

How Does the Liability Flow? A Discussion of Contractual Liability

Brian Johnson

Nonprofits Insurance Alliance Group

"In any negotiated agreement each party should be liable for the things over which they have control."

In [my previous blog](#), I discussed four tips for how you and your insurance broker could better work together, and one of the topics discussed was reviewing a contract with your broker before you sign to make sure there's no problematic wording.

In recent months, one of the questions we've received most often from our nonprofit members and our brokers has been concerning the contracts our members are being asked to sign by their local municipalities. These contracts cover everything from work the nonprofit is doing for the municipality (i.e. family/child services, foster care agencies, etc.) to the simple use of public space for a fundraising event. Recently, the contract wording has become increasingly draconian, often pushing all liability onto the nonprofit, and in many cases, inappropriately so.

Many of the questions we get are about the indemnification clause in the contract. This clause determines how the liability flows in case of a claim against the nonprofit or against the municipality. You want to make sure your nonprofit is covered in cases where there's a claim from an error or omission on your part. Accidents happen and things are sometimes missed, which is why you buy insurance. However, you need to make sure you're not being forced to cover someone else's liability because of onerous contract language. We always recommend that our members have someone with legal expertise review any contract before signing it. We will only opine on sections of the contract related to indemnification.

Indemnification Clauses

An [indemnity agreement](#) is a risk transfer mechanism (a contract) in which one party (the indemnitor) transfers risk from (indemnifies) another party (the indemnitee).

What exactly does that mean in layman's terms? The indemnification agreement attempts to ensure that liability is assigned to the person responsible for causing that claim, or through whose negligence or omission the claim has occurred. Again, each party should be liable for the things over which they have control. Here's an example of a nonprofit project and a typical indemnification clause:

The city of Mos Eisley has a contract with the nonprofit Solo Foundation to provide services to the homeless to help them obtain housing. Solo meets with the clients at their office to provide job search services, financial counseling, and prescreening for city funded housing. The city requires all of its contractors to include the following indemnification agreement in the Service Contract:

"Consultant agrees to add the city of Mos Eisley as an Additional Insured and to hold harmless and indemnify the city of Mos Eisley, its officers, agents and employees for all claims, legal expenses or judgements which is caused by any negligence, liable act or omission of the consultant or those acting in the consultant's behalf in the performance of your ongoing operations with respect to this contract."

A good contract would have mutual indemnification wording where each party agrees to defend and possibly indemnify the other party for claims caused by their respective actions. That being said, the indemnification

wording above would be considered a fair indemnification clause. We will talk about why it is fair in a bit but first we want to explain the term Additional Insured.

Additional Insured

An additional insured (AI) is a person or organization that enjoys the benefits of being insured under an insurance policy, in addition to whomever originally purchased the insurance policy (the named insured). Here's a real-life example:

A nonprofit hires a psychologist as a consultant to counsel its clients on-site once a week, in a group session. The psychologist requires, by contract, that the nonprofit add her as an additional insured on the nonprofit's insurance policy. On the way to a meeting, one of the clients slips on a wet floor on the nonprofit's premises and hurts their back. The client then sues the nonprofit and the psychologist as a result of the incident. As an additional insured, the psychologist would be defended by the nonprofit's insurance policy.

So why would anyone want to be added as an additional insured? Being added as an AI helps to ensure fiscal responsibility for a claim is allocated to the party liable for that loss. Again, people should be responsible for the things over which they have control. In the case of our previous example, the nonprofit should have been in control of keeping a safe environment (dry floors). The additional insured is being covered only for claims caused by the actions of the named insured to the policy. An entity/person should only be added as an AI when there is some legal relationship between the nonprofit and that entity. In other words, if you are not being required by written agreement to add someone as an additional insured, you shouldn't.

In some cases, the nonprofit will want to be added as an additional insured on another's insurance policy. As an example, if the nonprofit has hired a contractor to do construction at the nonprofits location, it is a good idea to have that contractor, by way of a written agreement, add the nonprofit as an additional insured to the contractor's insurance policy.

“Arising Out Of” vs. “Caused By”

What makes the above indemnification clause fair? Well, there are a couple phrases the nonprofit should look for and try to avoid with respect to the indemnification clause. These phrases are: “arising out of” and “sole negligence.” Here is the indemnification clause being referenced:

“Consultant agrees to add the city of Mos Eisley as an Additional Insured and to hold harmless and indemnify the city of Mos Eisley, its officers, agents and employees for all claims, legal expenses or judgements which is caused by any negligence, liable act or omission of the consultant or those acting in the consultant's behalf in the performance of your ongoing operations with respect to this contract.”

Now, let's change a few words:

*“Consultant agrees to add the city of Mos Eisley as an Additional Insured and to hold harmless and indemnify the city of Mos Eisley, its officers, agents and employees for all claims, legal expenses or judgements **arising out of** ~~which is caused by any negligence, liable act or omission of the consultant or those acting in the consultant's behalf in the performance of your ongoing operations with respect to this contract.~~”*

The first version states specifically that the claim must be “caused by” the nonprofit's negligence. This is preferable as the nonprofit should not accept liability for things outside their control. The second version is much broader in scope. It could be argued, inappropriately so, that any claim or loss that happens “arises out of” the nonprofits operations. Here is a real-life claims scenario to illustrate that point (note that the names have been changed to protect the innocent):

Good Heart Housing leases apartments and houses to ensure the availability of low cost housing for

their clients. They lease an apartment from Dick. Dick requires Good Heart to add him as an additional insured. In one of the apartments that Good Heart is using to house a family, there is a fire. The fire is caused by faulty wiring that Dick knew about but didn't fix (or tell Good Heart about).

It is clear that it was not the family's or the nonprofit's fault that the fire started. Should the nonprofit's insurance (via the indemnification clause with "arising out of" wording) reimburse Dick for the loss? Under "arising out of" scenario, Dick could argue that this fire loss should be covered under the additional insured language because the fire was "arising out of" the nonprofits actions (renting the house). Under the "caused by" wording, it is clear that the fire was not caused by the actions of our insured (or the family). It was not the fault of either that the fire started.

Sole Negligence

Now let's discuss the concept of "sole negligence." Here is another example of a poor indemnification clause:

The Nonprofit agrees to indemnify, defend, and hold harmless The City, its agents, employees and officers, from any and all liability, cost, or expense, including but not limited to attorneys' fees, arising out of or relating to the performance of the work, regardless of whether caused in part by the acts or omissions of the Nonprofit. Nothing herein shall be interpreted as obligating Nonprofit to indemnify The City against its sole negligence or willful misconduct.

Essentially, this clause means that if a claim is the result of the City being anything but 100% at fault, the nonprofit will be held responsible. In other words, let's say the City is 99% responsible for a claim/loss. The City can point to the sole negligence clause and try to push 100% of the liability onto the nonprofit. To make matters worse, it is very rare that a judge (jury) would find either party 100% liable for any claim/loss. That is why some municipalities insist on this wording. Better wording would be to suggest that indemnification for a claim will be allocated proportionally by the contribution of either party to that claim.

In summary, there are three things you would like to see in any indemnification clause for a contract you are going to sign:

1. You want to make sure the wording refers to claims "caused by" your actions and not "arising out of" anything. The "arising out of" wording is too broad and could lead to liability being assigned to you that is out of your control. Don't agree to take on liability for things outside your control.
2. If you are agreeing to indemnify another party via a written agreement you should ask that that party agree to also indemnify you (mutual indemnification). That way everyone is liable for the things over which they have control.
3. You should ask that any "sole negligence" wording be removed. This type of wording will almost always lead to the indemnitor being responsible for all losses.

Lastly, it is always a good idea to have your broker review any contract before you sign it to ensure you will be compliant with the indemnification and insurance clauses.

If your nonprofit is not a member of the Nonprofits Insurance Alliance Group and you'd like to learn more about joining our community, please check out our list of coverages as well as the benefits of membership, or simply send an email to info@insurancefornonprofits.org.

All members have unlimited access to risk management and loss control consultations, and those members with Directors & Officers coverage (who also have employees) have access to unlimited consultations with our employment risk managers on issues such as HR, labor and employment.

