CONTRACTUAL RISK TRANSFER: ADDITIONAL INSURED ENDORSEMENTS, CONTRACT LIABILITY COVERAGE AND OCP POLICIES

By: Leland Eugene Backus, Esq.

I. Additional Insured Endorsement

For the last several decades, "additional insured coverage" has become a significant tool for controlling liability insurance costs on large commercial ventures, particularly in the construction industry setting. This additional insured coverage also has significance in the commercial real estate lease arena and is utilized extensively in retail establishments.

Additional insured coverage is accomplished through the attachment of a standard endorsement to a commercial general liability ("CGL") policy. The Insurance Services Office ("ISO") has created over the years standard form additional insured endorsements. Essentially all additional insured ("AI") coverage endorsements have the same basic coverage grant extending coverage for the additional insureds' liability arising out of (1) the named insured's operations, (2) premises leased to the named insured, or (3) the named insured's product sold in the regular course of the additional insured's business.

Needless to say maintaining additional insured coverage has become an integral part of construction risk management. Additional insured coverage means that a general contractor or developer can be insured under a subcontractor's liability policy and this type of coverage can eliminate or reduce the general contractor's or developer's "out-of-pocket" expenses for third-party claims. It may also have the salutary effect of reducing premiums when the general contractor's or developer's own insurer appreciates that additional insured endorsements have been secured.

While additional insured endorsements have a great deal of variety in their drafting, as a general rule an additional insured is an insured like any other insured and is entitled to a defense and indemnity from the insurer according to the terms and conditions of the policy issued to the

subcontractor. Courts have confirmed the difficult duties of good faith and fair dealing between insurers issuing AI endorsements and those additional insureds.

Pragmatically, as often seen in complex constructional defect litigation, the AI carriers don't really stand up to the plate initially in providing a defense through their own selected defense counsel. Instead, they sit on the sidelines allowing the general contractor/developer CGL carriers to carry out the defense and then through separate AI counsel negotiate how much they will contribute to defense costs at or near the end of the litigation.

a. Additional Insured Status

One of the hottest areas of litigation is in the world of construction defect claims where additional insured endorsements have been issued. Real estate developers and general contractors require their subcontractors to be covered by a policy of comprehensive, commercial general liability insurance. The subcontract normally requires the subcontractor to obtain an additional insured endorsement naming the developer or general contractor as an insured on the subcontractor's CGL policy.

Through a "blanket" endorsement or specific additional insured endorsement, the developer or general contractor is provided coverage under the pertinent policy by being added as either a "named insured" or an "insured."

Developers and general contractors can be exposed to significantly large claims in construction defect litigation for property damage and/or bodily injury claims. The general contractor or developer finds itself in this predicament even though it is only passively at fault and did nothing actively to contribute to the injury. In fact in some states like California, developers find themselves in a situation where they can be held strictly liable for construction defects caused by the acts or omissions of their subcontractors.[1]

From a risk transfer management basis, the general contractor's risk could be transferred by means of an indemnity clause in the

[1] *See, e.g., Stearman v. Centex Homes*, Cal.App.4th 611, 92 Cal.Rptr.2d 761 (Cal.App. 2000)

subcontract agreement. But as the prior section demonstrates, the indemnity tool has proved to be imperfect. Courts and legislatures tend to be unfavorably disposed to indemnification agreements due to unequal bargaining positions and the fact there is a disincentive for the indemnitee to be vigilant in work-place safety. Due to the anti-indemnity sentiment there have been enacted in 41 states some form of an anti-indemnity statute. Furthermore, various courts have imposed rules of strict construction against indemnification for an indemnitee's own negligence.[2] Strict construction is followed everywhere but in Alaska, Massachusetts, Nevada, New Hampshire and Virginia.[3] Additionally, even if the general contractor/developer has a strong indemnity agreement and even if it is covered by the CGL policy of the subcontractor, the indemnitee has no direct rights in that subcontractor/indemnitor's policy. The general contractor/developer is not an insured, simply a claimant. The general contractor/developer is required to first go to court to obtain a judgment against the indemnitor before he can go after the insurance coverage.[4]

The most common AI endorsement form is issued by Insurance Services Office ("ISO") form CG 20 10. The basic form that came about in 1985 is CG 20 10 11 85. This CG 20 10 11 85 due to the manner in which it has been interpreted is often called out for in contract provisions to render a general contractor or developer as an additional insured under a subcontractor's liability insurance policy. That CG 20 10 11 85 endorsement states:

> WHO IS AN INSURED (Section II) is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of "your work" for that insured by or for you.

This type of coverage which is written on an occurrence basis in the CGL policy provides the general contractor or developer with

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[2] *See Ethyl Corp. v. Daniel Constr. Co.*, 725 SW2d 705, 708 (Tex. 1987); *Westinghouse Elec. Elevator Co. v. LaSalle Monroe Bldg. Corp.*, 70 N.E.2d 604, 607 (Ill. 1946)

[3] *See Patrick J. Wielinski, W. Jeffrey Woodward & Jack P Gibson*, Contractual Risk Transfer (Irmi 1995) at Ch.4, Section F.

[4] *Alliance Syndicate, Inc. v. Parsec, Inc.* 741 N.E.2d 1039 (Ill.App. 2000); *Alex Robertson Co. v. Imperial Cas. & Indem. Co.*, 8 Cal.App.4th 338, 10 Cal.Rptr.2d 165 (Cal.App. 1992) *See also*, *Travelers Cas. & Sur. Co. v. American Equity Ins. Co.*, 93 Cal.App.4th 1142, 113 Cal.Rptr.2d 613 (Cal.App. 2001).

liability coverage for the work of the subcontractors.[5] The last dependent clause in the above section starting with "but only" has been construed to disallow the additional insured from securing blanket coverage under the subcontractor's liability policy for liability that is not related to the subcontractor's work on the project in question.[6]

The best aspect of CG 20 10 11 85 was the fact that it provided coverage for completed operations. However, the 1993 version of the ISO CG 20 10 endorsement limited the coverage to "ongoing operations" of the subcontractor and that language has been interpreted as excluding coverage for completed operations since the issuance of that endorsement form.[7]

Another form used by ISO is CG 20 09 11 85 which is an endorsement supposedly used when contractual liability coverage is not being provided to the named insured. This widely used additional insured endorsement CG 20 09 11 85 excludes coverage for completed operations as stated as follows:

> This insurance does not apply to:
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> (2) "Bodily injury" or "property damage" occurring after:
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> (a) all work on the project (other than service, maintenance or repairs) to be performed by or on behalf of the additional insured(s) at the site of the covered operations has been completed; or
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> (b) that portion of "your work" out of which the injury or damage arises has been put to its intended use by any person or organization other than another contractor or subcontractor engaged in performing operations for a

[5] *See, Pardee Construction Co., v. Insurance Company of The West*, 77 Cal.App.4th 1340 (2000)
[6] *Time Warner Entertainment Co. v. Travelers Cas. & Sur. Co.*, 1998 U.S. Dist. Lexis 19460 at 25-26 (E.D.Pa. 1998).
[7] *See Pardee Construction Co. v. Insurance Company of the West*, 77 Cal.App.4th 1356-1360.

principal as part of the same project.

As earlier stated, additional insurers providing AI coverage for their insureds rarely step up to the plate in construction litigation and provide an immediate defense and indemnification to the claims against the general contractor/developer. Normal practice is for the primary carrier for the general contractor/developer to undertake the defense of the litigation and then those primary carriers make additional insured claims and secondarily negotiate with additional insurers to collect as a manner of reimbursement defense costs and indemnity costs.

b. Coverage Issues Raised by Additional Insured Endorsement

Additional coverage issues raised by the 1985 CG 20 10 Additional Insured Endorsement draws questions of (1) what did "arising out of" mean, (2) whether the additional insured could be covered for its own negligence, and (3) whether the additional insured was covered only when the named insured was negligent.

i. Interpretation of "arising out of" in CG 20 10.

The majority of courts give very broad meaning to the phrase "arising out of."[8] A few Federal Courts of Appeals have utilized an intermediate standard of causation to the language "arising out of."[9]

Presently, several states have adopted an intermediate

[8] *Andrew L. Youngquist, Inc. v. Cincinnati Ins. Co.*, 625 N.W.2d 178, 185 (Minn.App. 2001)(Due to the Comm-Tech operations, the injury was deemed to have occurred); *Hormel Foods Corp. v. Northbrook Prop. & Cas. Co.*, 938 F.Supp. 555 (D. Minn. 1996 *aff'd* 141 F.3d 143 (8th Cir. 1997)(federal court construing Minnesota law indicated "but for" causation satisfies "arising out of" language in AI endorsement); *Pennzoil Co. v. United States Fidelity & Guar. Co.*, 50 F.3d (8th Cir 1995)(interpreting North Dakota law and concluded that even though the contractor was not negligent and there was no contract between a testing service and the contractor, the court determined that the owner's liability to the testing companies employee arose out of the contractor's operations).

[9] *Marathon Hashland Pipeline LLC v. Millen Cas. Co.*, 243 F.3d 1232 (10th Cir. 2001)[interpreting Wyoming law]; *Merchants Insurance Co. of New Hampshire, Inc. v. United States Fidelity & Guaranty Co.*, 143 F.3d 5, 9 (1st Cir. 1998)[interpreting Massachusetts law]; *McIntosh v. Scottsdale Ins. Co.*, 992 F.2d 251 (10th Cir. 1993)[predicating Kansas law would hold arising out of imparts a more liberal standard than proximate cause, but it rejected strict but for causation]. Missouri appears to be in this camp. *See Union Pacific R.R. Co. v. American Family Mut. Ins. Co.*, 987 S.W.2d 340 (Mo.App.1998)

standard as well.[10]

In cases where the injured plaintiff is suing the additional insured and the injured plaintiff is an employee of the named insured, the courts consider this "arising out of" the work.[11]

Courts also broadly construed the term "arising out of" to extend coverage to an additional insured where the work being performed by the subcontractor is not actually done by the subcontractor's employee but someone else doing the work for the subcontractor.[12]

Similar analysis has been discussed when there is a subcontractor who has the additional insured endorsement but the negligence was of a sub-subcontractor's work. Since the sub-subcontractor is doing work for the prime subcontractor, additional insured coverage has been held to apply.[13]

In jurisdictions following the intermediate standard of causation, the employment relationship in and of itself does not necessarily meet the threshold. The mere presence of an employee on the construction site does not necessarily in these courts construction of "arising out of" trigger coverage.[14]

Under CG 20 10 11 85, the court has held that this version of the additional insured endorsement does indeed provide coverage to the additional insured for losses taking place after the named insured's work is completed.[15] This is of great importance in construction defect litigation, pollution cases and other continuous loss scenarios.

In the October '93 and March '97 versions of CG 20 10, the ISO decided to substitute "your on-going operations" in lieu of

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[10] *See, e.g., Union Pacific R.R. Co. v. American Family Mut. Ins. Co.*, 987 S.W.2d 340 (Mo.App. 1998).
[11] *See, e.g., Andrew L. Youngquist, Inc. v. Cincinnati Ins. Co.*, 625 N.W.2d 178, 185 (Minn.App. 2001); *Liberty Mutual Ins. Co. v. Westfield Ins. Co.*, 703 N.E.2d 439 (Ill.App. 1998)
[12] *Tishman Interiors Corp. of New York v. Fireman's Fund Ins. Co.*, 653 N.Y.S.2d 367 (N.Y.App. 1997)
[13] *Shell Oil Co. v. National Union Fire Ins. Co. of Pittsburgh, PA.*., 44 Cal.App.4th 1633, 52 Cal.Rptr.2d 580 (Cal.App. 1996)
[14] *See St. Paul & Marine Ins. Co. v. American Dynasty Surplus Lines Ins. Co.*, 101 Cal.App.4th 1038, 124 Cal.Rptr.2d 818 (Cal.App. 2002); *Pro-Con Constr., Inc. v. Acadia Ins. Co.*, 794 A.2d 108 (N.H. 2002)
[15] *Pardee Construction Co. v. Insurance Company of the West*, 77 Cal.App.4th 1340, 92 Cal.Rptr.2d 443 (Cal.App. 2000)

"your work" in the additional insured endorsement. The purpose for so doing was to clarify the intention not to provide coverage to additional insureds for bodily injury or property damage taking place after the named insured's work was completed. The risk managers for general developers insist on subcontractors having operations coverage for the owner and the general contractor and insist upon using CG 20 10 11 85. The current versions of the ISO CG 20 10 additional insured endorsement would not comply with this contractual requirement.

In *Weitz Company LLC v. Mid-Century Insurance Company,* ___ P.3d ____, 2007 WL 2264634 (Colo.App. 2007) the general contractor who had been sued by a homeowner brought an action against the insured that had issued a CGL policy to a subcontractor and asserted bad faith claims and deceptive trade practice claims. The court ruled in favor of the insurer on the basis as a matter of first impression, the additional-insured endorsement did not provide the general contractor coverage against liability arising out of this subcontractor's completed operations. This form of the additional insured endorsement was CG 20 10 10 93.

In the Iowa case of *Employer's Mutual Casualty Company v. Rinderknecht Associates, Inc.*, 728 N.W.2d 851, 2007 WL 108344 (Iowa.App. 2007), the court construed CG 20 10 03 97 and the "on-going operations" language. This court noted that the insurance carrier's obligations to the additional insured were to be defined not by the contractual obligations between the general contractor and the subcontractor but by the policy language. The court in reviewing a series of dispositive motions believed that the outcome should be determined by the court's interpretation of the "arising out of" endorsement language. The court noted that although it is the desire of the court to determine what the desire of the parties was when the contract was entered into, insurance contracts are to be construed most favorably to the insured.

Accordingly in providing a broad definition of "arising out of" the court stated that it "must be understood 'to mean originating from, growing out of, or flowing from and require only that there be some causal relationship between injury and risk for which coverage is provided.'" *Id.* at pg. 7. However,

in Iowa the Supreme Court has ruled in two cases that the dispositive coverage consideration is whether the third-party claims against the additional insured contractor were based on the contractor's individual fault or whether the named insured subcontractor is also alleged to be at fault and liable to an injured party.[16]

Another important issue in this area is the interpretation of the language "performed for that insured." In *St. Paul Mercury Ins. Co. v. Frontier Pacific Ins. Co.,* 4 Cal.Rptr.3d 416 (Cal.App. 2003), a crane company rented a crane to a steel company. The steel company was obligated under the lease agreement to have a CG 20 10 type endorsement that had the language that the steel company who performed work for the Lessor would have coverage provided to the Lessor. However, when an employee was killed when the steel company was doing work for the general contractor and the owner and not the Lessor, the coverage was held to be inapplicable.

In the Illinois case of *Pekin Ins. Co. v. United Parcel Service, Inc.*, --- N.E.2d ----, 2008 WL 642598 (Ill.App. 1 Dist., 2008), the appellate court found that where the additional insured endorsement provided coverage for "liability incurred solely as a result of some act or omission of the named insured," that summary judgment for the AI carrier was appropriate.

In the Ohio case of *Cincinnati Ins. Co. v. Grange Mut. Cas. Co.*, Slip Copy, 2007 WL 4237021 (Ohio App. 5 Dist., 2007), the court found that an additional insured who was negligent was not entitled to coverage when the named insured subcontractor was not negligent. There was no vicarious liability for the negligence, since there was no negligence, of the subcontractor. This court noted that "[t]o read the contracts as Cincinnati suggests not only conflicts with the plain language of the contracts, but violates R.C. 2305.31. The statute provides in agreements relative to the design, planning, construction, alteration, repair or maintenance of building, structure, highway, road, appurtenance, and appliance, including moving, demolition, and excavating, a contract or agreement requiring one party to indemnify

[16] *Allegiant Insurance Company v. Estes Co.*, 564 N.W.2d 846 (Iowa 1997) and *Gabes Construction Co., Inc. v. United Capitol Insurance Co.*, 539 N.W.2d 144, 148 (Iowa 1995)

another from liability for its own negligence is against [17]public policy and therefore void."

In the Iowa case of *IMT Ins. v. West Bend Mut. Ins. Co.*, Slip Copy, 2007 WL 4191933 (Iowa App., 2007), the court stated that "we construe the policy liberally in favor of the Smiths, Doyle's injuries "appear to have arisen from the operation and use of the leased premises, since they would not have been sustained 'but for' her plan to enter the club."

In the North Carolina case of *Pulte Home Corp. v. American Southern Ins. Co.*, 647 S.E.2d 614 (N.C.App., 2007), the court found that the AI endorsement covered the general contractor for its independent negligence, if there was a causal nexus with subcontractor's operations and further found that the general contractor's alleged liability for negligently failing to ensure safety and prevent worker's fall while installing trusses arose out of framing subcontractor's operations.

In the Wisconsin case of *Mikula v. Miller Brewing Co*., 281 Wis.2d 712, 701 N.W.2d 613 (Wis.App., 2005), the court allowed coverage under an AI endorsement for a general contractor when it was negligent. The court strongly stated: "Where the additional insured is held no more than vicariously liable for the acts of the named insured, the additional insured would have an action for indemnity against the primary wrongdoer. 'Thus, an endorsement that provides coverage only for the additional insured's vicarious liability may be illusory and provide no coverage at all. In this light, it is obvious that additional insureds expect more from an endorsement clause than mere protection from vicarious liability.

c. Whether The Additional Insured Is Covered By Its Own Negligence

The majority of courts ruling on this issue find in the affirmative. Generally speaking, the endorsements don't have any exclusion for the additional insured's own negligence and are construed strictly

[17] *Cited case at* 2007 WL 4237021, *2

against the insured.[18]

The minority view is still held onto by the state of Ohio, indicating that additional insureds are not covered for their own negligence.[19] The theory here is that such an additional insured endorsement would be in contradistinction to Ohio's anti-indemnity statute and no such anti-public policy construction would be proper.[20]

d. Does The Additional Insured Endorsement Apply Only When the Named Insured is Negligent?

It is clear that the ISO AI endorsement is not conditioned by the courts on the named insured's fault. Courts here look to the language of the endorsement and strictly construe it against the insurer. The language does not state that there will be coverage arising out of the negligence of the subcontractor but contrarily says that it arises out of the operations of the subcontractor. Several cases have settled the issue that the ISO CG 20 10 endorsements do not require the named insured's fault.[21]

In summary, numerous decisions have come to the conclusion that it is irrelevant whether the named insured was negligent since the endorsement never attempted to allocate for strict coverage according to fault.[22]

One must be careful if form CG 20 09 is used because that has an exclusion 3 which is an extremely broad exclusion and takes away coverage -- especially coverage arising out of any act or omission of the additional insured or any of the additional insureds employees other than general supervision by the additional insured of named insured's ongoing operations. The bottom line is that the

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[18] *See, e.g., Fireman's Fund Ins. Cos. v Atlantic Richfield Co.*, 94 Cal.App.4th 842, 853, 115 Cal.Rptr.2d 26, 24 (Cal.App. 2001); *Marathon Ashland Pipeline LLC v. Maryland Cas. Co.*, 243 F.3d 1232 (10th Cir. 2001); *Admiral Ins. Co. v. Trident NGL, Inc.*, 988 S.W.2d 451, 454 (Tx.App. – Houston 1999); *Merchant's Ins. Co. of New Hampshire, Inc. v. United States Fidelity & Guarantee Co.*, 143 F.3d 5, 10 (1st Cir. 1998) (Massachusetts law); *Sportmark, Inc. v. Daisy Mfg. Co.*, 645 N.E.2d 360, 363 (Ill.App. 1994); *McIntosh v. Scottsdale Ins. Co.*, 992 F.2d 251, 254 (10th Cir. 1993) (Kansas law); *Donald R. Freund v. Utah Power & Light Co.*, 793 P.2d 362 (Utah 1990)

[19] *Drzechek v. Standard Oil Co.*, 447 N.E.2d 760, 764 (Ohio App. 1982)

[20] *Buckeye Union Ins. Co. v. Zavarella Bros. Constr. Co.*, 699 N.E.2d 127 (Ohio App. 1997)

[21] *Township of Springfield v. Ersek*, 660 A.2d 672, 676 (Pa.App. 1995); *Casualty Ins. Co. v. Northbrook Property & Cas. Ins. Co.*, 501 N.E.2d 812, 815 (Ill.App. 1986); *Mid-Continent Cas. Co. v.Swift Energy Co.*, 206 F.3d 487, 499-500 (5th Cir. 2000)

[22] *Vitton Constr. Co. v. Pacific Ins. Co.*, 110 Cal.App.4th 762, 767, 2 Cal.Rptr.3d 1 (Cal.App. 2003)

additional insured has no coverage under this endorsement for its own negligence unless it was simply in the form of passive negligent supervision of the named insured. This is very similar to OCP policy coverage.

e. Failure to Obtain Additional Insurance Endorsement

It is a standard practice in this country for construction contracts to have an insurance provision requiring contractors to purchase a variety of insurance coverage for another party, whether that be the general contractor, developer or other contracting parties. It is incumbent upon the party mandating to be named as an additional insured under the other party's CGL policy to carefully monitor the procuring of the insurance required by the contract and to review the certificates of insurance. Failure to review a certificate of insurance which indicates there was no appropriate coverage provided can result in a party not complying with the insurance requirement and being exposed to a breach of contract action.[23] It is becoming unfortunately more typical for an owner or general contractor to require in a construction agreement that the other party not only name it as an additional insured, but under an ISO form such as CG 10 10 85. This might be an impossibility of performance that has to be reported to the party mandating this insurance requirement before signing the contract.

In *Massachusetts Bay Transt. Authority v. United States*[24], the Transportation Authority claimed that the Federal Railroad Administration should be held accountable in damages for its failure to secure insurance endorsements in connection with a renovation project. The Federal Railroad Administration found it very difficult, if not essentially impossible, to secure the mandated insurance and thus the government argued that it should be excused from its contractual performance under the doctrine of Impossibility of Performance. It ruled that the federal government was not entitled to such a defense because at the time of contracting, it knew or should have known of the unavailability of such insurance.

[23] *Stone Bldg. Co. v. Star Elec. Contractors, Inc.*, 796 SO.2d 1076 (Ala. 2000)
[24] 254 F.3d 1367 (Fed.Cir. 2001)

Even where a general contractor has the right to procure insurance when a subcontractor fails to do so, the general contractor's unwillingness to secure replacement coverage does not mean that the general contractor will lose a case against the subcontractor for recovering payments it had to make on behalf of the subcontractor's negligence.[25]

The breach of contract by a subcontractor usually does not permit the general contractor or owner in whose favor the insurance was to be obtained to proceed against the CGL liability carrier for the subcontractor.[26]

In contradistinction, a surety who provides a bond for a principal on a project can be held accountable for the principal's failure to provide for the insurance coverage.[27] In the same way in which a subcontractor may artfully argue that its failure to procure insurance was harmless is by contending that under its indemnification duty to the owner or general contractor is that the indemnity claim triggers contractual liability coverage under the "insured contract" exception to the CGL policy.[28]

Another concern that the subcontractor should have on every construction project is if the construction subcontract agreement has a flow-down clause that requires it to incorporate clauses in the general contractor's contract with the owner in its contract. If the general contractor was responsible to the owner under its agreement to provide additional insured coverage, the subcontractor may be obligated to do likewise.[29]

If the subcontractor secures a certificate of insurance naming the general contractor or owner as an additional insured under the CGL policy, but the policy itself failed to actually have an additional insured endorsement confirming such coverage, usually the certificate is insufficient to confer such status under the policy.[30]

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[25] *Rowland v. 1306 Realty Associated*, 193 A.D.2d 726, 598 N.Y.S.2d 53 (1993)
[26] *See State v. American Mfrs. Mut. Ins. Co.*, 188 A.D.2d 152, 593, N.Y.S.2d 885 (1993); *Office Structures, Inc. v. Home Ins. Co.*, 503 A.2d 193 (Del. 1985)
[27] *Hartford Fire Insurance Co. v. Riefolo Construction Co.*, 81 N.J. 514, 410 A.2d 658 (1980).
[28] *Reliance Insurance Co. v. Gary C. Wyatt*, 540 S.W.2d 688 (Ala. 1988)
[29] *Mountain States Construction Co. v. Tyee Electric, Inc.*, 43 Wash.App. 542, 718 P.2d 823 (Div. 3 1986)
[30] *TIG Ins. Co. v. Sedgwick James of Washington*, 56 F.3d 754 (5th Cir. 2002)

With respective of a broker, generally a broker should not be held liable for a failure to procure an additional insured endorsement if the broker was not asked to obtain the same.[31]

Where, however, the insurance agent is provided with a copy of the subcontract or lease, then a jury may properly find that an agent breached the standard of care in failing to procure an endorsement when it had an opportunity to review the contractual requirements.[32]

Relative to the subcontractor failing to procure additional insured endorsements naming the general contractor, much will depend upon the language of the construction subcontract. In one case, subcontractor was shown not have breached the construction subcontract when it failed to obtain a certificate of insurance naming the general contractor as an additional insured on the subcontractor's CGL policy prior to commencing performance of the subcontract and before an employee of the subcontractor was injured in an accident.[33] Here the court noted that the general contractor failed to exercise an option in the subcontract to secure coverage on behalf of the subcontractor in the event the certificate of insurance was not received in the office of the general contractor prior to the start of construction. The court noted that the general contractor also had the option of terminating the contract for failure to produce the certificate of insurance.

One final concern for a contractor seeking to be named as an additional insured is how many claims and payments have been made under the CGL policy of the subcontractor. Some court have held that if the named insured has exhausted its policy limits, then those limits are exhausted as to the additional insured.[34] Other courts have found that the insurer must not prefer one insured over the other.[35]

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[31] *SM International, Inc. v. China Ocean Shipping Company, ???*, 5912 (CBM)(US Dist. Crt. S.D., New York 2000)
[32] *Martini v. Beaverton Ins. Agency, Inc.*, 2003 Wl. 22749021 (N.D.Cal., 2003)
[33] *Colorado Structures, Inc. v. North American Capacity Insurance Company*, 121 F.Sup.2d 301 (N.D.Cal. 2003)
[34] *Travelers Indem. Co. v. Citgo Petroleum Corp.*, 166 F.3d 761 (5th Cir. (Tex.) 2001) and *Millers Mut. Ins. Assoc. of Illinois v. Shell Oil Co.*, 959 S.W.2d 864 (Mo.App. 1998).
[35] *Great Lakes Dredge & Dock Co. v. City of Chicago*, 260 F.3d 789 (7th Cir. (Ill) 2001) and *Western Alliance Ins. Co. v. Northern Ins. Co. of New York*, 176 F.3d 825 (5th Cir.(Tex.) 1999).

f. Primary or Excess Coverage?

Whether the additional insurance endorsement will be primary or excess coverage is often dictated by the other insurance clause in the CGL policy. The standard CGL policy has a pro rata other insurance clause, as opposed to the other types of insurance clauses which are excess and strict clauses. Unless this clause is abrogated or changed by some of the provisions in the policy, this clause will limit the additional insured coverage under the subcontractor's policy to its pro rata share of the loss along with the owner's and contractor's own policies.

Owners and contractors attempt to defeat this dilemma by obligating the subcontractor in the construction subcontract to have additional insurance coverage that is primary thereby having its own CGL policy be excess over any additional insured coverage. The problem in this type of contractual mandated coverage is that in the real world frequently the subcontractor fails to procure the appropriate type of coverage and the general contractor ends up with pro rata or concurrent coverage.

The 1999 edition of CGL CG 00 01 provides in Section IV Other Insurance that the CGL policy's coverage is excess over " . . . [a]ny other primary insurance available to you covering liability for damages arising out of the premises or operations for which you have been added as an additional insured by attachment of an endorsement."

A problem arises however when the additional insured endorsement also contains an excess clause and under a variety of case decisions, the general contractor still ends up with a pro rata split. This is true when the *Lamb Westin* doctrine is applied which is followed in many jurisdictions.[36]

g. Multiple Endorsements Obtained by Multiple Parties

This is similar to the other insurance issues described previously. However, practically speaking in this day and age where there are multiple subcontractors who provide additional insured

[36] Lamb Westin Doctrine considers all other insurance clauses ? to each other and concludes that coverage will be pro rated is followed in Oregon, Alaska, Arizona, Delaware, Idaho, Indiana, Nevada, and Rhode Island and partially in several other states including Maine, Michigan, Louisiana and Tennessee.

endorsements to protect a general contractor or owner, courts have ruled that there should be equal shares amongst the additional insurers.[37] However, there are several apportionment methods available to courts in addition to equal shares, including time on the risk, policy limits, combined policy limit time of the risk, premiums paid, and maximum loss methods.[38] Generally courts want to have some equitable contribution amongst multiple insurers. When the court determines that multiple insurers cover the same risk, they will equitably spread that risk amongst the several insurers.[39] Pragmatically, subcontractors find the need for CG 20 33 endorsements where they have many jobs within a year policy period and are required to name many owners and contractors as additional insurers under its policy. It is vastly more simple to have a blanket endorsement than to run to the insurance agent each and every time a new contract is entered into. However given our discussion above on failure to procure insurance and given the vast difference between construction contracts, it is probably prudent to go to a sophisticated insurance broker to examine each and every contract agreement to make sure that even the blanket endorsement under a CGL comports with the insurance obligations.

Another form of endorsement for named insureds who lease equipment from others and have an obligation to add owners of the leased equipment as additional insureds is found in CG 20 34 titled "Additional Insured – Lessor of Leased Equipment – Automatic Status When Required in Lease Agreement With You

h. Blanket Additional Insured Endorsement [CG 20 33]

CG 20 33 is an ISO endorsement which was introduced to the market in 1997 titled "Additional Insured – Owners, Lessees or Contractors – Automatic Status When Required In Construction Agreement With You." Endorsement CG 20 33 is essentially the same as CG 20 10. The main exception is that CG 20 33 has a professional services exclusion found in CG 20 07 which is the additional insurance endorsement for architects, engineers and surveyors. The court orders that the agreement to add an additional insured has to be "in writing" for the endorsement to be

[37] *Legal Homes, Inc. v. CNA Ins.*, 217 Ariz. 159, 171 P.3d 610 (2007)
[38] *Centennial Ins. Co. v. U.S. Fire Ins. Co.*, 88 Cal.App.4th 105, 105 Cal.Rptr.2d 559, 562-64 (2001)
[39] *Montrose Chemical Corp. v. Admiral Ins. Co.*, 10 Cal.4th 645, 687, 42 Cal.Rptr.2d 324, 913 P.2d 878 (1995)

applicable. We might argue that it only applies when the named insured has a construction contract directly with the additional insured. Accordingly, CG 20 33 blanket endorsements might not satisfy the additional insured requirement if a subcontractor has an agreement with sub-subcontractor and that agreement requires additional insured coverage for the general contractor. There is no privity of contract between the general contractor and the sub-subcontractor.

Several courts have held that if the AI endorsement limits scope of coverage to the amounts in the construction contract, then the construction contract has to be read by the court with the policy to determine the full scope of coverage.[40]

i. Is Separate Counsel Required for the Additional Insured?

The answer is yes for those courts having addressed this issue.[41]

j. Revisions to ISO in 2004

There are several recent changes that occurred in July of 2004 with ISO additional insured endorsements. The intent of the form of endorsements in 2004 were clearly to reduce the scope of coverage available under the additional insured endorsements. Some endorsement modifications may be mandated by local jurisdictions and others will be optional. The changes in ISO in 2004 came about as a result of various adverse court decisions.

i. Replace "arising out of" with "caused by" in AI endorsements

In construing the historic CG 20 10 1985 endorsement "arising out of" some courts found that the clause was to be interpreted broadly as we earlier discussed in this paper and that the additional insurer would have to respond to damage or injury arising out of the additional insured's sole negligence. The ISO

[40] *Shell Oil Co. v. National Union Fire Ins. Co. of Pittsburgh, PA.*, 44 Cal.App.4th 1633, 52 Cal.Rptr.2d 580, 584 (Cal.App. 1996); *Certain Underwriters at Lloyd's, London v. Oryx Energy Co.*, 957 F.Supp. 930, 936 (S.D.Tex. 1997)

[41] *Consolidated Rail Corp. v. Hartford Acc. & Indem. Co.*, 676 F.Supp. 82 (D. Pa. 1987); *First Ins.Co. v. State*, 66 Haw. 413, 665 P.2d 648 (Haw. 1983) and *Spindle v. Chubb/Pacific Indem. Group*, 89 Cal.App.3d 706 (1979).

had not intended this result with the 1985 endorsement form. It was only intended by the ISO to provide coverage where the general contractor, for example, was held to be vicariously liable for the acts of the actively negligent subcontractor. In this case law development, they also decided to replace the "arising out of" in the endorsement form with "caused by." The intent of this new language is to allow coverage only where the named insured is solely at fault or contributorily at fault, but not where the additional insured is solely negligent. Such coverage for the additional insured's sole negligence is precluded by the 2004 form of the CG 20 10 additional insured endorsement.

ii. Preclude coverage for an additional insured's sole negligence in CG 20 10

The ISO in 2004 further revised this endorsement form to preclude coverage for the additional insured's sole negligence. The subcontractor will have to be totally or partially at fault in order for the coverage to trigger for the additional insured.

iii. Withdraw CG 20 09

The ISO decided to withdraw this form of coverage since contractual liability is rarely excluded in CGL policies any longer in insurance policies.

The insured may secure an OCP policy.

k. The 2013 Revisions

i. The 2013 revisions to CG 20 10 maintain the same language used in the 2004 endorsements, with the exception of two important caveats. The newest 2013 endorsements begin with a broad "HOWEVER," narrowing coverage such that insurance afforded to an additional insured (1) only applies as permitted by law, and (2) if such coverage is required by contract, the coverage afforded "will not be broader than that which you are required by the contract or agreement to provide for such additional insured."

ii. The 2013 endorsement also contains an additional restriction on the limits of insurance such that if coverage for the additional insured is required by contract, such insurance is limited to the lesser of the amount (1) required by contract or agreement or (2) available under the limits of insurance listed in the declarations.

iii. The first change (limiting the coverage to the maximum extent permitted by law) does not reduce coverage. A court would not enforce an endorsement that violates a statute, so, in many ways, this clause is a clarifying statement. The second and third changes, however, do reduce the scope of coverage for additional insureds.

To the Extent Permitted by Law

iv. For years in various jurisdictions, the construction industry has been able to avoid some of the effects of anti-indemnification statutes that prohibited the transfer of indemnitees' concurrent negligence through contractual indemnity provisions. The construction industry did so by using the additional insured requirements to insure against losses that could potentially violate states' anti-indemnification statutes.

v. But states have begun prohibiting construction entities from obtaining additional insured status for risks prohibited by the state's anti-indemnification statutes. For example, California, Colorado, Kansas, Montana, New Mexico, Oregon, and Texas all prohibit additional insureds from receiving greater coverage than they would be able to obtain by indemnification. The new 20 10 endorsement seeks to address these states.

vi. Over the past several years, new breeds of endorsements have arisen in these states. Though there are some differences, the state-specific additional insured endorsements appeared generally as follows:

> **SECTION II - Who is An Insured** is amended to include as an additional insured the person(s) or organization(s) shown in the Schedule, but only with respect to liability for "bodily injury", "property damage" or "personal advertising injury" caused by your ongoing operations for the additional insured(s) at the location(s) designated above and only to the extent that such "bodily injury", "property damage" or "personal and advertising injury" is caused by your acts or omissions or the acts or omissions of those performing operations on your behalf.

vii. It is not clear whether these state-specific endorsements will remain or whether the endorsements will be deleted in light of the 2013 changes.

To the Extent Sought under the Parties' Contract

viii. This clause in the endorsement ensures that insurers do not provide greater coverage than required by the contract. For example, if the contract states that the named insured only provides coverage to an

additional insured for the named insured's vicarious liability, then the CG 20 10 endorsement only provides coverage for the named insured's vicarious liability, even though the policy would ordinarily provide broader coverage.

ix. Thus, it is essential for contracting parties to dictate the terms of the coverage in the construction documents.

Coverage Limit Is Restricted to That Required by Contract

x. This clause essentially means that insurers can deny the additional insured coverage even when the named insured has broader coverage. For example, if the contract documents require the contractor to maintain CGL limits of $1 million per occurrence, but the contractor obtains coverage for $2 million per occurrence, the owner would only receive the benefit of the $1 million in coverage.

xi. Additional gaps in coverage could also occur when excess policies are implicated. In the above example, any excess coverage could generate coverage gaps of $1 million in the coverage band between $1 million and $2 million.

Conclusion

xii. The 2013 additional insured changes fit in context with previous ISO changes to the additional insured endorsements. The most recent round of changes clarifies three key points:

1. (1) coverage will not exceed that permitted by law;

2. (2) coverage is restricted to the amount required by contract; and

3. (3) coverage is limited to that which is required by contract.[42]

l. Recent case law on CG 20 10

i. In February of 2014, the Fifth Circuit decided *Carl E. Woodward LLC v. Acceptance Indem. Ins.*, 743 F. 3d 91 (5th Cir. 2014) rehearing denied 749 F.3d 395 addressing facts common to many construction contracts. Woodward, the design-builder, agreed to build a condominium complex in Mississippi. It entered into a number of subcontracts including one with a concrete subcontractor, DCM, Inc. The subcontracts required each

[42]Mark M. Bell and Christopher S. Dunn, 2013 ISO Additional Insured Endorsements: Putting the Changes into Context for the Construction Industry (August 2013)

subcontractor to include Woodward as an additional insured on its commercial general liability (CGL) policy. The condominium project was completed in August 2007 and began experiencing problems in 2008. The owner sued Woodward for defective construction including allegations that the concrete fell below industry standards because the slab was not properly sloped and DCM failed to comply with the construction drawings. Based on the complaint, Woodward filed a cross-suit against DCM seeking a defense under DCM's insurance policy. The parties arbitrated the dispute, and one of the major defects was attributed to DCM. DCM's insurer, Acceptance Indemnity, denied that it owed a defense to Woodward based on the CG 20 10 additional insured endorsement it had issued naming Woodward as an additional insured. Its CG 20 10 endorsement states that the additional insured is only covered "with respect to liability arising out of [DCM's] ongoing operations performed for [Woodward]." Acceptance argued that the CG 20 10 endorsement excludes coverage for "damage discovered after completion of the project." The district court rejected Acceptance's argument, explaining, "Acceptance has not identified any property damage that occurred after the project was completed, and the court has not located any evidence of such damage." The court reviewed the other exclusions cited by Acceptance and rejected those finding that Acceptance owed a duty to defend Woodward while reserving whether it owed a duty to indemnify it, too.

ii. Acceptance appealed the case to the Fifth Circuit Court of Appeals, which disagreed with the district court's opinion and reversed the lower court's holding. The Fifth Circuit focused on the language of the 20 10 additional insured endorsement, finding that "ongoing operations" could only include activities "actually in process" and could not include anything that happened after the activities were completed. The court explained that claims "can be brought after ongoing operations are complete, but the underlying liability cannot be due to the 'completed operations.'" The court relied on recent cases from the Mississippi and Colorado courts of appeals in finding that the "ongoing operations" provision of the additional insured endorsement limits coverage to liability caused by the subcontractor's active work at the project and that it does not cover damage or injuries appearing after the subcontractor stops working on the project. The court also explained that the subcontractor's breach of the construction specifications did not fall within the "ongoing operations" provision of the endorsement. The court held that "[i]t is true that Woodward's liability for the alleged damage is causally related to DCM's operations. Though a causal relation is required, the policy specifically excludes liability for property damage occurring after all work has been completed."

In short, the court limited liability for construction defects exclusively to completed operations. "Courts have held, quite logically, that liability for construction defects arises out of a subcontractor's completed operations." The court concluded that "[t]he breach necessarily arises from the completed construction, which is the point in time when [the owner] received the completed building." By its language, the court effectively foreclosed coverage for defect-related causes of action under the CG 20 10 endorsement.[43]

iii. The *Woodward* case demonstrates that requesting and obtaining completed operations coverage by endorsement can prove essential when seeking coverage for losses related to defective construction.

II. Contractual Liability Insurance and the CGL Policy

m. 1986 CGL policy language

Contractual liability insurance under a CGL policy has been essentially automatically provided in these policies since 1986. The mechanism by which this coverage is afforded is somewhat awkwardly constructed in the ISO policy. In the 2001 CGL policy, the first indication of contractual liability coverage is in the form of an exclusion. The coverage is eliminated by the exclusion is there is an assumption of liability in a contract or agreement. However there are two very significant exceptions as follows:

1. Liability of the insured that would be incurred without the contract or agreement; or
2. Liability assumed in the contract or agreement that is an "insured contract."

The term "insured contract" is later in the policy has been subject to revision in recent years. It is critical to the understanding of the coverage provided.

i. Breach of contract claims

Simply stated, the general rule is when there is a breach of contract action as opposed to a tort action, the insurer does not have expanded contractual damage coverage. For instance the contractor fails to fulfill the contract terms in installing tile

[43] Mark M. Bell, Court Finds No Construction Defect Coverage under CG 20 10 (March 2014).

improperly and there is a business loss, such coverage is not afforded under contractual liability.[44]

ii. Assumption of liability by contract or agreement

In *Olympic, Inc. v. Providence Washington Insurance Co.,* 648 P.2d 1008 (Alaska 1982) the court noted clearly that "liability assumed by contract" did not cover a breach of contract.

iii. Assuming a duty versus assuming a liability

This is an area that is somewhat difficult to comprehend and some CGL carriers mistakenly deny claims when there is a duty created by a contract as opposed to an assumption of liability of another. When one assumes the liability of another, it is agreeing to be responsible for the other's legal obligation to pay damages to third parties. When one assumes a duty it is the obligation to act or to not act that would not exist but for the contract.

If we look at the situation where a contract is entered into to maintain kitchen equipment and the party undertaking that duty fails to perform its maintenance task and the kitchen equipment catches on fire causing injury, one might think that this could be a claim that could be denied because the claim is a breach of contract claim and thus would be excluded under a contractual liability exclusion of the policy. However, when one looks at the claim in more detail, it is actually a tort-based claim, specifically negligence -- the breach of a duty that caused injury. The duty was created by the contract and there was no assumption of liability with a hold harmless or indemnity agreement. The damages are not by the other party to the contract but by a third party who was injured. There are no damages for breach of contract to other party to the contract, but tort damages to the injured unrelated party. In *Olympic,*[45]

[44] *McDonald Constr. Co., Inc. v. Bituminous Cas. Co.*, RP, 2000 Ga.App. LEXIS 206 (Ga.App. 2006); *See also French v. Assurance Company of America*, 2006 U.S.App. LEXIS 10470 (4th Cir. 2006) [the court deemed the damages as economic loss stemming from non-fulfillment of contract and therefore the insured had no duty to indemnify] This is the case law that indicates there must resultant damage, the work that was wrongfully done has to actually cause property damage or bodily injury other than to the work itself.
[45] *Id.*

the court held that ""legally obligated to pay as damages because of ... bodily injury" refers to liability imposed by law for torts, and not to damages for breach of contract, except contracts for indemnity." The only exception to this general rule arises when the contract breach itself results in injury to persons or property."

iv. What is and is not an "insured contract"

The exception to the contractual liability exclusion in the CGL policy provides broad contractual liability coverage along as it can be demonstrated that the bodily injury or property damage occurred after entering into the contract and the liability was assumed in a hold harmless or indemnity agreement falls within the definition of "insured contract." In 2004 the contractual liability coverage in the CGL policy was also "broad form," in that it applied even if an insured assumed liability for the sole negligence of the indemnitee.

"Insured contract" is defined in the policy with the definition by listing fives types of contracts that are relatively common in business as follows: (1) lease of premises (but not for a promise to pay fire damage to a premise which you rent or occupy, (2) side track agreements, (3) easement or license agreement (not for construction or demolition on or within 50 feet of a railroad), (4) indemnify a municipality (except for work for a municipality, (5) elevator maintenance agreement.

An "insured contract" does not include an agreement to indemnify (1) railroad construction or demolition operations within 50 feet of railroad property and affecting any railroad bridge or trestle, tracks, roadbeds, tunnel, underpass or crossing, (2) an architect, engineer or surveyor for their professional services, or (3) others for professional services if assumed by an insured with an architect, engineer or surveyor. The parties need to get railroad, defective liability or professional liability insurance if these exposures are incurred.

n. 1988 – ISO CG 21 39

The broad automatic coverage did not last long. In 1988, ISO had contractual liability limitation endorsement, CG 21 39, that had the

effect of eliminating paragraph (g) of the "insured contract" definition dealing with tort liability assumed.

o. 2004 – ISO CG 21 39 and CG 24 26

In 2004, the ISO introduced another endorsement that had the effect of limiting contractual liability coverage although it wasn't as narrow as the ISO CG 21 39 in 1988. The 2004 version referred to as the amendment of "insured contract" definition CG 24 26, this provided coverage for tort liability assumed only in those situations where the indemnitor (the one who agrees to hold the indemnity harmless) or anyone acting on the indemnitor's behalf causes the injury or damage in whole or in part. This eliminated the indemnification for full negligence. As we saw earlier in this paper, the latest 2004 additional insured endorsement CG 20 10 aligns itself with this amendment to endorsement CG 24 26.

p. Contractual liability and sole negligence – revise "insured contract" definition

The construction agreement may provide contractually that the subcontractor is obligated to indemnify the general contractor or owner for their sole negligence. Accordingly, the ISO has revised the "insured contract" with a new optional endorsement which removes coverage for an additional insured's sole negligence. This will need to be used in those states that permit indemnification for sole negligence of the indemnity. Contractual endorsements may be used by an insurance carrier in conjunction with CG 20 10 and CG 20 33.

IV. Owners and Contractors Policy [OCP Policy]

The owner's and contractor's protective liability or OCP policy addresses similar issues to additional insured endorsements and contractual liability coverage. The policy addresses the exposure of one party on a vicarious liability basis for actions with an independent contractor. As discussed in this paper the other methods for contractual risk transfer are having an indemnification clause or adding a contractor as an additional insured under the subcontractor's CGL policy.

The OCP policy is another method for dealing with the exposure. A general contractor might purchase an OCP with the project owner as the named insured or the subcontractor could purchase an OCP policy which has the general contractor as the named insured. Under this OCP coverage, there is no coverage afforded to the party purchasing the policy. The form is CG 00 09. It is a free-standing insurance policy. It is generally written by the same company that writes the CGL policy for the party acquiring it for someone else. Subject to the insurance is the named insured's liability which arises out of (1) operations performed for the named insured by the contractor "who is required to be identified in the declarations" in connection with the project "the location of which has to be defined" or (2) the named insured's own acts or omissions in connection with its general supervision of the independent contractor's work. In other words, the coverage is triggered by vicarious liability or a passive failure to supervise work. Since this OCP coverage does not cover liability for injury or property damage which occurs after the independent contractor's work on the project was completed or arises out of a portion of work that has been to its intended use. There is no completed operations coverage. Exclusion D states:

> This insurance does not apply to "bodily injury" or "property damage" arising out of (the named insured's) or the (named insured's employees) acts or omissions other than general supervision of "work" performed for (the named insured) by the "contractor." The term "general supervision" is broadly interpreted by the courts, however there is no real judicial consensus at to the meaning of that phrase.

This portion of the Contractual Risk Transfer paper was prepared by Leland Eugene Backus, Esq. of Backus Carranza & Burden in Las Vegas, Nevada. If there are any questions regarding the contents of this paper please contact Mr. Backus at (702) 872-5555 or gbackus@backuslaw.com.