

INSURANCE INDEMNIFICATION AND HOLD HARMLESS AGREEMENTS

The Purchase Order Agreement

Lee M. Hoffman, CIC, LIC, CPIA

As part of ongoing services, attorneys should review their commercial clients standard Purchase Order Agreement to make sure it provides proper protection. The most overlooked business transaction for a risk transfer agreement is the commercial (business to business) purchase order agreement. An order to purchase goods is an insurable contract under most commercial liability policies.

Manufacturers who purchase components from vendors routinely include insurance and indemnification provisions in their purchase orders. They are usually pre-printed on the back of the purchase order agreement or in electronic format as an attachment to the purchase order. They are, for the most part, overlooked or ignored by eager vendors wanting to make a sale. Rarely will a vendor try to negotiate the terms and conditions of an indemnification agreement on a purchase order.

Attorneys who assist clients with setting up or incorporating new businesses or who routinely provide corporate consulting and related documents should make sure that their clients primary line of defense from supply chain liability is by contract as opposed to tort. Like any other business transaction, the supply of goods and services has risks associated with it, but with proper risk management and well written purchase order agreements, those risks can be mitigated. Creating effective insurance and indemnification provisions in purchase order agreements is an excellent way to accomplish this objective.

Your client's insurance company will pass a claim onto or subrogate against a vendor if they feel a claim was caused by the vendor's defective product. Unfortunately too many insurance companies adjust claims based on economics, not fault. If it costs more to subrogate or litigate then the claim is worth, it is doubtful that the insurance company will pursue the vendor.

However, the existence of an indemnification provision in a purchase order agreement increases the odds that an insurance company will approach the vendor with the claim. In addition, a well written indemnification agreement can make a vendor liable by contract as opposed to tort. In supply chain type claims it is not always easy to identify the tortfeasor. Such an agreement is another risk management tool that attorneys can create for their clients to control exposures to risk.

A number of years ago while selling insurance I was directly involved in such a situation. My customer had the best insurance program available and I had placed their insurance with a highly rated insurance company. Unfortunately, my client almost went out of business because of the skyrocketing cost of their insurance due to a large number of claims that could not be successfully subrogated because the tortfeasor was not easy to identify.

W.M. Hose Assemblies, Inc. (WM), not their real name, was a manufacturer of washing machine inlet hose assemblies. An inlet hose is under constant water pressure even when the washing machine is not in operation. When a failure occurred and the rubber tube burst, it usually resulted in a flooded house and a large amount of property damage. The homeowner's insurance carrier paid their insured and then subrogated against the manufacturer of the washing machine. Since the washing machine manufacturer purchased the component part (hose assembly) from their supplier WM, they tendered the claim to WM. One of the reasons they could do this was the existence of a well written indemnification agreement on the purchase order holding the supplier liable for any failure of a supplied part for any reason whatsoever.

Contract Law vs. Tort!

The washing machine inlet hose is an assembly made by crimping metal couplings onto a length of rubber tube. The metal couplings and rubber tube were component parts purchased from vendors. WM's operation involved cutting the tube to length and attaching (crimping) the metal ends on to form a completed assembly. As part of their quality control procedures water pressure testing was performed and the testing never produced a failure within the specified operating pressure range.

Almost all the failures occurred in the area of the crimp. The hose never came loose from the crimp, but that is the area where the rubber would fail. A bubble would develop in the area of the crimp and eventually burst. In addition, some of the failed assemblies showed signs of external abrasion on the rubber tube meaning that they were rubbing up against a wall in back of the washing machine.

Various engineering reports commissioned by the washing machine manufacturer and the rubber tube supplier pointed to the assembly (crimping) process as the cause of the failures. However, engineering reports commissioned by both WM and the insurance company for WM pointed to defective rubber. It should be noted that engineering reports all performed in the middle 1980's by engineers for both sides of the dispute used visual inspection as the basis for their analysis. None of the reports were ever supported by comparative analysis, statistical data, chemical analysis or historical data until years later. In 1989 tests by a well known and respected engineering firm vindicated the assembly process. The engineering firm supported their findings with chemical and physical testing, comparative analysis and historical data. The results conclusively assessed the blame to the use of the wrong rubber reinforcing material in the rubber tube manufacturing process. This allowed the reinforcement between the layers of rubber to weaken and eventually burst. By 1989, hundreds of claims were paid by the insurance carrier for WM that should have been paid by the rubber manufacturer.

Unfortunately WM did not have a written indemnification agreement with their rubber supplier and the supplier denied every claim. WM had to rely solely on tort. With Business to Business transactions, tort is not where you want to begin dispute resolution. It is a very expensive and time consuming proposition.

Fortunately WM was able to sell their business the same year I was about to deliver a products liability premium that had quadrupled from the previous year, which had just doubled before that. WM received far less than the company was worth due to negotiations over outstanding liabilities and the fact that prospects for subrogation were not very promising.

Tort versus Contract! Attorneys have as big a role in making sure their clients are properly protected against claims as do insurance agents. Had they used a purchase order agreement with a properly worded indemnification provision, WM may have received their full asking price.

I have assisted attorneys with the drafting of insurance and indemnification agreements for their clients purchase orders. They can be very simple or extremely complex depending on the nature of the business and transactions contemplated. The following is an "example" of a simple all purpose purchase order agreement with insurance, indemnification and risk management elements included:

Company
(Address)
(City, State, Zip)

Addendum to /Contractor/Subcontractor/Supplier Purchase Order # _____

In exchange for compensation paid or payable to the undersigned for services performed and/or materials or labor provided to _____ (Company) its Affiliates and Assigns, the undersigned contractor/subcontractor/supplier (Contractor) agrees to furnish such services and/or materials according to generally accepted industry standards. Contractor further agrees to adhere to all OSHA rules and regulations while on Company's premises. Contractor will carry all necessary insurance applicable to the services performed and/or materials provided including but not limited to the coverages and minimum limits below:

- A. **Commercial General Liability:** \$1,000,000 Each Occurrence, \$2,000,000 General and Products/Completed Operations Aggregates, \$1,000,000 Personal & Advertising Injury Liability. Such insurance is to be provided on a primary & non-contributory basis.
- B. **Automobile Liability:** \$1,000,000 Combined Single Limit including Owned, Hired and Non-Owned Auto.
- C. **Workers Compensation:** Employers Liability \$500,000 Each Accident/\$500,000 Disease – Policy Limit/\$500,000 Disease Each Employee. If Contractor is an independent contractor and/or is otherwise exempt from their state's Workers Compensation Act in which the work is being performed, Contractor will provide the State Approved Exemption Certificate and sign below. Contractor must also comply with the requirements of the Workers Compensation Law of the State where goods or services are being provided.
- D. **Umbrella -** \$2,000,000 Each Occurrence and \$2,000,000 Aggregate.

For work involving the installation of materials, Contractor agrees to insure such materials for all causes of loss until such materials are installed and accepted by the Owner.

Contractor agrees to name Company, its Affiliates and Assigns as Additional Insured for ongoing and completed operations and provide an original Certificate of Insurance on Acord Form #25 or equivalent evidencing compliance with this requirement prior to the commencement of any work.

NOTICE: If you are a Temporary Employment Service providing workers to Company, you MUST add the Alternate Employer Endorsement NCCI Form #WC 00 03 01 A or equivalent to your Workers Compensation Insurance Policy naming Company as an Alternate Employer. A Copy of the Endorsement must be provided to Company prior to the beginning of work.

To the greatest extent permitted by law, Contractor agrees to indemnify, defend and hold Company harmless from any and all claims arising out of services performed, labor provided and products sold or installed by Contractor and Contractor's subcontractors, their employees, laborers, agents and assigns. (Contractor) further agrees to waive any rights of subrogation – including workers compensation - against Owner.

This agreement is primary to and survives any prior or subsequent written or verbal agreement that conflicts with the terms and conditions of this agreement.

Consent:

I certify that I am an independent contractor/subcontractor/supplier under the laws of the State of _____
and am authorized to sign this agreement for _____
(Contractor/Subcontractor/Supplier). I understand and agree to the terms and conditions of this addendum.

(Authorized Representative)

(Date)

Disclaimer: This wording is merely for educational purposes only and must be modified to meet your clients' needs and to comply with the laws of their jurisdiction. In addition, you should engage the services of a competent insurance consultant to review your document for up to date insurance and indemnification language.

Lee Hoffman CIC, LIC, CPIA is an insurance consultant to the legal profession. He can be reached by e-mail at leehoffman@msn.com
