



**IRMI<sup>®</sup>**

**Workshop I**

***ALLOCATING RISKS IN CONSTRUCTION  
CONTRACTS***

Presented by

**Panelists**

**Mark E. Christensen**  
Managing Partner  
Christensen & Ehret

**Todd Rowland**  
Senior Vice President  
Zurich Construction

**Paige K. Lawrence**  
Senior Vice President  
Willis, Inc.

**Richard B. Usher**  
Principal Managing Member  
Hill & Usher LLC

**Eric L. Wilson**  
Vice President  
Hensel Phelps Construction Co.

***Wednesday, November 10, 9 a.m.–noon***

**Workshop I**

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**Mark E. Christensen**  
**Managing Partner**  
**Christensen & Ehret**

Mr. Christensen is a panelist for Workshop I, "Allocating Risks in Construction Contracts," on Wednesday morning. He is a respected trial attorney and former president of the Illinois Division of the National Association of Railroad Trial Counsel. He represents the interests of businesses and their insurers in catastrophic property and bodily injury claims. Mr. Christensen has a breadth of experience in products, construction, and directors and officers liability defense, having represented boat manufacturers, crane and hoist companies, construction contractors, and financial and nonprofit institutions in litigation throughout the Midwest. He is also coverage and reinsurance counsel for various London-based and domestic insurance companies and has an intimate knowledge of these practice areas, including coverage trial experience. Finally, Mr. Christensen has a unique maritime practice in admiralty claims, charterer's, and stevedore's liability and cargo loss in the Great Lakes region.

His educational background includes: Wheaton College (B.A., with high honors, 1977); Northwestern University (J.D., *cum laude*, 1982). Admitted to bar, 1982, Illinois and U.S. District Court, Northern District of Illinois including Trial Bar; 1989, U.S. Supreme Court; 1988, U.S. Court of Appeals, Sixth and Seventh Circuit; 1992, U.S. District Court, North Dakota; 1993, Western District of Wisconsin, Eastern and Western Districts of Michigan; 1994, Southern District of Illinois; 1999, Eastern District of Wisconsin; 2003, California. Member: Chicago and Illinois State Bar Associations; National Association of Railroad Trial Counsel; Committee Member, Board of Ethics, City of Chicago (1999-2001).

**Paige Lawrence, CPCU, ARM**  
**Senior Vice President**  
**Willis, Inc.**

Ms. Lawrence is a panelist for Workshop I, "Allocating Risks in Construction Contracts," on Wednesday morning. She recently became senior vice president at Willis, Inc., having served in the same position at Marsh. There, she was client executive and senior casualty advisor on several major home building and construction accounts. As client executive, Ms. Lawrence was accountable for the delivery of all services and resources. In her role as senior casualty advisor, she was responsible for the design and integration of all casualty lines of coverage as well as financial program alternatives. This included utilization of captives, high retentions, integrated risk, and finite risk programs. In addition, she was actively involved in the review of contractual obligations for Marsh clients.

Ms. Lawrence was recognized both regionally and nationally within the Marsh organization as a resource within the home building and construction industry practices. In that role, she assisted other offices on client-specific issues and marketing strategy.

Prior to joining Johnson & Higgins (predecessor firm) in 1996, Ms. Lawrence worked with another predecessor firm, Sedgwick, for 11 years. Areas of specialization have included construction and financial products. She has served as an interim professor at the University of Georgia School of Risk Management.

Ms. Lawrence graduated from the University of Georgia with a bachelor of business administration degree in risk management and insurance. In addition, she has obtained the Chartered Property and Casualty Underwriter (CPCU) and Associate in Risk Management (ARM) designations.

**Todd Rowland**  
**Senior Vice President**  
**Zurich Construction**

Mr. Rowland is a panelist for Workshop I, "Allocating Risks in Construction Contracts," on Wednesday morning. As senior vice president—Construction Specialty Products and Services, located in San Francisco, he is responsible for directing underwriting and services for Construction Specialty Products, including Subguard, Project Risk, Homebuilder's Protective, Professional Liability and Alternative Risk Transfer, for the Zurich North America's Construction Business Unit. During his 30-year career, Mr. Rowland has had diverse experience in the engineering, construction, and insurance industries in the roles of profit center management, risk management, construction management, labor relations and safety, and insurance underwriting management.

He came to Zurich from Ulico Insurance Group's construction operation where he was senior vice president. Prior to joining Ulico, Mr. Rowland spent 4 years with the Brand Companies, a specialty contracting subsidiary of Waste Management International, where he served in several capacities including Business Unit president. He spent 16 years prior to that with the Bechtel Companies assigned to various domestic job sites and regional offices, where he performed increasingly responsible duties, culminating with an assignment as a business unit operations vice president.

Mr. Rowland attended California State University and Butte College where he studied Public Administration and Fire Engineering Technology. He was a member of a U.S. Department of Energy Benchmarking Task Force, a national management trustee for the Laborers and Employers Cooperation and Education Trust, a founding board member of the Environmental Management Employers' Association, and a former vice chairman of the Texas Safety Association. He is a current member of the Construction Financial Management Association.

**Richard B. Usher**  
**Principal Managing Member**  
**Hill & Usher, LLC**

Mr. Usher is a panelist for Workshop I, "Allocating Risks in Construction Contracts," on Wednesday morning. He is managing member of Hill & Usher Insurance & Surety, an Arizona-based independent agency licensed in 49 states and the District of Columbia. He owned and operated an Arizona specialty carpentry and millwork contracting business for more than 12 years and worked for a large self-performing general contractor for 8 years. He is a lifelong advocate for fair construction contract terms and conditions.

Mr. Usher has served the American Subcontractors Association (ASA) as its Arizona president, National Industry Liaison chair, National Surety & Insurance Task Force chair, and National Finance Committee chair. He was founder and chairman of the Arizona Construction Industry Coalition and treasurer and executive committee member of the Industry Advisory Council, Del E. Webb School of Construction, Arizona State University—Alliance for Construction Excellence.

His many recognitions include the ASA's National President's Award, Merit Award for Excellence in Government Relations, and J.H. Hampshire Award for Lifetime Achievement; ASA Arizona's Excellence in Construction Innovative Leadership Award; Arizona Society of the American Institute of Architects Excellence in Architecture as Contractor as well as its President's Award; Associated General Contractors of America, Arizona Building Chapter, Construction Industry Support Person of the Year; Arizona State University Del E. Webb School of Construction, Plus One Award for outstanding contributions to industry education; and *Engineering News Record's* Top 25 Newsmakers of 2000.

**Eric L. Wilson**  
**Vice President and General Counsel**  
**Hensel Phelps Construction Co.**

Mr. Wilson is a panelist for Workshop I, "Allocating Risks in Construction Contracts," on Wednesday morning. He is the vice president and general counsel of Hensel Phelps Construction Co., a general contractor based in Greeley, Colorado, with district offices in Orlando, Florida; Chantilly, Virginia; Austin; Dallas; and Irvine and San Jose, California. Prior to joining Hensel Phelps, he was a partner in the Denver-based law firm of Davis, Graham & Stubbs, where his practice was concentrated in the areas of government contracts and construction. Mr. Wilson also previously worked as an assistant U.S. attorney for the District of Hawaii.

## ***Notes***

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# **ALLOCATING RISKS IN CONSTRUCTION CONTRACTS**

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Most construction risk professionals acknowledge that risk allocation is an important element of contracting, and many would even agree that transferring liability to another party is justified in some circumstances. But disparate opinions exist with regard to the appropriate scope of risk transfers, the methods commonly used to execute these transfers, the extent to which current insurance policies are effective in funding risk transfers, and myriad related issues.

In this session, a distinguished panel representing a cross section of the industry will discuss a variety of contractual risk transfer issues, some of which are controversial, with the goal of increasing awareness, opening dialogues, and improving cooperation among project participants.

## ***In Their Words ...***

In preparing this handout material, we asked each of our panelists to provide us with their viewpoints on the new additional insured endorsements and legislation. The panelists represent the perspectives of the contractor, subcontractor, broker, and insurer. Their responses are presented below.

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## **GENERAL CONTRACTOR'S VIEWPOINT**

**Eric L. Wilson  
Vice President**

**Hensel Phelps Construction Co.**

Standard construction agreements require the party that is undertaking to perform work to indemnify the party for whom the work will be performed against personal injury and property damage claims and other liabilities arising from the improper performance of the work. This standard risk allocation provision assigns responsibility for claims and legal actions to the party who has control and responsibility over the performance of the work. In the case of subcontracts entered into by general contractor, it allows the general contractor to require each subcontractor to take control of its work and be responsible for claims that arise out of the performance of that work.

To make this risk allocation structure effective, it is also important to ensure that the party performing the work has proper general liability insurance in place to cover claims arising out of the work. Therefore, standard construction subcontracts require general liability insurance with specified minimum limits to cover claims for which the subcontractor bears responsibility under the indemnification clause.

In order to ensure that the specified general liability insurance will respond to a claim for which the subcontractor is responsible, standard subcontracts also require that the subcontractor's general liability carrier name the general contractor as an additional insured under the policy. This additional insured status creates a direct relationship between the insurance company and the general contractor so that the general contractor has the right to directly demand that the carrier respond to a claim for which it is responsible to provide coverage. This additional insured status avoids the more cumbersome process of tendering the claim or action to the subcontractor, who, in turn, must tender it to the insurance carrier and request that coverage be provided to the general contractor as called for by the subcontract. Instead, the carrier has a direct obligation to the general contractor to provide the required coverage, and

the general contractor has the right to enforce the policy provisions in the event the carrier fails to respond.

A party may be named as an additional insured under a general liability policy using a variety of endorsements. Many general liability policies contain blanket additional insured endorsements, of the type set forth in ISO Form CG 01 05 04 94. This provision provides that any party that the named insured has agreed to name as an additional insured under a covered contract automatically becomes an additional insured. This is the simplest method for a named insured to honor its contractual obligations to add additional insureds to its policy.

If the named insured's general liability policy does not include a blanket additional insured endorsement, then each party that the named insured must add as an additional insured under its various contracts must be added by specific endorsement. Traditionally, this was accomplished through the issuance of ISO Forms CG 20 26 11 85, or CG 20 10 11 85. Both of these forms added the additional insured as an insured under the policy with respect to either liability arising out of the named insured's operations or premises owned by or rented to the named insured (CG 20 26 11 85), or liability arising out of the work performed by the named insured for the additional insured (CG 20 10 11 85). Neither of these forms of endorsement called for the additional insured status to cease when the work was complete, but instead the status continued under the completed operations portion of the policy.

More recent versions of these additional insured endorsements issued by ISO have restricted the additional insured status so that it ceases when the work is complete by the named insured. See both CG 20 10 10 93, and CG 20 10 10 01. This cessation of additional insured status upon completion of the work creates a gap in the risk allocation scheme since many personal injury and property damage claims relating to a subcontractor's work occur after completion of the job when the deficiency in the work either leads to some form of property damage upon failure, or causes an injury upon failure. To address this gap, an additional endorsement, CG 20 37 10 01, also must be issued to grant additional insured status to the general contractor under the products-completed operations hazard portion of the policy. Having to obtain this additional endorsement is cumbersome, but necessary for the contractual risk allocation process to be complete.

In some states, legislation has been proposed to restrict or prohibit a general contractor's and owner's ability to require the other contracting party to provide additional insured coverage under the named insured's general liability policy. Although the legislation may be well intended, the result will be requiring multiple carriers to respond to a personal injury or property damage incident that is primarily or solely attributable to another party's work. This will result in more cumbersome and expensive litigation, as multiple parties have to participate in the defense of an action that should clearly be allocated to the primarily responsible party. Instead of reducing insurance and litigation costs, this legislation is most likely to increase those costs, further burdening an already taxed insurance system.

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**SUBCONTRACTOR'S VIEWPOINT**  
**Richard B. Usher**  
**Principal Managing Member**  
**Hill & Usher LLC**

The contractual risk transfer model of the late twentieth century forces responsibility and payment for construction claims to be borne by subcontractors regardless of fault. A system that can as often penalize the innocent with demise as let the negligent escape without consequence is morally hazardous and affords no substantive incentive affecting behavior. Moral hazard stacks the deck against insurers. Transparency to accurate loss history is the mantra of free market insurance without which underwriters are sailing rudderless ships. When degree of control and extent of fault are determinative in paying for cost of loss, economics will drive safety and quality construction for the benefit of all.

Subcontractors<sup>1</sup> actually perform 80 to 90 percent of the work on a construction project. Often subcontractors perform 100 percent of the work.<sup>2</sup> It follows that the primary function of general contractors and home builders is the selection, coordination, and supervision of subcontractors, including the scheduling, sequencing, inspection, and instructive correction of their work. Skillful leadership is crucial to project safety and quality construction.

As it is currently structured, however, the construction market does not consistently reward the skillful leaders, nor punish the poor ones. This is because “hold harmless” terms and “additional insured” requirements have become ubiquitous in construction industry subcontracts, allowing, and even forcing, project leaders to “pass the buck” for their own mistakes to subcontractors.

Any form of insurance or indemnity can increase the likelihood that a loss event will occur, because a party expecting to be indemnified or insured without consequence will be inclined to use less care to avoid the insured event. Insurance companies respond to this “moral hazard” problem by using rating organizations to share historic loss information about their policyholders, enabling them to use premium increases or denial of coverage to discourage named insureds from taking insufficient care to avoid claims. Premium rate increases cannot, however, discourage contractual indemnitees or additional insureds from making claims, because they are “not responsible for premium payments to the insurer and [are] unaffected by the raising of premiums.”<sup>3</sup>

Contract requirements for broad indemnity, additional insured status of the CG 20 10 11 85 variety, and waivers of subrogation on workers compensation and general liability have created considerable friction among construction stakeholders. The legal cost associated with construction claim issues is estimated to be as high as 40 percent of total claim cost. The construction industry is a dangerous place to work, where 5 percent of the country’s employed account for 20 percent of workplace fatalities and a high percentage of serious injuries.<sup>4</sup> Defective construction claims based on shoddy, low-bid, poorly supervised construction work are becoming more commonplace throughout the country. Construction is, therefore, a special case with high priority. Loss-shifting terms in construction contracts have far more potential to cause harm than in other transactions.

<sup>1</sup>Keisha Rutledge, *Subcontractors Building Recognition on the Job*, Tampa Bay Business Journal, March 12, 2001; Rachel L. Dodes, *The Construction Conundrum, If the Industry is Booming, Why are Subcontractors Getting Run Into the Ground*, Business Forward, November 2000 (Real Estate) at <http://www.bizforward.com/wdc/issues/2000-11/realstate>; Kirk Alter and John Koontz, *Curriculum Development and Continuing Education In Project Management for the Specialty Subcontracting Industry* (1996), at <http://asceditor.unl.edu/archives/1996/alter96.htm>.

<sup>2</sup>Overton A. Currie, et al., *Construction Subcontracting: A Legal Guide for Industry Professionals* §1.3 (Smith, Currie & Hancock, ed., 1991).

<sup>3</sup>Mehta, *Additional Insured Status in Construction Contracts and Moral Hazard*, 3 Conn.Ins.L.J. 169, 187 (1996).

<sup>4</sup>The United States Bureau of Labor Statistics (BLS), data for 2002, counted 5,524 workplace fatalities for 2002, and BLS attributes 1,121 of them to construction. That’s 20.3 percent of workplace fatalities. See: <http://www.bls.gov/iif/oshwc/cfoi/cfch0001.pdf>.

BLS reports that the construction industry employs 5.2 percent of the nonfarm workforce. See: <http://www.bls.gov/iag/construction.htm>. The figure for workplace fatalities includes 789 farm-related fatalities. By excluding the farm fatalities to match the workforce figure, construction’s share of fatalities ends higher than 20.3 percent. Also, by adding farm-related employment to the workforce figure, construction’s share of total workers is lower than 5.2 percent of total workforce. When we say that construction employed 5 percent of the workforce but was responsible for 20 percent of workplace fatalities in 2002, our figures are necessarily *conservative and understated*, because the workforce figure excludes farm payrolls while the fatalities figure does not. BLS data for 2001 and 2000 showed the same thing: construction employed 5 percent of the (nonfarm) workforce, but accounted for 20 percent of workplace fatalities (including agriculture workers).

Many states address unfairly broad indemnity provisions in construction contracts with anti-indemnity statutes. Recently enacted indemnity reform statutes in New Mexico<sup>5</sup> and Montana,<sup>6</sup> as well as a 1995 Oregon<sup>7</sup> statute, void or restrict construction contract provisions that require additional insured coverage extending to liability caused by the additional insured. Insurance Services Office, Inc. (ISO), recently filed new standard edition additional insured endorsements for the construction industry, available for use in July 2004, that exclude coverage for the sole negligence of the additional insured. ISO has also filed a standard endorsement intended to modify contractual liability insurance to exclude coverage for the sole negligence of the indemnitee.

In a capitalist society, the incentive to prevent accidental losses lies in financial responsibility as allocated by the tort liability system. Rational business people can be expected to use valuable resources to prevent accidents when each is held financially responsible for the accidental losses that they cause. On the other hand, when a party responsible for causing or failing to prevent an accident, in whole or in part, can shift much or all of the financial consequences to others, without regard to fault, then loss prevention efforts will only add to overhead and be punished in the competitive marketplace. The result is a "race to the bottom."

Owners and general contractors who can successfully shift the financial consequences of accidental injury losses and defective construction to other parties never have to make claims on their own insurance policies and so never face the consequences of their own actions and decisions affecting workplace safety and construction quality. Immunity breeds arrogant disregard for all but expedient financial reward.

Owners, general contractors, and prime contractors should be aware, and should make others aware, of effective alternatives to "additional insured" requirements, like Owners and Contractors Protective Liability Insurance<sup>8</sup> endorsed with Project Management Protective Liability Coverage.<sup>9</sup> In fact, the standard form AIA Document A201-1997, General Conditions of the Contract for Construction, bars the owner from requiring the prime contractor to name it as an "additional insured"<sup>10</sup> and instead endorses the Project Management Protective Liability alternative.<sup>11</sup> Furthermore, "additional insured" coverage is increasingly subject to restrictions, by insurance carriers, state legislatures, and even the courts. For example, courts have begun to recognize that limited construction of additional insured policy endorsements "furthers [the public's] interest in preventing construction-related accidents."<sup>12</sup> Insurers, regulators, and commentators are increasingly recognizing that additional insureds face moral hazards undermining project safety and quality, because they receive coverage without underwriting, monitoring, or the threat of future premium increases.

The continuing efforts of construction service buyers and general contractors to unfairly shift risk to trade contractors is the focus of considerable objection from the American Subcontractors Association and many other trade associations throughout the states. The contemporary construction risk transfer model is a one-sided approach that deters jobsite safety and quality construction, and is, therefore, destined to be replaced in an enlightened, democratic society. The most successful businesses will, as usual, be ahead of the curve and adapt before it happens.

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<sup>5</sup>NM Stat. § 56-7-1

<sup>6</sup>Title 28, Chapter 2, Part 21, Section 1. Eff: 7-1-2003.

<sup>7</sup>OR. Rev. Stat. § 30.140

<sup>8</sup>ISO form CG 00 09

<sup>9</sup>ISO form CG 31 15

<sup>10</sup>See Paragraph: 11.3.3

<sup>11</sup>See Paragraph: 11.3.1

<sup>12</sup>*Nat. Union Fire Ins. Co. v Nationwide Ins.*, 82 Cal Rptr 2d 16, 22 (Cal App 4 Dist 1999).

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**BROKER'S VIEWPOINT**  
**Paige K. Lawrence**  
**Senior Vice President**  
**Willis, Inc.**

Contractual requirements for additional insured status under various liability policies are commonplace in most construction agreements. The owner wants to be an additional insured on the general contractor's (GC's) policies, and, likewise, the GC will pursue that same status under the subcontractors' policies. This contractual requirement reinforces the indemnity agreement to the extent a claim is covered by the terms of the policy and gives the additional insured direct access to the policy for claims that arise from the work being performed by the contractor providing the additional insured status. The additional insured status also allows for direct access to the defense provisions of the policy for which the additional insured has been added. Historically, these additional insured endorsements were routinely issued without reference to specific contracts, and the "arising out of" wording utilized in the endorsements did not require a direct causal relationship between the named insured's conduct, work, or operations and the additional insured's conduct.

Over the years, these additional insured endorsements have been interpreted in many ways. Insurance companies grew more concerned as the interpretations seemed to stray from the original intent, which was to provide coverage for the additional insured's vicarious liability for activities or work of the named insured—not to cover the sole negligence of the additional insured. Effective June 1, 2004, Insurance Services Office, Inc. (ISO), introduced revised general liability additional insured endorsements. The primary goal of these revisions is to clarify intent of coverage and exclude coverage for an additional insured's sole negligence. The new endorsement language will provide coverage for the additional insured's liability for bodily injury, property damage, or personal and advertising injury caused, in whole or in part, by the acts or omissions of the named insured or those acting on behalf of the named insured. The endorsements no longer use the language "arising out of" the named insured's work or ongoing operations.

ISO has also introduced a new, optional ISO endorsement that modifies the definition of "insured contract." Once again, the purpose of the revision is to establish intent. Just as coverage for the sole negligence of an additional insured is being eliminated, contractual liability coverage pertaining to the indemnity agreement is also being amended to exclude coverage when the named insured has assumed liability for the sole negligence of another party.

What does this mean? The meaning will differ depending upon perspective. If you are a general contractor who has traditionally relied upon risk transfer to your subcontractors, you may find more claims being addressed under your own corporate program. You may also find it less realistic to rely upon additional insured status to ensure a defense.

Historically, general liability policies have offered broader defense obligations than required under the indemnification provisions. If you are a subcontractor, you may find these endorsements help you and your insurer to defend against claims that result from liability that was created outside your scope of work.

Contractors will need to review their existing and pending contracts. Often, the contract requirements under the insurance section and the indemnification provisions will extend well beyond the coverage afforded under the new additional insured endorsements, and therefore, the named insured may be exposed to requests for indemnification straight from their balance sheet or threats of breach of contract

litigation. Most construction contracts do not attempt to transfer "sole negligence" of the indemnitor to the indemnitee. However, if such a contract is presented, it is critical that the contractor fully understands the statutes of the state to which the contract is subject. If the statutes allow for the transfer of sole negligence, the contractor considering accepting such contract language must either amend the contract or negotiate the inclusion of an additional insured endorsement that will respond to the contract terms. For those contractors retaining significant risk themselves (e.g., via large deductibles), negotiation of terms may be possible.

All contractors need to be familiar with the revised endorsements and aware of potential implications. These endorsements are not yet commonplace but will certainly start appearing on renewals in 2004.

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## **INSURER'S VIEWPOINT**

**Todd Rowland  
Senior Vice President  
Zurich Construction**

Every construction insurance underwriter understands that additional insured status is a common and effective risk transfer tool; it protects one party from certain risks arising out of another party's activities. Underwriters also understand that their customers, whether general contractors or specialty contractors, are routinely required in contracts to provide additional insured status to their clients. Failing to do so might very possibly limit their ability to secure work.

### **Additional Insured Issues**

Until recently, most construction insurers agreed to provide "blanket additional insured" coverage for their customers for little, if any, additional premium. The provision of this "blanket" status has become severely problematic of late, however. The Insurance Services Office, Inc. (ISO), additional insured endorsements were meant to respond to the additional insured's liability "arising out of" operations performed for the additional insured by the named insured. Many courts have found that the phrase "liability arising out of" confers additional insured status only for the vicarious liability of the additional insured for the negligence of the named insured. Unfortunately, other courts have construed the phrase more broadly to confer additional insured status for the affirmative negligence of the additional insured. In other words, these courts have found coverage under the additional insured endorsement even though the named insured was not at fault in the accident. Much of this litigation has taken place with respect to construction risks.

Another issue that has arisen under additional insured endorsements is that of "Targeted Tender." A few states permit an insured under more than one policy to select or "target" the policy that will respond to a claim without regard to the "other insurance" provisions of the respective policies. For example, in these states an additional insured under multiple potentially applicable policies may "target" a single policy to respond to the entire loss. A Targeted Tender can result in one insurer paying an entire loss that either is more appropriately paid by another insurer or should be shared with other insurers.

Other key areas that have resulted in coverage disputes under ISO forms include:

- An agreement between the named insured and additional insured to terms of coverage for the additional insured that differ from the terms of the policy;
- Other insurance provisions that may conflict with, or are inconsistent with, one another; and
- The named insured's oral agreement to add an additional insured to its policy.

The impact of the inclusion of additional insured endorsements on a customer's policy may also have a negative impact on that customer:

- Diluting available limits, because payment of a claim involving an additional insured reduces the occurrence and aggregate limits available to the named insured for future claims
- Creating a conflict of interest if a lawsuit is brought against both the named insured and an additional insured. The two parties may not agree on where the liability for the claim resides although the named insured's insurer may be obligated to provide a defense to both parties. As a result, the insurer may appoint separate defense counsel for each party increasing defense costs.

## The Industry's Response

The construction insurance industry has not developed a unified approach to dealing with these issues. ISO has filed several new endorsements, which more narrowly define the intent of coverage and in some cases restrict it to active projects. Some individual companies have developed and filed their own endorsements, further narrowing coverage, particularly for residential construction of any sort.

## Solutions

If there is a "silver bullet" that might resolve these issues fairly and equitably for owners, contractors, subs, and their insurers, it is most likely the adoption of uniform public policy, which mandates the use **comparative fault/negligence** language in all construction contracts. This approach has several benefits.

- It reduces leverage around indemnity and insurance issues when awarding contracts between owner and general or general and sub;
- Insurance and indemnity flow down provisions in contracts become much fairer, appropriately allocating risk to the party in the best position to control it and finance it; and
- Underwriters can assess and price risk around their own customer's operations and not be required to insure third parties, whom they have not had an opportunity to underwrite.

Unfortunately, issues of public policy are generally developed at the state legislative level and are always very political. While some states have embraced comparative fault theory, many others have not or are just now beginning to recognize the issues; special interests on both sides of the issue are active in promoting their own agendas; and most importantly, there is not one voice that speaks for the construction industry, so solutions that consider the needs of all stakeholders have not been explored or actively promoted.

What's needed? A high-level dialogue across the construction industry and construction insurers, which is designed to develop and promote an agreeable common approach. The power of such an effort cannot be overemphasized, nor can the difficulty!

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## **COVERAGE ATTORNEY'S VIEWPOINT**

**Mark E. Christensen  
Managing Partner  
Christensen & Ehret**

### **Introduction**

There are competing interests surrounding the use of additional insured endorsements. Owners and contractors seek wholesale risk transfers downstream maintaining that they should not have to bear the cost of subcontractor employee injuries. Notwithstanding their potential legal duties of providing a safe workplace or properly supervising the work, general contractors contend that most subcontractor employee injuries arise from the means and methods of that trade's jurisdictional work and are not the result of an overt act by the general contractor. As a result, the general contractor does not want its insurance loss record to be tagged with the third-party costs of these claims. Insurers are also reluctant to accept that risk. They do not want to pay for claims caused by an additional insured's negligence. Insurers are motivated to limit coverage to protect the viability of their general liability rating schemes that can be skewed by excessive unrated additional insured losses. Thus, contractors are caught between the bargaining power of the owner reflected in unalterable indemnity and insurance contract provisions on the one hand and the inflexible underwriting guidelines of insurers to reduce the scope of additional insured coverage on the other. Contractors acquiesce to the contract terms to get the work, while purchasing insurance in a shrinking uncompetitive market.

The ISO CG 20 10 07 04 form attempts to potentially forge a middle ground between these interests, and time will tell whether it achieves its intended goal.

We will touch upon three critical issues with respect to the new endorsement. First, will the courts read the change in language as an attempt to narrow the scope of coverage provided? Second, does the form establish clear parameters of when additional insured coverage exists, or will it spawn claims for breach of contract for failure to procure additional insured coverage consistent with contract terms? Third, will the endorsement be used? The context of these comments will be made against the backdrop of a general contractor's tender to a subcontractor's insurer of a third-party suit brought by the subcontractor's employee against the general contractor. This is by far the most frequent situation in which additional insured coverage is sought.

### **Change in Language**

The ISO form makes a significant change in the additional insured language by eliminating the phrase "arising out of your ongoing operations" and substituting the new language "caused, in whole or in part, by your acts or omissions ... in the performance of your ongoing operations for the additional insured ..."

As we know, there is a whole body of law construing the phrase "arising out of" very broadly to include coverage for the additional insured's own negligence, including its sole negligence. Under the former ISO form the additional insured's liability merely had to arise out of the named insured's ongoing operations, not its negligence. As one court put it, "in order to establish the obligation to defend under the policy, [the additional insured] need only show that [its] potential liability ... arises from operations performed at the construction site for [the additional insured] by [the named insured]." *Casualty Insurance Company v Northbrook Property*, 150 Ill App 3d 472, 474, 501 NE2d 812, 814 (1st Dist 1986).

The new ISO wording that requires that bodily injury be caused in whole or in part by the named insured or its agent's acts or omissions does not provide the additional insured coverage for its sole negligence.

Further, the additional insured's coverage may be limited to those circumstances where the named insured's *negligence* caused the additional insured's liability. The issue is whether the injury may simply result from the "performance" of the "ongoing operations" or must result from a "negligent" performance. Instructive is whether the word "cause" refers to the issue of culpability or merely a causal connection. An injury can be caused without negligence or liability, and the new ISO language chooses not to use either the words "liability" or "negligence." Alternatively, the language "caused ... by your act or omissions" carries the ring of proximate causation under traditional negligence parlance.

If one pushes the latter interpretation to the extreme, the new ISO form reduces additional insured coverage to vicarious liability that is an exceedingly remote theory of recovery in construction injury disputes. Section 409 of the Restatement (Second) of Torts severely limits vicarious liability exposure in the construction setting. If found liable at trial, general contractors are held *directly* negligent for their acts under traditional tort allegations.

In any event, as a practical matter the form will be a tool in the hands of adjusters for a number of years before any appellate court interprets its meaning. How tenders of defense may be addressed is discussed in the next section.

## **Does the New ISO Form Facilitate Additional Insured Coverage?**

Whether "caused in whole or in part" is read broadly or narrowly, an interesting dilemma results. Since the named insured subcontractor is frequently immune from liability due to the exclusive remedies provision of the various state workers compensation statutes, it is unlikely that prior to trial there would ever be a determination as to whether the bodily injury or property damage was caused, in whole or in part, by the named insured. Moreover, if the named insured is not a third-party defendant, there may never be a judicial determination as to whether the named insured's act or omission caused in whole or in part the personal injury. Thus, while the new ISO form may have been written to avoid coverage for the sole negligence of the additional insured, as the issue of causation cannot be resolved until trial the new endorsement form may not reduce the costs stemming from the duty to defend. Just exactly how there will be an ultimate determination of the extent of the named insured's complicity remains unresolved.

Notably, since the duty to defend is broader than the duty to indemnify, the narrowed scope of coverage under the endorsement should not be used to deny a tender simply because the insurer has reason to believe that (A) its named insured did not cause the accident or (B) the accident was caused by the sole negligent acts of the additional insured. As the actual cause apart from the allegations of the complaint can only be determined at the end of the trial, the ISO form will probably increase the number of tenders accepted subject to a reservation of rights. Once the reservation of rights is issued, the potential uninsured exposure may lead to a claim for breach of contract against the subcontractor. Reservations of rights that turn on facts developed during the case raise conflict of interest issues where insurer-designated defense counsel control the defense. Indemnity dollars for settlement may be scarce for the additional insured if the adjuster believes its named insured is not culpable. Alternatively, if denials become routine, the cost of declaratory proceedings will shift to the contractor if it desires to challenge an outright denial.

## **Will the Endorsement Be Used?**

The final issue is whether the new ISO form's impact is overstated. At present two out of the four large construction insurers have their own manuscript additional insured endorsements. Many midmarket insurers utilize manuscript endorsements as well. Clout-heavy contractors with substantial premium will likely insist on the previous ISO form in order to maintain consistency between their contractual obligations and coverage actually purchased.

## **Conclusion**

The new ISO additional insured form attempts to address a business risk in the construction market that the insurance industry has decided not to fully insure. Where those costs will ultimately be absorbed—by the additional insured's own primary policies, by increased construction costs, or by the named insured's policy through the court's decision to broadly interpret CG 20 10 07 04—will unfold in the days ahead.