# ALLOCATING EXTRAORDINARY RISK IN LEASES:

## Indemnity/Insurance/Releases and Exculpations/Condemnation

(Including a Review of the Risk Management Provisions of the
Texas Real Estate Forms Manual's Office Lease)

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State Bar of Texas
27th ANNUAL ADVANCED REAL ESTATE LAW COURSE
June, 2006

San Antonio, Texas

**CHAPTER 45**

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Table of Contents

## THE BASIC PRINCIPLES

Page

I. INTRODUCTION ..... 1

II. INDEMNITY ..... 2

A. Terminology ..... 2

B. Requirements for Enforceability ..... 2

1. Fair Notice. ..... 2
2. Express Negligence. ..... 2
3. Overcoming the Worker's Compensation Bar. ..... 3
4. Comparative Indemnity. ..... 3
5. Strict Liability. ..... 3

III. INSURANCE ..... 3

A. Contractually Assumed Liability Insurance: Coverage for the Protecting Party ..... 3

1. Exception to an Exclusion. ..... 3
2. Named Insured Not Insured for all Contractually Assumed Liabilities - No Coverage for Indemnified Person's Sole Negligence. ..... 4

B. Additional Insurance: Coverage for the Protected Party ..... 4

1. Purpose. ..... 4
2. Automatic Coverage or by Endorsement. ..... 5
3. Endorsements: ISO or Manuscripted Forms. ..... 5
4. Covered Matters. ..... 5
   a. Ongoing Operations ..... 5
   b. Completed Operations ..... 6
   c. Premises ..... 6
5. Covered Liabilities. ..... 8
   a. Negligence ..... 8
      (1) Additional Insured's Vicarious Liability for Named Insured's Negligence ..... 8
      (2) Additional Insured's Own Negligence ..... 8
   b. Interpretation of Additional Insurance Covenants ..... 8
      (1) Express Negligence Test Not Applicable to

Insurance Covenant ..... 8
(2) 2004 Revision to ISO Forms ..... 9
c. Manuscript Additional Insured Endorsement to Limit Coverage to Indemnified Liabilities ..... 9
6. Liability for Failure to List Other Party as Additional Insured. ..... 9
7. Caveat. ..... 10

C. Protected Party's "*Other Insurance*" ..... 10

1. Generally All Policies Are "*Primary*" and "*Contributory*" Unless Amended. ..... 10
2. Endorsing Named Insured's Policy to be Primary Not the Solution. ..... 11
a. Primary vs. Sole Contributing ..... 11
b. Endorsing the Additional Insured's Policy to Be Excess Coverage ..... 11

IV. RELEASES AND EXCULPATIONS ..... 11

V. CONDEMNATION ..... 12

A. Allocation in the Event Lease is Silent ..... 12

1. Value of Tenant's Interest ..... 12
a. Loss of Tenant's "Leasehold Advantage" ..... 12
b. No Award Allocated to Tenant for Its Lost Business or Personal Property ..... 12
c. Moving Expenses Compensable ..... 12
d. Tenant's Improvements and Fixtures Compensable ..... 13
2. Interplay with Other Lease Clauses ..... 13
a. Permitted Use Clauses ..... 13
b. Renewal Clauses ..... 13
3. Effect on Tenant's Obligation to Pay Rent. ..... 13
a. Rent Abated on Total Condemnation ..... 13
b. Rent Not Proportionally Abated if a Portion of Leased Premises Taken ..... 13

B. Contractual Apportionment of Award ..... 14

1. Value of Tenant's Use is Less than Highest and Best Use at Time of Taking ..... 14
2. Value of Tenant's Improvements Not Fully Amortized at Time of Taking ..... 14

C. Contractual Allocation of Award to Landlord ..... 14

1. "*Termination-on-Condemnation*" Clauses ..... 15
a. Automatic, Optional and Mixed ..... 15
(1) Automatic termination clauses ..... 15
(2) Optional termination clause ..... 15

(3) Mixed termination clause. .......... 16
b. Coupling with a clause for rent abatement or partial rent adjustment or partial rent abatement .......... 17
c. Coupled with a Disclaimer of Claim or Assignment of Claim Clause. .......... 17
d. “Ownership of Improvements at End of Lease Term” Clauses .......... 18
2. Types of Allocation Clauses. .......... 18
a. Allocation of Set Amount to Tenant or Establishing a Method of Valuation of Tenant’s Interest in Tenant’s Improvements .......... 18
b. Assign Rights to Improvement Value to Landlord .......... 18
c. Permit Removal of Improvements at End of Lease Term due to Condemnation .......... 18
d. State Landlord Owns Leasehold Improvements at End of Lease Term .......... 18
e. Better to Recognize Tenant’s Right to Improvement Value as Opposed to Being Silent .......... 18
3. Protecting Tenant’s Lender. .......... 19

I. HYPOTHETICAL .......... 20

II. FORMS .......... 23

A1. Texas Real Estate Forms Manual Ch. 11 Leases - Manual’s Commentary on Risk Allocations .......... 24

A2. Forms Manual Form 11-3 Office Lease .......... 26

A3. Forms Manual Form 11-35 Tenant Improvements Rider to Lease or Work Letter .......... 31

A4. Forms Manual Form 11-34 Insurance Addendum to Lease .......... 32

A5. Supplement to Insurance Addendum to Lease .......... 35, 42

B. Office Lease - Tenant’s Certificates of Liability and Property Insurance .......... 46, 49

C. Office Lease - Landlord’s Certificates of Liability and Property Insurance .......... 53, 55

D. Tenant’s Contractor’s Certificates of Liability and Property Insurance .......... 59

E. Endorsement to Tenant’s Insurance Policy Making Landlord Additional Insured: CGL Endorsement - CG 20 11 01 96 Additional Insured–Managers or Lessors of Premises .......... 67

F. Endorsement to Landlord’s Insurance Making Tenant Additional Insured: CGL Endorsement - CG 20 26 07 04 Additional Insured–Designated Person or Organization .......... 73

G. Endorsement to Contractor’s Insurance Policy Making Tenant and Landlord Additional Insureds: CGL Endorsement - CG 20 10 07 04

Additional Insured – Owners, Lessees or Contractors – Scheduled Person or Organization ..... 77

H. CGL Waiver of Subrogation Endorsement - CG 24 04 10 92 Waiver of Transfer of Rights or Recovery Against Others To Us ..... 79

I. Endorsement to Tenant's Business Auto Policy Making Landlord Additional Insured: TE 99 01B (BAP Texas) Additional Insured ..... 80

J. Endorsement to Tenant's Business Auto Policy Waiving Insurer's Subrogation Rights As to Claims Against Landlord: TE 20 46A (BAP Texas) Changes In Transfer Of Rights Of Recovery Against Others To Us (Waiver Of Subrogation) ..... 82

K. Endorsement to Tenant's Workers Compensation Policy Waiving Insurer's Subrogation Rights As to Claims Against Landlord: WC 42 03 04 A Workers Compensation And Employers Liability Insurance Policy ..... 84

**DETAILED ANALYSES OF THE BASIC PRINCIPLES**

FOOTNOTES (Separate Table of Contents) ..... 90

# I. INTRODUCTION

Risk allocation provisions are contained in all contracts. They are used in an attempt to assure the intended economic objectives of the "deal." The most common methods by which risk is shifted in a contract are by the use of representations and warranties, insurance covenants, express assumption of liabilities, indemnity, exculpation, release and limitation of liability provisions.

Every provision of a contract is either restating the rule that would be supplied by the court in the absence of the provision or is expressly shifting a risk from one party to the other.

This Article concerns lease provisions dealing with the shifting of certain "extraordinary" risks from one party to the other including indemnities, exculpations and releases and supporting liability insurance. This Article does not address casualty loss of property or property insurance, which topic is being addressed by an Article at this seminar.

"***Indemnity***" [2] is, "I agree to be liable for your wrongs." Indemnity is a shifting of the risk of a loss from a liable person to another. However, many times scriveners use an indemnity provision when they do not know whether the Indemnified Person is a potentially liable person. Sometimes, an indemnity provision is no more than a restatement of existing duties, "I will indemnify you for my wrongs;" "You will indemnify me for your wrongs."

**"*Exculpation*"** [76] is, "I am not liable to you for my wrongs." An exculpatory provision is designed to exclude, as between the parties to a contract, certain designated duties, liabilities or costs due to the occurrence or non-occurrence of events.

**"*Release*"** [76] is, "You are not liable to me for your wrongs." A release is an agreement in which one party agrees to hold the other without responsibility for damage or other liability arising out of the transaction involved.

Each contracting party's risk-related goals are (1) to accept no more risk than it can reasonably bear or insure, and (2) to transfer the balance of the risk to the other party. The following factors are involved in the ultimate determination as to how much risk a party receives or transfers: (A) which party is in the best position to control the extent of the occurrence of the risk?; (B) does one party have specialized knowledge of the type of risks most likely to occur and how to prevent or identify them?; (C) custom and practice in the particular industry (for example, sellers to buyers; landlords to tenants; owners to contractors; contractors to subcontractors); (D) the bargaining strength of the respective parties; and (E) statutory and common law public policies.

This Article examines how liability insurance can be used to protect an indemnifying party through coverage for its contractually assumed liabilities and to protect an indemnified party by being an additional insured on the indemnifying party's liability insurance. Generally, the indemnifying party is required by the indemnified party to carry commercial general liability ("***CGL***") insurance naming the indemnified party as an additional insured on the indemnifying party's CGL policy. In such case, the indemnifying party is the "***named insured***" and the indemnified party is the "***additional insured***." In this article the indemnifying party and the named insured are sometimes referred to in this article as the "***protecting party***" and the indemnified party and the additional insured are sometimes referred to as the "***protected party***." Insurance is also a form of indemnity. However, Texas courts on public policy grounds construe the same "arising out of" indemnity triggering language used in both types of indemnity strictly against coverage of an indemnified party's negligence by a contract and broadly in favor of coverage of an additional insured's negligence in additional insured endorsements issued pursuant to the same contract. [26 - 29] Indemnity agreements are strictly construed in favor of the indemnifying party. [14]

The most common method of risk management is through contractual provisions for insurance. The success of an entity's approach to contractual risk transfer can be considered successful if it meets the following criteria.

- Risks retained are appropriate and affordable.

- Risk as an element of the overall transaction and negotiation is incorporated at the onset.

- Indemnity, insurance, and other pertinent conditions are not so onerous that contact negotiations drag on unnecessarily delaying the transaction or necessitating the use of second-rate service providers to accomplish the contract's purpose.

- Contractual conditions allocating risk are not so onerous that a court disallows their operation at a future point in time.

- Insurance requirements are clear, using recognized terms that can be interpreted both at the time the contract is negotiated and in possible future disputes.

- Insurance and other support for the indemnity is in place when a loss occurs.

- A thorough insurance monitoring process keeps the transferee in compliance with the insurance requirements.

- The performance of the contract is monitored and regularly evaluated.

Criteria quoted from CONTRACTUAL RISK TRANSFER Strategies for Contract Indemnity and Insurance Provisions (International Risk Management Institute, Inc. 2005).

This Article contains a discussion of certain risk management provisions in the lease forms contained in the *Texas Real Estate Forms Manual* of the State Bar of Texas. Accompanying each of these forms is a commentary noting the bias (the protected party) and a discussion of the risk allocations and the methods by which the risk is allocated. Also, included are the insurance endorsement forms commonly referenced in the risk management provisions and a commentary as to risk coverage and exclusions to coverage addressed by these insurance endorsements. Each of these forms has been annotated with footnotes identifying relevant case law and containing additional commentary explaining the risks being addressed by each form and certain gaps in coverage not addressed or possibly inadvertently being misaddressed.

## II. INDEMNITY

### A. Terminology

"**Indemnity**" [2] is, "*I agree to be liable for your wrongs.*" Indemnity is a shifting of the risk of a loss from a liable person to another. It is like insurance between the parties. Sometimes, an indemnity provision is no more than a restatement of existing duties, "*I will indemnify you for my wrongs*;" "*You will indemnify me for your wrongs*."

### B. Requirements for Enforceability

The Texas Supreme Court has imposed certain contract drafting requirements in order for a negligent party to shift its liability to another person.

#### 1. Fair Notice.

The concept of fair notice was introduced into Texas indemnity law in 1963 by the Texas Supreme Court in *Spence & Howe Const. Co. v. Gulf Oil Corp.*, 365 S.W.2d 631 (Tex. 1963). The fair notice requirement focuses on the appearance and placement of the provision as opposed to its "content." The supreme court in *Spence* reasoned that

> [t]he obvious purpose of this rule is to prevent injustice. A contracting party should be upon ***fair notice*** that under his agreement and through no fault of his own, a large and ruinous award of damages may be assessed against him solely by reason of negligence attributable to the opposite contracting party. *Id.* at 634.

#### 2. Express Negligence.

In 1987 the Texas Supreme Court expressing frustration with the writing style and craft of Texas lawyers in *Ethyl Corp. v. Daniel Const. Co.*, 725 S.W.2d 705, 707 (Tex. 1987) adopted the "express negligence" requirement. [6] In *Ethyl*, the court observed

> As we have moved closer to the express negligence doctrine, the scriveners of indemnity agreements have devised novel ways of writing provisions which fail to expressly state the true intent of those provisions. The intent of the scriveners is to indemnify the indemnitee for its negligence, yet be just ambiguous enough to conceal that true intent from the indemnitor. The result has been a plethora of lawsuits to construe those ambiguous contracts. We hold the better policy is to cut through the ambiguity of those provisions and adopt the express negligence doctrine. The express negligence test replaced the "clear and unequivocal" test....

The express negligence requirement is a rule of contract interpretation and therefore is to be determined by the court as a matter of law. *Fisk Electric Co. v. Constructors & Associates, Inc.*, 888 S.W.2d 813, 814 (Tex. 1994). The indemnity must expressly state that it indemnifies the indemnified person for liabilities caused in whole or in part by its negligence and not leave it to inference. For instance, "x will indemnify y for all loss arising out of the acts or omissions of y except for loss caused by

the gross negligence or willful misconduct of y" will not be enforced to indemnify y for loss caused by its negligence.

### 3. Overcoming the Worker's Compensation Bar.

Unless there is an enforceable written indemnity covering an employer's negligence, a landlord, tenant, and contractor can find itself liable to an employer's injured employee, not only for its own portion of the negligently caused injury but also for the proportionate part attributable to the employer's negligence without the ability to claim back against the employer for contribution. The Workers' Compensation Act bars contribution actions by third parties unless the employer has executed before the injury a written indemnity agreement for injuries to its employees arising out of the employer's negligence. Texas Workers' Compensation Act, TEX. LABOR. CODE ANN. § 417.004 (Vernon 1996). [20 - 22]

### 4. Comparative Indemnity.

The Texas Supreme Court in *Ethyl* found that the following indemnity provision did not protect an "indemnified" party either for its negligence or the indemnifying party negligence for injuries caused to the indemnifying party's employee:

> Contractor (Daniel) shall indemnify and hold Owner (Ethyl) harmless against any loss or damage to persons or property as a result of operations growing out of the performance of this contract and caused by the negligence or carelessness of Contractor, Contractor's employees, subcontractors and agents or licensees.

*Id*. at 708. [12] The court termed this claim as one for "**comparative indemnity**." The court held that the indemnity provision did not meet the express negligence test in this respect. The court stated

> Indemnitees seeking indemnity for the consequences of their own negligence which proximately causes injury jointly and concurrently with the indemnitor's negligence must also meet the express negligence test. ... Parties may contract for comparative indemnity so long as they comply with the express negligence doctrine set out herein.

### 5. Strict Liability.

In 1994 the Texas Supreme Court in *Houston Lighting & Power Co. v. Atchison, Topeka, & Santa Fe Railway Co*., 890 S.W.2d 455 (Tex. 1994) expanded the express negligence doctrine to require indemnity agreements intending to cover a protected party's strict liability to expressly state that it covers such strict liability. [17 - 19]

## III. INSURANCE

There are two insurance methods to effectuate protection: (1) directly, either by purchasing a CGL policy naming the protected party as the named insured or by the protecting party causing its insurer to list the protected party as an additional insured on the protecting party's CGL policy; and (2) indirectly, by the protecting party insuring its contractually assumed liability (its indemnity).

### A. Contractually Assumed Liability Insurance: Coverage for the Protecting Party

### 1. Exception to an Exclusion.

Most but not all CGL policies cover the protecting party for liability for "Bodily Injury" and "Property Damage" arising under an "insured contract" (sometimes referred to as "**contractually assumed liability insurance**"). Coverage is accomplished through the addition to the CGL Policy of an **exception to an exclusion** from coverage. Standard form CGL policies (ISO CG 00 01) provide as to "Coverage A" the following exceptions to the exclusion from coverage of contractually assumed liability. [43]

Coverage A under standard form CGL policies is for loss arising out of "Bodily Injury" or "Property Damage." "Bodily Injury" is in such policies defined as "bodily injury, sickness or disease sustained by a person, including death resulting form any of these at any time." "Property Damage" in such policies is defined as "physical injury to tangible property, including all resulting loss of use of that property ... or loss of use of tangible property that is not physically injured." The exception to exclusion from Coverage A reads

> This **insurance does not apply to** "Bodily Injury" or "Property Damage" for which the insured is obligated to pay damages by reason of the **assumption liability in a contract** or agreement. This **exclusion does not apply to liability** for damages:
>
> 1. **assumed in** a contract or agreement that is an "**Insured Contract**", provided the "Bodily Injury" or "Property Damage" occurs subsequent to the execution of the contract or agreement; or
>
> 2. that the insured would have in the absence of the contract or agreement. (Emphasis added)

An "**Insured Contract**" is defined in the standard ISO CGL policy form as including

> that part of any other contract or agreement pertaining to your business (including an indemnification of a municipality in connection with work for a municipality) under which you **assume the tort liability** of another party to pay for "Bodily Injury" or "Property Damage" to a third person or organization [**2004 endorsement CG 24 26 *, provided the 'bodily injury' or 'property damage' is caused, in whole or in part, by you or by those acting on your behalf***"]. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement. (Emphasis added)

Note that ISO has published the italicized language for inclusion in CGL policies by an endorsement CG 24 26. [43] This introduces into the "insured contract" definition a "contributory negligence" condition equivalent to the one contained in the 2005 revisions to ISO's additional insured endorsements discussed below in Section **III B5b(2)**. Inclusion of this type language into a CGL policy effectively eliminates coverage for the named insured's indemnification of a third party for its sole negligence. Care therefore must be taken by named insureds in coordinating and negotiating the terms of their CGL policies and indemnity agreements. It is possible for a named insured to be "uncovered" in such circumstances for an indemnity of another party's sole negligence. If this is coupled with an exclusion from additional insured coverage for an additional insured's sole negligence, the named insured may find itself acting as the insurer or in breach of its covenants to protect the additional insured/indemnified party!

**2. <u>Named Insured Not Insured for all Contractually Assumed Liabilities - No Coverage for Indemnified Person's Sole Negligence</u>.**

Until 2004, the standard CGL policy form published by ISO insured its named insured for its contractually assumption of liability for its indemnitee's sole negligence. [39] ISO issued in 2004 an endorsement, CG 24 26 07 04, which modifies the definition of "insured contract" to eliminate coverage for the sole negligence of an indemnitee. Thus, an indemnifying person should review its CGL policy to determine whether it will extend to protect it should it decide to indemnify the other party to its contract for the other party's sole negligence. See **<u>Forms E-G</u>** to this Article.

**B. Additional Insurance: Coverage for the Protected Party**

**1. <u>Purpose</u>.**

Another commonly employed risk transfer technique is to require the protecting party to arrange for its insurance to cover the protected party as an additional insured. [44-56] An additional insured endorsement is equivalent to an insurance policy written for the additional insured. The strongest rationale for this request is the perceived fairness of making the protecting party's insurance carrier responsible for the increased exposure to loss created for the additional insured due to the protecting party's operations, work or control of the premises. Issuance of additional insured endorsements is routine and inexpensive as compared to a separate policy being issued to cover the exposure of the party to be protected. The risk of loss has been factored into the named insured's premium.

An additional insured designation seeks to achieve the following results: It provides a limited form of primary coverage for the additional insured. It may remove the possibility of subrogation against the additional insured for covered liabilities. It provides the additional insured with direct policy rights within the primary insured's policy, including separate defense cost coverage for claims involving the additional insured. It provides a "safety net" should the indemnity provision be unenforceable or otherwise be deficient. Additional insured endorsements generally do not carve out from the

coverage afforded the additional insured loss due to "***Personal and Advertising Injury***." In these circumstances, protection for the protected party's Personal and Advertising Injury is covered whereas without specific endorsement to the named insured's CGL Coverage B, the named insured's indemnity for such liabilities is not reinsured and the named insured not carving out this type of liability is uninsured as to its contractually assumed liability. Additionally, additional insured status may automatically entitle the additional insured to the named insured's excess liability or umbrella coverage because such policies frequently cover all insureds (including the additional insureds) under the primary liability policy.

There are important considerations for a protected party to remember when evaluating whether to forgo a contractual indemnity by the protecting party and to rely solely on being an additional insured on the protecting party's CGL policy. The policy may be canceled with or without the protected party's knowledge; the insurer may become insolvent; and the additional insured's coverage under the protecting party's CGL policy is subject to the policy's limits and exclusions from coverage.

**2. Automatic Coverage or by Endorsement.**

Coverage may be accomplished (1) by endorsement of the protecting party's CGL insurance or (2) through blanket additional insured provisions in the protecting party's CGL policy, which provide automatic additional insured status for persons that a named insured is obligated by contract to provide such coverage.

**3. Endorsements: ISO or Manuscripted Forms.**

Additional insured endorsements can be divided into two categories: endorsement forms promulgated by the Insurance Services Office, Inc. ("***ISO***") and all other endorsement forms (referred to in the insurance industry as "***manuscripted***" forms). [39] There are four nationwide insurance advisory organizations that develop standard insurance forms. ISO is the largest national insurance advisory organization. Its forms are considered to be the industry's "standard" forms. 1 CONTRACTUAL RISK TRANSFER Strategies for Contract Indemnity and Insurance Provisions §XIII, p. XIII.B.2 (International Risk Management Institute, Inc. 2003).

ISO forms are identified by a two-letter prefix identifying the type of coverage, four digits identifying the form category and individual form number, and four digits identifying the edition date by month and year. For example, the CG 20 10 07 04 additional insured endorsement form is made up of "**CG**" to indicate that this is a CGL form; "**20**" indicates the category of CGL endorsement that this form belongs to, an additional insured endorsement; "**10**" is the number assigned to this particular CGL additional insured endorsement; and "**07 04**" indicates that this form is the July 2004 edition of the CG 20 10. [39]

ISO has promulgated 33 forms of additional insured endorsements, each tailored to a different risk transfer, including CG 20 10 07 04–Additional Insured–Owners, Lessees or Contractors–Schedule Person or Organization and CG 20 26 07 04–Additional Insured–Designated Person or Organization. [39]

**4. Covered Matters.**

Additional insured endorsements furnish coverage to an additional insured for liabilities "**arising out of**" the named insured's "**work**", "**operations**", or "**premises**" or some variation of these themes.

**a. Ongoing Operations**

ISO form CG 20 10 is ISO's standard endorsement for use in adding a project owner as an insured to a general contractor's CGL policy or a general contractor to a subcontractor's CGL policy (See **Form G** CG 20 10 07 04 Additional Insured – Owners, Lessees or Contractors – Scheduled Person or Organization). CG 20 10 provides coverage for the additional insured's liabilities arising out of the "***ongoing operations***" of the named insured. CG 20 10 has undergone changes from coverage for liabilities "*arising out of the work*" of the named insured in the November 1985 version (CG 20 10 11 85), to "*arising out of the ongoing operations*" of the named insured in the October 1993 version (CG 20 10 10 93), the March 1997 version (CG 20 10 03 97), and the October 2001 version (CG 20 10 10 01). ISO made this change to clarify that this particular form of additional insured endorsement is intended to cover liabilities arising out of the "ongoing operations" of the named insured as opposed to liabilities arising out of operations that have been completed. The October 2001 revision added an express exclusion from coverage for liabilities "*occurring after ... all work ... has been completed*" to further emphasize the "ongoing" operations requirement. The 2004

revision to CG 20 10 to eliminate coverage for the additional insured's sole negligence is discussed at **III B5b(2)** of this Article.

**b. Completed Operations**

The ISO CG 20 10 11 85 additional insured endorsement ("arising out of your work") was construed in *Pardee Constr. Co. v. Insurance Co. of the West*, 92 Cal. Rptr.2d 443 (Cal. App. 2000) to cover an additional insured contractor's liabilities arising out of the completed operations of its named insured subcontractor. In *Pardee* the CGL policy and additional insured endorsement were issued 4 years after completion of the subcontractor's work on the project in question and were held to cover injuries arising out of the earlier work of the subcontractor. The wording of the additional insured endorsement must be examined to determine if complete operations coverage is included (*e.g.,* by not limiting coverage to "*ongoing*" operations or by not expressly excluding coverage for completed operations). If completed operations coverage is desired and coverage is not afforded by the proffered endorsement form, coverage may be effected either by manuscripting the endorsement to extend to completed operations or by adding the coverage by a completed operations endorsement. ISO CG 20 37 Additional Insured – Owners, Lessees or Contractors – Completed Operations is designed to cover completed operations liabilities, first by stating that it covers liabilities "*arising out of your* (the named insured's) *work*" and stating that the liabilities covered are those liabilities arising out of the work that are "*included in the products-completed operations hazard*."

**c. Premises**

There are two ISO endorsements used primarily to add as an additional insured the owner of premises or land leased to the named insured, CG 20 11 01 96 Additional Insured – Managers or Lessors of Premises and CG 20 24 11 85 Additional Insured – Owners or Other Interests from Land Has Been Leased. Similarly, see **Form E** for CG 20 11 01 96 Additional Insured – Managers or Lessors of Premises, which ISO additional insured endorsement adds designated persons as additional insureds as to designated "***premises***" and covers the Additional insured's liability:

> arising out of the ownership, maintenance or use of that part of the **premises** leased to you (the named insured) and **shown in the Schedule** subject to the following additional exclusions: ... Any "occurrence" which takes place after you cease to be a tenant in that premises. (and) Structural alterations, new construction or demolition operations performed by or on behalf of the (additional insured)....

An almost identical ISO endorsement is CG 20 24 11 85 Additional Insured – Owners or Other Interests from Land Has Been Leased. The sole and obvious difference being "land" versus "premises." The most common factually litigated scenario regarding these endorsements involves injuries occurring "**outside**" the "**part**" of the premises "shown in the schedule" leased to the tenant. This issue can also take on the nuance of whether coverage is effected if the schedule designates more or less than the "part of the premises" leased to the named insured.

**Cases Finding No Coverage.**

For example, in *General Accident, Fire and Life Assurance Corp. v. Travelers Ins. Co.,* 556 N.Y.2d 76 (1990), the court held that the AI endorsement did not cover a claim brought by the named insured's injured employee when the injury occurred outside the leased "premises." The court denied coverage even though tenant named insured's CGL policy was endorsed to name its landlord as an additional insured and designated the landlord's entire property as the "premises." The court reviewed the lease and found that it defined the term "premises" as a specific area and the "premises" was not where the injury occurred. New York follows a rule that these type endorsement designate the location ("the premises") where the injury must occur, and do not provide coverage when the injury occurs outside of the designated area even though the "occurrence" might be viewed as having "sprung" from the use of the landlord's facility. See *Greater N. Y. Mut. Ins. Co. v. Mut. Marine Office, Inc.* 3 A.D.3d 44, 769 N.Y.S.2d 234, 237 (2003), N. Y. App. Div. Lexis 13316 (2003)–injury occurred to a HVAC repairman who was injured while walking on roof of landlord's multi-tenant retail center to get to HVAC unit that tenant was obligated to maintain pursuant to lease of a retail space in the center. The additional insured endorsement form was an ISO CG 20 11 Additional Insured – Managers and Lessors of Premises (**Form E**). The injury neither occurred in the retail space leased to tenant or on the roof

directly above the space. See also *Rensselaer Polytechnic Inst. v. Zurich Am. Ins. Co.*, 176 A.D.2d 1156, 1157, 575 N.Y.S.2d 598 (N.Y. 3rd Dept. 1991)–stating that court was not persuaded that a duty to indemnify existed by the argument that although the accident did not occur within the leased premises, it did arise out of use of the leased premises; *Commerce & Indus. Ins. Co. v. Admon Realty, Inc.,* 168 A.D.2d 321, 323, 562 N.Y.S.2d 655 (1st Dept. 1990)–finding no duty to indemnity where the cause of the damage occurred outside the leased premises; *Northbrook Ins. Co. v. American Stats Ins. Co.*, 495 N.W.2d 450 (Minn. 1993)-additional insured endorsement held not to cover injuries occurring in alley behind named insured's bakery in a shopping center (in this case an employee of the bakery was injured when he slipped on ice while loading a truck parked in the alley behind the shopping center); *USF&G v. Drazic,* 877 S.W.2d 140 (Mo. 1994)-additional insured not covered for injuries to named insured tenant's employee who slipped and was injured on an icy parking lot.

**Cases Finding Coverage.**

An earlier New York case, *J. P. Realty Trust v. Public Serv.,* 476 N.Y.S.2d 325 (1984), found coverage for the additional insured for an injury occurring to the named insured's employee injured while using a freight elevator. The additional insured endorsement designated landlord's entire building as "that part leased to the insured;" however, the lease designated only two floors of the building as leased to the tenant as the "premises." The lease provided tenant use of the freight elevator. This court looked to the intent of the parties and construed the additional insured endorsement broadly in favor of coverage. Similarly, the court in *Harrah's Atlantic Inc. v. Harleysville Ins. Co.*, 288 N. J. Super. 152, 671 A.2d 1122 (1996) found coverage for the additional insured landlord for an injury occurring outside the premises leased to tenant (employee of NI tenant injured crossing street separating landlord's parking garage and landlord's building which housed tenant's retail space). The court noted

> However, the requirement that there be a causal link or connection between the accident and the leased premises does not mean that there must be any degree of physical proximity between the leased premises and the scene of the accident. The two concepts are quire different. Thus, we would expect the outcome in the *Franklin* case to have been the same had the tenant's business guest fell on the building's exterior steps even if they were some distance from the luncheonette. This so because the negotiating for such an endorsement in a lease the landlord is simply attempting to ensure against the risk of liability generated by the business about to be conducted by the tenant, and place the cost of insuring that risk on the tenant.

*Franklin Mut. Ins. v. Security Indem. Ins.,* 275 N. J. Super. 335, 340, 646 A.2d 443, *cert denied* 139 N. J. 185, 652 A.2d 173 (1994). Also see *ZKZ Associates LP v. CNA Ins. Co.*, 224 A.D.2d 174, 637 N.Y.S.2d 117 (N.Y. 1st Dept. 1996)–court required the insurer of the tenant of a garage to defend the owner of the garage in a personal injury suit even though the accident occurred on the sidewalk in front of the tenant's property. The additional insured endorsement was issued on an inapplicable form as it provided additional insured coverage as to injuries arising out of premises "leased to" the named insured. There were no leased premises as the named insured was a garage operator. The court noted that named insured's CGL policy provided coverage to the named insured for garage operations including "the ownership, maintenance or use of locations for garage business and that portion of the roads or other accesses that adjoin these locations ...[; and] all operations necessary or incidental to a garage business." The court reasoned that "without traversing the sidewalk for access to and from the garage, there could be no use at all of the garage as a parking facility." *Id.* at 176. In *University of California Press v. G. A. Insurance Co. of New York*, 1995 U.S. Dist. Lexis 21442, 1995 WL 591307 (E.D.N.Y. 1995), the property damage and actual injury occurred within the leased premises. Books stored within the leased premises were damaged by leaking water from a sprinkler system malfunction one floor above the leased premises. The court found the language of the insurance agreement to be ambiguous and unclear as to whether

> the term "arising out of" referred to where the breach took place, where the accident occurred or where the damage occurred.

Unable to reconcile that ambiguity, the court followed a basic principle of contract law and construed the ambiguity against the insurer as the policy's drafter. Thus, because the damage occurred within the leased premises, the court found in favor of coverage. The court in *Hormel Foods Corp. v. Northbrook Property & Casualty*

*Insurance Co.,* 938 F.Supp. 555 (D. Minn. 1996), *aff'd*, No. 97–1197, 1997 U.S. App. Lexis 34146 (8th Cir. 1997) upheld coverage for an additional insured landlord which leased a hog-processing facility to the employer (Quality Pork Products, "QPP") of a person who was killed using a machine designed and manufactured by Hormel, installed on the premises, and leased to QPP by Hormel. The Northbrook insurance policy AI endorsement covered losses "arising out of the ownership, maintenance or use, of the leased premiss." The court held that the machine was so intertwined with the facility's operations as to make injuries flowing from it attributable to the "ownership, maintenance, or use" of the facility. The machine was bolted to the floor walls and was "unambiguously part of the premises." How far some courts will extend additional insured coverage is illustrated by *SFH, Inc. v. Millard Refrigerated Services, Inc.*, 339 F.3d 738 (8th Cir. 2003). The warehouse lease required the lessee to carry CGL insurance and the lessor and its manager as additional insureds. Coverage was affected through a blanket additional insured endorsement covering all additional insured's required by named insured's contracts to be covered. The additional insured language was identical to the ISO CG 20 11 coverage as to "liability arising out of the ownership, maintenance or use of that part of the premises leased to you." The lessee's property was destroyed by a fire at the warehouse. It was determined that the one of the manager's employees had disabled the sprinkler system. The court found in favor of coverage, stating

> Construing the "arising out of" language broadly, we conclude that [the warehouse manager's] liability arose out of its maintenance of the leased premises. the fire started within the portion of the warehouse leased by [the lessee] and injured [the lessee's] property located in the leased premises. [The lessee's] loss was caused, or significantly increased, by the conduct of the [manager's] employee who shut off the water to the building's sprinkler system.

**5. Covered Liabilities**.

**a. Negligence**

**(1) Additional Insured's Vicarious Liability for Named Insured's Negligence**

Additional insured status affords the additional insured protection against vicarious liability arising out of the named insured's acts or omission. [44] An additional's insured's vicarious liability for the acts or omissions of a named insured is an exceptional situation, for example, an owner's liability for its contractor's acts or omissions in the case of non-delegable duties and other exceptions to the independent contractor rule. 44 TEX. JUR. 3D, *Independent Contractors* (1996); and RESTATEMENT (SECOND) OF TORTS Introductory Comment to §§ 416-429 (1966). It has been urged that limiting additional insured coverage to the additional insured's vicarious liability is illusory and against public policy. *See* the dissent in *National Union Fire Ins. Co. of Pittsburgh, Pa. v. Glenview Park Dist.*, 158 Ill.2d 116, 632 N.E.2d 1039 (Ill. 1994). As noted below, Texas courts have followed the majority rule that additional insured coverage is not limited to coverage of the additional insured's vicarious liability for the named insured's negligence, or even to cases where the named insured is concurrently negligent with the additional insured.

**(2) Additional Insured's Own Negligence**.

Depending on the language of the protecting party's insurance, the protected party may be covered for its own negligence, whether or not the protecting party is negligent. As such, it supplements the protection afforded by the protecting party's indemnity. [44]

**b. Interpretation of Additional Insurance Covenants**

**(1) Express Negligence Test Not Applicable to Insurance Covenant**

In *Getty Oil Co. v. Insurance Co. of North America, NL Industries, Inc., Youell and Companies*, 845 S.W.2d 794 (Tex. 1992), *cert. den'd*, 510 U.S. 820, 114 S. Ct. 76, 126 L. Ed. 2d 45 (1993), the Texas Supreme Court declined to extend the express negligence doctrine to invalidate contractual provisions requiring the protected party (Getty) to be listed as an additional insured on the protecting party's (NL Industries') liability policies. [45] In *Getty* the injuries arose out of Getty's sole negligence; the indemnity provision excluded indemnity for Getty's negligence; the insurance covenant was silent as to whether the insurance was or was not to cover injuries due to Getty's negligence; the insurance covenant in the contract provided for NL Industries to maintain commercial general liability insurance and for such insurance was to "*extend to and protect Getty*." The court found that there was not a basis for preventing litigation as to whether Getty

was an additional insured under NL Industries' policies (*e.g.,* through an automatic blanket insured provision).

**(2) 2004 Revision to ISO Forms**

Recently, ISO issued revisions to its AI Endorsements, including the CG 20 26, CG 20 10 and CG 20 37 (attached hereto as **Forms F and G**) to eliminate coverage for an Additional insured's sole negligence. For example, the CG 20 10 form will exclude coverage for liabilities attributable to the additional insured's sole negligence as follows:

> **Section II – Who Is An Insured** is amended to include as an additional insured the person(s) or organizations shown in the Schedule, but only with respect to liability for "bodily injury", "property damage" or "personal and advertising injury" caused, in whole or in part, by:
>
> 1. Your (the named insured's) acts or omissions; or
>
> 2. The acts or omissions of those acting on your behalf;
>
> in the performance of your ongoing operations for the additional insured(s) at the locations(s) designated above.

The 2004 revision seeks to limit the trigger for additional insured coverage to occurrences caused by the sole or partial negligence of the named insured.

**c. Manuscript Additional Insured Endorsement to Limit Coverage to Indemnified Liabilities**

One approach parties have used is have the protecting party's insurer issue a manuscripted additional insured endorsement that is limited to insurable indemnified liabilities. In *Certainteed Corp. v. Employers Ins. of Wausau,* 939 F. Supp. 826 (D. Kan. 1996). In *Certainteed* the additional insured endorsement issued by Wausau was a blanket automatic insured provision in the CGL policy it issued to its named insured contractor. This provision provided as follows:

> Section Two–Who Is an Insured:
>
> 5. Any person or organization ... for which you have agreed by written contract to procure .... liability insurance, but only for liability arising out of operations performed by you or on your behalf, provided that: ... (b) The insurance afforded to any person ... as an insured under this Paragraph 5 shall include only the insurance that is required to be provided by the terms of such agreement to procure insurance, and then only to the extent that such insurance is included within the scope of this policy.

The insurance provision of the construction contract, required the protecting party (the named insured contractor providing construction services to the plant owner) to provide insurance coverage for all "liability assumed" by the protecting party. The construction contract contained an indemnity agreement whereby the protecting party indemnified the protected party (the additional insured plant owner) for its negligence except if due to its sole negligence. The court construed the blanket addition insured provision as covering the additional insured's liability for injuries jointly caused by the protected party and by another contractor (a construction manager) to an employee of the named insured. The court thus held that the scope of the additional insured coverage was the same as the scope of the insurance that the named insured was to procure to protect the named insured on its indemnity.

**6. Liability for Failure to List Other Party as Additional Insured.**

A party that breaches its contractual obligation to list the other party as an additional insured is liable for all damages that would have fallen within the protection of the additional insured endorsement.[50] The court in *Coastal Transport Co. v. Crown Central Petroleum Corp.*, 20 S.W.3d. 119 (Tex. App.-Houston [14th Dist.] 2000, *writ denied*) found that Coastal failed to list Crown as an additional insured on Coastal's Trucker's Policy and was liable to Crown for the $4,816,549.28 judgment obtained by an employee of Coastal that was injured on Crown's premises. The insurance covenant did not refer to an additional insured designation but required Coastal to obtain