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Understanding Hold Harmless and Contractual Liability Insurance

In our litigious society, lawsuits abound. Specifying your responsibility in a contractual relationship is an effective way to limit your liability. Risk is transferred contractually by including “hold harmless” clauses in agreements.

In a hold harmless agreement, one party agrees to protect or “indemnify” another from claims brought by a third party for financial loss or damage. An example is a general contractor who hires a subcontractor to provide services to a third party. The general contractor may require the

subcontractor to sign a hold harmless agreement to indemnify the general contractor if any problems arise due to the work provided by the subcontractor.

Know what you’re signing

The indemnitor in a hold harmless agreement (the party that has assumed the liability) is responsible for all financial loss. Some hold harmless clauses are very broad. They may include liability even if the indemnified company was solely responsible for the damage. A contractual liability insurance policy can protect the indemnitor, but may not cover all aspects of liability. Be aware, for example, that a new insurance endorsement that became effective July 2004 in many states excludes coverage for assumption of another party’s sole negligence.

The hold harmless agreement, in our example above, gives the general contractor the right to collect for damages paid to the third party to the extent enforceable under the law. A word of caution, however, for the party indemnified. A hold harmless agreement may not fully protect you under the law. The ability to uphold indemnification agreements differs by state because state laws vary as to what risks may be transferred. In addition, some courts have ruled indemnification clauses unenforceable if they were not clear and precise.

Protecting your assets

Contractual liability insurance is automatically provided as part of the commercial general liability policy. The coverage is designed to pay to a third party damages assumed as part of an “insured contract.” The definition of an insured contract is limited, however, and coverage is written as an exception to an exclusion. That means the policy excludes coverage except for specific circumstances. Other types of policies, such as professional liability insurance, may be needed to cover exposures that are not covered under contractual liability policies.

Generally, contractual liability insurance covers only bodily injury or property damage. But these, too, are subject to exclusions, conditions and limitations, and the injury or damage must have occurred after entering into the contract.

In addition, the liability must be one that would be imposed without the contract or one that is assumed in a hold harmless or indemnity agreement that falls within the definition of insured contract under the policy. Contractual liability policies do not cover breach of contract.

Talk to an attorney before signing any contract so that you do not assume liability that is not covered under your commercial liability insurance policy. Read your insurance policy endorsements carefully and ask me to explain anything you do not understand. I can help you determine the type of coverage your business needs to protect your assets.

Thanks,

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