Minnesota Policyholder Scores Victory On "Insured Contract" Coverage for Direct Liability Indemnification

May 20, 2013

The Eighth Circuit Court of Appeals recently ruled that an indemnitor's insurer was obligated to provide coverage under the "insured contract" provision of a commercial general liability (CGL) policy for the indemnitee's own, direct negligence. *Harleysville Ins. Co. v. Physical Distribution Services, Inc*., No. 12-1713, 2013 U.S. App. LEXIS 9017 (8th Cir. May 2, 2013) (PDSI). This is an important decision because it provides an alternative way for indemnitors to backstop contractual direct liability indemnification.

Many business contracts require one party to indemnify the other party for third-party claims. Some even require indemnification for the indemnitee's own negligence or fault (direct liability indemnification). Most, if not all, CGL policies exclude contractual liability, but carve out certain exceptions for an "insured contract." One such exception restores coverage where the insured assumes the tort liability of another to pay for bodily injury or property damage to a third party in a contract or agreement. Insured contract coverage provides a means by which an indemnitor can use its own insurance to backstop its indemnity obligation. Another common way to do this is by naming the indemnitee as an additional insured on the indemnitor's policy. In both instances, there is frequently a dispute as to whether the indemnity obligation covers the indemnitee's own direct liability (or only vicarious liability) and, if so, whether the indemnitor's insurer is obligated to provide coverage for direct liability. These issues were front and center in the PDSI case.

PDSI, a Minnesota company, entered into an employee lease agreement with Miller, which required PDSI to indemnify Miller for liability it incurred for an injury to a leased employee. The agreement further provided that PDSI would insure the contractual risks and name Miller as an additional insured on PDSI's policy. PDSI had CGL coverage with Harleysville. Miller was not named as an additional insured on the policy. The policy contained the following amended definition of "insured contract":

That part of any other contract or agreement pertaining to your business … under which you assume the tort liability of another party to pay for "bodily injury" or "property damage" to a third person or organization, provided the "bodily injury" or "property damage" is caused, in whole or in part, by you or by those acting on your behalf.

This definition was added by endorsement and is narrower than the endorsement found in the standard form policies insofar as it requires that the injury or damage be "caused" in whole or in part by the insured or

those acting on its behalf.

While on the job, one of PDSI's leased employees was injured at Miller's facility and subsequently sued Miller for its own negligence. Miller tendered the claim to PDSI which in turn, tendered it to Harleysville, which then denied coverage. Miller settled its liability to PDSI's employee in the underlying case and demanded indemnification from PDSI under the contract and from Harleysville under the CGL policy. Harleysville commenced a declaratory judgment action against Miller and PDSI seeking a no coverage determination.

The Court first concluded that the indemnity agreement covered Miller's own fault or direct liability. Next, the Court concluded that PDSI, or those acting on its behalf, at least partly "caused" the employee's injury. As a result, the Court held that Harleysville was obligated to indemnify Miller for the settlement payment (i.e., its own direct liability) and Miller's attorneys' fees in the underlying action.

The PDSI decision stands in contrast to a recent Minnesota Supreme Court decision which interpreted a Blanket Additional Insured (Contractors) Endorsement and concluded that coverage for the indemnitee was limited to vicarious liability. *Eng'g & Constr. Innovations, Inc. v. L.H. Bolduc Co*., 825 N.W.2d 695 (Minn. 2013) (Bolduc). The Bolduc Court's decision largely turned on the wording of the additional insured endorsement, which limited coverage to injury or damage "caused by acts or omissions" of the insured and specifically excluded coverage for "independent acts or omissions" of the additional insured. These limitations are not found in the CGL standard policy definition of "insured contract" within the insured contract provision. The Bolduc decision, however, did not address potential insured contract coverage for the claims.

The lesson here is that broad CGL "insured contract" coverage can provide an important backstop to an indemnitor's obligations. As in Bolduc some "additional insured" endorsements limit coverage to vicarious liability of the indemnitee. And a contractual indemnification provision is only as good as the indemnitor's balance sheet. Therefore, contracting parties should be mindful of "insured contract" coverage, both in negotiating the scope of the indemnification clause and making sure that the insured contract coverage is co-extensive with the indemnity obligation. Finally, in the event of a claim, PDSI demonstrates that there may still be coverage for the indemnitee's liability, even if the indemnitor failed to name the indemnitee as an additional insured.