insurance. Contractual liability insurance is intended to pay on *behalf of the tenant* the $400,000 of damages the tenant owed the landlord due to the landlord's liability for damages to the injured patron. The liability of the tenant to the landlord was *not*

imposed by law—the court did impose liability on the tenant, but only for $100,000 or 20 percent of the damages. As noted previously, the tenant's liability to pay the additional $400,000 of damages was derived completely from the tenant's promise to indemnify the landlord. Stated differently, the tenant had agreed to be financially liable for the actions of the landlord—including the landlord's failure to maintain the alarm and sprinkler system, mark the exits, and keep the exits passable.

Other than the observation as to the purpose of contractual liability insurance, it is crucial to note that no mention was made of insurance throughout the illustration. It is difficult to overstate that an indemnity agreement is not insurance. The tenant is liable to the landlord for the $400,000 of damages regardless of whether the tenant had purchased any liability insurance. Although the tenant is the indemnitor, the tenant is not an insurance company. The indemnity agreement itself is found within a real estate lease. A real estate lease is not an insurance policy.

In short, the liability of the tenant to the landlord was created by a contract that is not an insurance policy and is also outside of any insurance the tenant may have purchased. In fact, the tenant's promise to indemnify the landlord is often called *noninsurance* contractual risk transfer.

Contractual Liability Insurance

In most cases, the tenant would have liability insurance, specifically a commercial general liability (CGL) policy, to fund the tenant's liability to the landlord in the example we have used. The standard Insurance Services Office, Inc. (ISO), CGL policy is provided for bodily injury or property damage "for liability for damages assumed in a contract or agreement that is an 'insured contract,' provided the bodily injury or property damage occurs after the execution of the contract or agreement in which the liability of others was assumed."[3]

Limitations of Contractual Liability Insurance

Too often, an indemnitee is thought to *automatically* have the status of an insured or additional insured on the CGL policy of the indemnitor. Using our illustration of tenant and landlord, the landlord does not have the status of an insured or additional insured on the tenant's CGL policy merely as a result the indemnity agreement.

Contractual Confusion. The confusion seems to stem from the failure to distinguish insurance from indemnity obligations. As it is very common for the landlord to be listed as an additional insured on the CGL policy of the tenant *in addition to* the indemnity agreement, it is too often assumed that the an indemnitee is an additional insured. Put another way, because additional insured status and indemnity agreements are so frequently seen together, they may seem

indistinguishable from one another or at least appear that one is the result of another, i.e., an indemnity agreement results in additional insured status. The reasoning seems to be that if the contract fits within the definition of "insured contract," such as a lease of premises agreement, it follows that "insured contract" also means the landlord is automatically an additional insured. This belief is simply mistaken. An indemnitee is not an insured.

The tenant's CGL policy must be amended to extend coverage to provide additional insured status to the landlord. Just because the contract happens to be an "insured contract" does not mean the tenant's CGL provides additional insured status to the landlord. In other words, the indemnitor's CGL policy must be amended to include an additional insured endorsement to provide the indemnitee the status of additional insured. To repeat—having the status of indemnitee is not the same as being an additional insured.

A Practical Distinction. An additional insured is a party to the insurance policy and therefore has "privity," meaning the additional insured generally has direct rights to enforce the terms of the policy against the insurer issuing coverage to the additional insured. An indemnitee generally does not have privity and therefore has no right to enforce the terms of indemnitor's CGL policy. The indemnitee's rights are only those found in the indemnity agreement itself.

While this may seem like distinction without a difference, consider this. If you are the indemnitee, would you rather have the ability to recover from an insurer directly or from the indemnitor, whose financial wherewithal is likely substantially less than the vast majority of insurers? In many cases, the reason to be an additional insured as well as an indemnitee is that you want two avenues of recovery. Why two avenues? Because you can't know if being an indemnitee or an additional insured will provide you the better recovery opportunity in any particular situation.

In fact, in serious claims, indemnitees may pursue recovery from both directions simultaneously—as an indemnitee and as an additional insured. The merits of this "belt-and-suspenders" approach to the indemnitee/additional insured issue becomes more apparent when considering that indemnity agreements, unlike insurance policies, contain no limits or exclusions. In other words, indemnity may allow a broader or greater recovery than insurance.

Direct Responsibility

If in our previous illustration the tenant also agreed in the lease to be responsible for any damage to the building, regardless of cause or fault, would this be considered "… liability for damages assumed in a contract or agreement … for property damage…?"

Let's say that a tornado caused substantial damage to the building that will cost the landlord, who owns the building, $750,000 to repair it. The landlord obtained an estimate for repair, engaged a general contractor to begin the repairs, and handed the repair bill to the tenant with a letter referring to the portion of the lease in which the tenant has promised to be responsible for damage to the building, even if the damage is not the fault of the tenant. Is this also an indemnity agreement? If so, is this an "insured contract?"

A contract for the lease of premises does fall squarely within the definition of "insured contract," albeit with the limitation that an agreement to indemnify any person or organization for damage *by fire* to the premises rented to you is not an "insured contract." Of course, in this instance, the damage is not by fire, so the fire limitation is not a concern.

By agreeing to be responsible for damage to the landlord's building, has the tenant "assumed the liability" of the landlord? More accurately, is the landlord legally liable for damage to its own building? Drilling down a little further, is the landlord's cost to repair its own building "damages" that are "assumed in a contract or agreement?"

The answer to all of the above is no. The agreement to accept responsibility for damage to the landlord's building is not an indemnity agreement. The landlord has no liability imposed on it by law to repair its own building. Similarly, because the landlord has no liability, the costs to repair the building are not "damages" from the viewpoint of the landlord. You may have already noticed—this agreement does not involve three persons; it involves only two persons as the landlord in our illustration is not liable to a third person.

CGL Exclusion b. Further, while a contract for a lease of premises is an "insured contract," that does not mean that all obligations created in a lease of premises agreement are covered by contractual liability insurance. To fully understand the scope of contractual liability insurance, the definition of "insured contract" must be read in conjunction with exclusion b. of the CGL policy.

Exclusion b. eliminates coverage in the CGL for the insured's obligation to pay damages by reason of assumption of liability in a contract or agreement, but does not apply to "… liability for damages … assumed in a contract or agreement that is an "insured contract." In other words, contractual liability insurance applies only if the insured has *assumed liability* for *damages* in a contract or agreement *and* that contract or agreement falls within the definition of "insured contract." Going back to our illustration regarding the tenant's agreement to be responsible for damage to the building, the tenant has neither assumed the landlord's liability nor does the agreement involve "damages." Contractual liability insurance does not apply in this illustration.

Contractual Liability Insurance and CGL Policy Exclusions

To some, the obvious answer to the above illustration regarding the tenant's agreement to be responsible for damage to the landlord's building is not whether the agreement is an "insured contract," but rather that the CGL policy excludes property damage (with some limited exceptions that did not apply to the illustration) for property the named insured rents or occupies. Of course, they are correct.

Of particular importance here is understanding that the contractual liability insurance coverage provided in the CGL via the exception to the contractual liability exclusion b. is in turn subject to every other exclusion found in the CGL policy. Stated differently, unless otherwise noted, all exclusions found in the CGL apply to liability assumed by contract in an "insured contract." The notion that liability assumed in an "insured contract" somehow "overrides" the exclusions in the CGL is erroneous.

The Tavern—An Illustration

Let's go back to our tenant and landlord illustration. The only additional fact we will introduce is the tenant operates a tavern and is engaged in the business of selling and serving alcohol. All other facts are the same, including the indemnity in favor of the landlord.

A patron is "overserved" by the tenant and, in his intoxicated state, injures another patron. The injured patron sues both the tenant and landlord, alleging violation of the dram shop act. The case goes to trial and liability is imposed on the tenant as well as the landlord—the basis of the landlord's liability is the state's dram shop statute, which imposes liability on the landlord for the acts of its tenant.

The injured patron is awarded $100,000 of damages; the court determines liability to be 50 percent the tenant and 50 percent the landlord. After each (tenant and landlord) pays its share of the damages to the injured patron, the landlord seeks recovery for the $50,000 of damages it has paid to the injured patron by enforcement of the indemnity agreement. Will the tenant's CGL insurer pay on behalf of the tenant the damages owed to the landlord for the landlord's liability to the injured patron? Keep in mind that the tenant has assumed the liability of the landlord in a contract (lease of premises) that is considered an "insured contract." While the tenant is liable to the landlord via the indemnity agreement, the tenant's CGL policy specifically excludes coverage for the tenant's liability for the selling or serving of liquor. Therefore, the insurer will not pay the damages that the tenant owes to the landlord as the tenant's liability originated from an activity for which the tenant does not have coverage—the sale of alcoholic beverages.

Employers' Liability Exclusion

In most cases, the CGL policy excludes any liability for bodily injury to its employees arising out of and in the course of employment by the insured. But this exclusion does not apply if the liability is assumed by the insured in an "insured contract." Here is one of the few situations when liability assumed in an "insured contract" is not subject to a CGL exclusion.

The Construction Site—An Illustration

Assume a general contractor enters a construction contract with a subcontractor. Included in the construction contract is an indemnity agreement in which the subcontractor agrees to indemnify the general contractor for "any injury or damage arising out of the work, except injury or damage that is caused by the *sole negligence* of the General Contractor."

The subcontractor's employee is injured on the jobsite. In addition to collecting workers compensation benefits from the subcontractor, the employee sues the general contractor for failing to keep a safe workplace. The general contractor is found partially but not *solely* negligent in causing the injury to the subcontractor's employee, who was awarded $200,000 damages for his injuries, all of which were paid by the general contractor. As with the other illustrations, the general contractor seeks to recover $200,000 from the subcontractor by enforcing the indemnity agreement.

If the agreement to indemnify the general contractor is not considered an "insured contract," the subcontractor's CGL policy would *not* pay for the damages the subcontractor owes to the general contractor because the liability exclusion on the subcontractor's employers' CGL policy would apply. Fortunately, this indemnity agreement does fall within definition f. as an "insured contract."

Therefore, even though the subcontractor is actually paying for damages resulting from injuries to the subcontractor's own employee, the employers' liability exclusion *does not* apply due to the express exception in the exclusion for liability assumed by contract in an "insured contract." Therefore, the subcontractor's CGL insurer will pay $200,000 of damages on behalf of the subcontractor to the general contractor in accordance with the indemnity agreement.

Conclusion

Some straightforward examples of the workings of contractual liability insurance, including explanations of the nature of an indemnity agreement and the limitations and exclusions that apply to contractual liability insurance, are usually useful in understanding the basics. A grasp of the fundamental concepts is the gateway to applying the principles to ever more complex situations and also will enhance your overall command of an often misunderstood aspect of commercial general liability insurance.

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[1]Occasionally, "hold harmless" is used to mean a release or waiver of liability. A more accurate description of a release or waiver is "exculpatory agreement" and involves only two parties. In the context of this article, a hold harmless agreement, which in some circumstances may be somewhat broader than an indemnity agreement, is considered to be synonymous with an indemnity agreement.

[2]The terms "people" or "person" are used for the sake of illustration only. An indemnitor, indemnitee, and the third person include not only individuals but various types of organization, such as corporations, partnerships, trusts, etc.

[3]For a discussion of what is considered an "insured contract," see "Contractual Liability and the CGL Policy."

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Contractual Liability and the CGL Policy

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What is meant by contractual liability and how it actually works is not always well understood. In this new column, Craig Stanovich helps clear up the misconceptions.

by Craig F. Stanovich

Contractual liability is a very important concept in the world of risk management and insurance. Yet, what is meant by contractual liability and how it actually works is not always well understood. This article is intended to clarify the concept of contractual liability with examples of risk transfer by contract as well as providing an explanation, with illustrations, as to how the contractual liability insurance, found in the commercial general liability (CGL) insurance policy, applies.

In General

Outside the context of insurance, contractual liability (or liability because of a contract) has a very broad meaning—a promise that may be enforced by a court. Consider the following simple

example. I agree to paint your house for $1,000 and collect $500 prior to the job. After I accept the $500, I obtain a more lucrative offer and never show up to paint your house. You can go to court and claim the $500 you paid me, as I have breached the contract. Your claim is a contractual liability claim.

Agreement To Assume Liability

It is common for businesses or organizations to agree, usually in writing, to take on the liability of someone else—liability they would not otherwise have. This form of agreement, where one party takes on or assumes the liability of another by contract, is commonly called a "hold harmless" or "indemnity" agreement.

Hold Harmless or Indemnity Agreement.

In an indemnity or hold harmless agreement, one party (the indemnitor) promises to reimburse, and in some cases defend, the other party (the indemnitee) against claims or suits brought against the indemnitee *by a third party*. The purpose of the hold harmless or indemnity agreement is to transfer the risk of financial loss from one party (the indemnitee) to another party (the indemnitor). This transfer or shifting of financial consequences is often called non-insurance contractual risk transfer and is considered a risk financing technique.

Properly written hold harmless and indemnity agreements override common law and afford an indemnitee the right to collect from the indemnitor, in some cases even if liability arises out of the indemnitee's *sole negligence*. While each state has its own statutes and case law that may restrict what may or may not be transferred, it is a mistake to conclude that *all* hold harmless and indemnity agreement are void and against public policy simply because the agreement assumes liability for the sole negligence of another.

One very important aspect of the hold harmless or indemnity agreement is that it does *not* relieve the indemnitee (the party with the benefit of the promise) from liability to the third party. The indemnitee may be found to be completely liable to the third party for its bodily injury or property damage. The hold harmless gives the indemnitee a legal right to collect from the indemnitor (to the extent included in the contract and allowed by law) for the damages paid to the third party. The purpose of contractual liability insurance is to pay, on behalf of the indemnitor, the damages to the third party.

Where To Find Hold Harmless and Indemnity Agreements.

Businesses or organizations enter into in a wide variety of contracts in which hold harmless or indemnity agreements may be found. One very common contract, in which a hold harmless or indemnity agreement is almost always found, is a real estate lease agreement between tenant and landlord. A sample hold harmless and indemnity clause found in a real estate lease is:

The Lessee will save the Lessor harmless and keep it exonerated from all loss, damage, liability or expense occasioned or claimed by reasons of acts or neglects of the Lessee or his employees or visitors or of independent contractors engaged or paid by Lessee whether in the leased premises or elsewhere in the building or its approaches, unless proximately caused by the negligent acts of the Lessor.

As many indemnity or hold harmless clauses may be quite lengthy and difficult to read, it is often a challenge for risk managers to determine with any precision the scope of liability that has been assumed. The following example may prove helpful to explain how the above agreement might work.

An Illustration of the Workings of a Hold Harmless or Indemnity Agreement.

A tenant (Lessee) in a multi-tenanted professional office building hires an electrician (an independent contractor) to rewire a portion of the tenant's (Lessee's) office. About a year after the rewiring is finished, another tenant receives a severe electrical shock when plugging in an appliance, resulting in serious injuries to the tenant.

The injured tenant brings suit against the landlord (Lessor) demanding compensation for her injuries, alleging that the landlord breached its duty to properly wire the building. The investigation strongly suggests that the injury of the tenant was caused, at least in part, by the electrician's wiring job. Nonetheless, the landlord (Lessor) is found to have responsibility for the injuries and is ordered to pay the injured tenant $150,000 in compensatory damages.

As the tenant (the Lessee) has agreed to indemnify the landlord (Lessor) for the acts of the tenant's (Lessee's) independent contractors, the tenant (Lessee) is obligated by the lease's hold harmless clause to pay the $150,000, either as payment to the landlord or directly to the injured tenant. In this situation, the tenant (Lessee) would not normally have had any liability to the injured tenant. His liability arises solely from the agreement, as part of the lease, to take on the liability of the landlord. The tenant's contractual liability insurance would pay on his behalf the $150,000 damages owed.

While the electrician may ultimately have to pay $150,000 (or a lesser amount) via a subrogation action, the landlord (Lessor) does *not* have to wait for the result of further litigation or be concerned with proving fault on the electrician's behalf in order to recover the $150,000 (the tenant assumed liability for *the acts* of his independent contractors, regardless of negligence). Even if the Landlord could prove fault on the electrician's behalf, it may only be partial fault, and may result in the landlord collecting less than the $150,000 in damages.

In short, the landlord has transferred the financial risk of having tenants in his or her building back to each tenant via the hold harmless and indemnity agreement inserted in the lease.

Contractual Liability Insurance and the Commercial General Liability Policy

Contractual liability insurance has been automatically provided within the commercial general liability (CGL) policy since 1986. The mechanics of how coverage is actually provided does merit some explanation.

The first mention of "Contractual Liability" in the 2001 CGL policy is as the title of an exclusion. Coverage is eliminated by this exclusion for assumption of liability in a contract or agreement. There are, however, two important exceptions:

- Liability of the insured that would be imposed without the contract or agreement

  or

- Liability assumed in a contract or agreement that is an "insured contract."

The term "insured contract" is defined later in the policy and is critical to understanding the coverage provided. More on "insured contract" later.

Breach of Contract Claims

On occasion, a policyholder will seek coverage under the CGL policy for a breach of contract claim. In other words, the damages being demanded do not arise from liability assumed in a hold harmless or indemnity agreement, but are due to failure to meet an agreed upon obligation. Avoiding coverage for breach of contract claims is the very reason the CGL first excludes all contractual coverage, then grants limited contractual liability coverage by an exception to the exclusion. Here is an example of what is intended to be excluded:

A contractor agrees in a construction contract to insure a building that is being built for the owner. Unfortunately, the contractor forgets to place the insurance on the building, which a tornado

destroys shortly before its completion. The owner seeks payment from the contractor for the value of the building, asserting a breach of contract action for failing to purchase insurance. The contractor then makes claim under the contractual liability coverage of his CGL policy for the value of the building.

Assumption of Liability by Contract or Agreement

What is actually meant by "liability assumed by contract" has been the topic of a considerable amount of litigation, with varied outcomes. An Alaska case—*Olympic, Inc. v Providence Washington Insurance Co.*, 648 P2d 1008 (Alaska 1982), as quoted in *Gibbs M. Smith v United States Fidelity & Guaranty Co.*, 949 P2d 337 (Utah 1997)—provides this explanation, which reinforces the concept that coverage is not for breach of contract:

Liability assumed by the insured under contract refers to liability incurred when one promises to indemnify or hold harmless another, and does not refer to liability that results from breach of contract.

The court went on to explain the differences in the nature of the obligations:

Liability ordinarily occurs only after breach of contract. However, in the case of indemnification or hold harmless agreements, assumption of another's liability constitutes performance of the contract.

Assuming a Duty versus Assuming a Liability

Assuming the *liability* of another (agreeing to be responsible for some else's legal obligation to pay damages to third parties) is sometimes confused with assuming a *duty* to others (an obligation to act or not to act that would not exist but for an agreement). For example, I may enter into a maintenance contract whereby I agree to regularly service the machinery on your premises, creating a duty that I would not otherwise have had. But I carelessly fail to service a machine that later malfunctions, injuring your employee. It is subsequently found that my failure to service the machine caused the malfunction and employee's injury. The employee brings suit against me for her injuries.

Some insurers have mistakenly denied CGL claims such as these, contending the claim is a breach of contract claim and thus excluded by the contractual liability exclusion of the CGL. A more careful analysis of this type of claim will reveal that it is in actuality a tort-based claim—specifically negligence. I breached a duty (to maintain the machinery), such breach being the proximate cause of the injury to the employee. The *duty* was assumed or created by the contract; no assumption of liability via a hold harmless or indemnity agreement was involved. The

damages claimed were not by the other party to the contract and were not the cost to fulfill the contract, but rather damages resulting from injuries to an unrelated party, the injured employee.

This issue was addressed in *Olympic*, in which the Alaskan court held that:

Legally obligated to pay as damages … refers to liability imposed by law for torts and not to damages for breach of contract … the only exception to this general rule arises when the *contract breach itself results in injury to persons or property.* (Emphasis added.)

Coverage by Exception—The "Insured Contract"

The exception to the contractual liability exclusion does provide broad contractual liability coverage for liability assumed in a contract as long as:

1. The bodily injury or property damage occurs after entering into the contract, and
2. The liability is assumed in a hold harmless or indemnity agreement that falls within the definition of "insured contract."

The contractual liability coverage provided for "insured contracts" is "blanket" in that the insured does not need to list or designate the covered contracts (as was required under the 1973 Contractual Liability Coverage Part), nor is a separate premium charge made for contractual liability coverage. Contractual liability coverage in the CGL is also "broad form," as it applies even if an insured assumes liability for the sole negligence of the indemnitee.

"Insured contract" is defined, and the definition begins by listing five types of contracts that are common to many businesses and organizations:

- Lease of premises (but not for a promise to pay fire damage to a premises you rent or occupy)
- Sidetrack agreement
- Easement or license agreement (not for construction or demolition on or within 50 feet of a railroad)
- Indemnify a municipality (except for work for the municipality)
- Elevator maintenance agreement

Coverage for the above five contracts was automatically included in the 1973 CGL policy (and prior editions) as "incidental contracts." When the CGL was overhauled and simplified in 1986, the listing of these "incidental contracts" remained to clarify that coverage was still intended to apply to liability assumed in these contracts.

The "blanket" contractual clause extends coverage to any contract pertaining to the named insured's business under which they assume the *tort* liability of another. Tort liability means liability imposed *other than by contract.* Put another way, coverage applies only to a particular type of assumed liability—that which arises from a breach of duty and that exists independent of any contractual relationship the indemnitee may have with the injured party. [Barry R. Ostranger and Thomas R. Newman, *Handbook on Insurance Coverage Disputes* 7.01 (8th Ed. 1995).]

What Is Not an "Insured Contract"

"Insured contract" does not include an agreement to indemnify:

- A railroad for construction or demolition operations within 50 feet of railroad property and affecting any railroad bridge or trestle, tracks, roadbeds, tunnel, underpass or crossing.
- An architect, engineer or surveyor for their professional services.
- Others for professional services if assumed by an insured who is an architect, engineer or surveyor.

Railroad protective liability and professional liability coverage is needed if an insured has exposures falling within the exclusions.