

Preconference Workshop 1

Monday, November 7, 9:00 a.m.–noon and 1:30–4:30 p.m.

ADDITIONAL INSUREDS AND THE DUTY TO DEFEND

Presented by

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Recently the coverage provided to additional insureds has been under attack from both the insurance industry and the legislative branch. The 2004 changes to standard additional insured endorsements dramatically restrict the scope of the additional insured's coverage, and many of the nonstandard endorsements currently in use are even more restrictive than the standard versions. At the same time, a number of state legislatures have introduced, and in some cases passed, legislation that makes it illegal to require insurance coverage that exceeds the scope of allowable indemnification under the anti-indemnity statute. In many instances, even the new standard additional insured endorsements would exceed the allowable scope of coverage. This workshop will provide a brief review of the evolution of the standard additional insured endorsements and present a panel of experts who will address a variety of concerns that standard and insurer endorsements present for owners and general contractors.



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Ms. Berkeley is a panelist for Monday's Preconference Workshop 1, "The Changing Face of Additional Insured Coverage." A partner, she leads the Insurance Practice Group at Schiff Hardin LLP in Chicago. Ms. Berkeley's practice focuses on insurance coverage. She has extensive experience representing insurers, self-insurers, and policyholders in coverage litigation and risk management issues relating to construction, product liability, environmental, intellectual property, and general commercial disputes. Ms. Berkeley has authored numerous papers and articles, including the reference guide, *CGL Reporter—The Insurance Coverage Litigation Handbook*. Some of her recent publications include: "Six Myths To Overcome for Insuring Economic Loss, Breach of Contract, and Faulty Workmanship," *CGL Reporter*, Spring 2004; "Duty to Defend," *Commercial and Professional Liability Insurance*, Illinois Institute of Continuing Legal Education, 2002; "Managing the Ongoing Insurer-Insured Relationship," *The Brief*, Vol. 30, No. 2, p.60 (Winter 2001); "Getting Along with the Insurer: A Guide for the Zealous Defense Litigator," *The Practical Litigator*, Vol. 9, No. 6, p.19 (November 1998); "Policyholder Panacea? The Role of Independent Counsel," 44 *Risk Management* 57 (June 1997).

Ms. Berkeley graduated from the University of Michigan with a B.A. with High Honors, 1972, Phi Beta Kappa, and from Northwestern University School of Law, 1975.

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Additional Insureds and the Duty to Defend

**by Jill B. Berkeley
Schiff Hardin LLP**

In the construction field, owners and contractors usually require their subcontractors to maintain commercial general liability policies that name the owner and contractor as additional insureds. The purpose of an additional insured endorsement is to protect the additional insured (i.e., the owner or contractor) from potential liability arising out of the work of a named insured (i.e., subcontractor). One common liability situation occurs when an employee of a named insured is injured on a construction site and seeks damages from the owner and/or general contractor of the project. The additional insured seeks coverage for its liability to the named insured's employee. The additional insured, named insured, and named insured's insurer each have different interests in the pursuit of coverage provided in the additional insured endorsement.

The Insurance Services Office ("ISO") in drafting standard additional insured endorsements used by contractors and subcontractors attempts to balance the interests of all three parties and to avoid disputes. In the July 2004 revised standard additional insured endorsements, ISO has limited the scope of coverage but created new problems as a result of the new endorsement language.

Standard ISO Endorsements Prior to the 2004 Revisions

The previous ISO additional insured endorsements generally provided coverage to the additional insured for liability "arising out of" ongoing operations performed by the named insured on behalf of the additional insured. In the typical situation in which an employee of a named insured brings a claim against the additional insured, the fact that the named insured was

working on the project is sufficient to trigger the duty to defend under the additional insured endorsement. If an employee of the named insured is injured performing any duty related to the construction project, courts have typically found the injury qualifies under the “arising out of” nexus. The relationship between the subcontractor and the project, in essence, meets the necessary “arising out of” requirement. Consequently, the named insured’s insurer will have the duty to defend the additional insured, even if the injury was a result of the sole negligence of the additional insured.

A recent example of such an interpretation is *Mikula v. Miller Brewing Co.*, No. 2004AP498, 2005 WL 839519 (Wis. Ct. App. April 12, 2005). *Mikula* involved a subcontractor naming the general contractor and site owner as additional insureds on its CGL policy. The subcontractor’s insurer agreed to defend and indemnify the site owner for liability arising out of the subcontractor’s ongoing operations at the site.¹ An employee of the subcontractor was injured in an elevator owned and maintained by the site owner. Nothing in the record alleged negligence on the part of the subcontractor or general contractor. The site owner argued that the “arising out of” language was intended to be broad and comprehensive and that the additional insured endorsement extended liability coverage to the site owner without an allegation of the named insured’s fault.² The court ultimately agreed with the site owner, stating that “there need not be negligence alleged against the named insured for the additional insured to be covered.”³ The fact

¹ *Mikula v. Miller Brewing Co.*, No. 2004AP498, 2005 WL 839519, at 2 (Wis. Ct. App. April 12, 2005).

² *Id.* at 5.

³ *Id.* at 7.

that the injured employee was executing his job for the subcontractor was sufficient to trigger coverage. Furthermore, the court stated that if the subcontractor intended to limit coverage in instances where the additional insured was solely negligent, it should have stated that within the policy.⁴ In *Mikula*, the fact that the injured employee was doing his job, despite no alleged negligence on his part or the part of the contractor/subcontractor, was sufficient to provide the site owner coverage as an additional insured.

Broad judicial interpretations such as these were the basis for tension between named insureds, additional insureds, and insurers. The named insured and its insurer argued that the additional insured endorsement provided broader protection than the indemnification clause in the subcontractor's contract. The additional insured argued that the additional insured endorsement necessarily provided broader protection, including the duty to defend, in order to plug the gap created by anti-indemnity statutes. Some insurers, not satisfied with the broad interpretation of the "arising out of" language, modified standard additional insured endorsements. A modified endorsement was used to provide coverage to an additional insured only if the named insured was solely liable for the injuries caused. These provisions were enforced to deny the additional insured any protection unless the named insured was solely responsible for the injuries sustained.⁵

Despite these extreme positions, most parties to a construction contract typically intend to provide coverage on a middle ground. Most general contractors/owners expect coverage as an additional insured in situations beyond the named insured's sole negligence. Conversely, the

⁴ *Id.* at 8.

⁵ See, e.g., *Vill. of Hoffman Estates v. Cincinnati Ins. Co.*, 670 N.E.2d 874 (Ill. App. Ct. 1996).

named insured does not intend to provide coverage to an additional insured where the additional insured is solely negligent. As one commentator has noted, “Subcontractors no doubt view it as unfair that their policies’ experience is negatively affected by the actions of negligent parties, whose own policies may sit on the sidelines, unimpaired, when the time comes to compensate an insured party.”⁶ In an attempt to achieve the proper balance between the expectations of the additional insured and the named insured, the 2004 ISO endorsements were issued. The question remains whether they will strike the correct balance.

2004 ISO Additional Insured Endorsements: Precluding Coverage for Additional Insured’s Sole Negligence

The goal of the new ISO additional insured forms is to strike a balance between the interests of the general contractor/owner and the subcontractor. The general contractor/owner is interested in being afforded the broadest coverage feasible, consistent with the former “arising out of” additional insured endorsement language. Simultaneously, subcontractors and their insurers want to provide the narrowest coverage possible, seeking to defend and indemnify the general contractor/owner for vicarious liability or liability arising out of the subcontractor’s (i.e., the named insured) sole negligence only.

The new form includes the following language:

A. *Section II – Who Is An Insured is amended to include as an additional insured any person(s) or organization(s) shown in the Schedule, but only with respect to liability for “bodily injury”, property damage” or “personal and advertising injury” caused, in whole or in part, by:*

1. *Your acts or omissions; or*

⁶ Randy J. Maniloff, *Additional Insureds Coverage And Legislative Changes On The Horizon*, MEALEY’S LITIGATION REPORT: INSURANCE, April 12, 2005, at 20.

2. *The acts or omissions of those acting on your behalf; in the performance of your ongoing operations for the additional insured(s) at the locations designated above.*

B. *With respect to the insurance afforded to these additional insureds, the following additional exclusions apply:*

This insurance does not apply to “bodily injury” or “property damage” occurring after:

1. *All work, including materials, parts or equipment furnished in connection with such work, on the project (other than service, maintenance or repairs) to be performed by or on behalf of the additional insured(s) at the location of the covered operations has been completed; or*
2. *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 principal as a part of the same project.”*

The new “fault-based” additional insured endorsement attempts to find a balance between these two extremes. The new ISO endorsements provide additional insureds with coverage for liability that is caused in whole or in part by the acts or omissions of the named insured. This language precludes coverage to the additional insured in situations where the additional insured is **solely** negligent. Furthermore, the language requires some “act or omission” on the part of the named insured. Therefore, the language of the new ISO endorsements require that: (1) the additional insured is not solely negligent and (2) the named insured commits some act or omission which causes the injury. As a result, subcontractors’ insurers no longer have a duty to defend or indemnify the general contractor under their CGL policies when the general contractor is solely responsible for the plaintiff’s injuries or when the named insured did not contribute to the injury.

The purpose of the new ISO endorsement is not to preclude coverage for an additional insured when it is negligent, but rather to preclude coverage in instances where the additional insured is solely negligent.⁷

Does the Elimination of Sole Negligence Coverage Limit the Duty To Defend?

Eliminating the burden on the named insured's insurer to defend and indemnify the additional insured for the additional insured's sole negligence has helped effectuate the named insured and its insurers' interest. Unfortunately, the revision has not adequately protected the additional insured's interests, in particular, when the duty to defend should exist. When an injured employee of the named insured files a claim against an additional insured, there is rarely any allegation of negligence on the part of the named insured (i.e., the injured employee's employer) as a result of the workers compensation exclusive remedy bar. Under the former "arising out of" language, without an exception for the additional insured's sole negligence, courts held that when the complaint stated that the injured employee was injured fulfilling his employee obligations at the job site, the duty to defend was triggered.⁸

A good example of the struggle to enforce additional insured coverage under an endorsement similar to the 2004 ISO form is *U.S. Fire Insurance Co. v. Aetna Life & Casualty*, 684 N.E.2d 956 (Ill. App. Ct. 1997). An injured employee of a subcontractor filed a complaint against the general contractor. The general contractor was listed as an additional insured under

⁷ Maniloff at 20.

⁸ See, e.g., *Cas. Ins. Co. v. Northbrook Prop. & Cas. Ins. Co.*, 501 N.E.2d 812, 815 (Ill. App. Ct. 1986).

the subcontractor's CGL policy. The additional insured endorsement was similar to the 2004 ISO endorsement, covering the additional insured only when the injury arose from some operation on the construction site and when the named insured's acts or omissions contributed to the injury.⁹ The named insured's insurer argued that since the injured plaintiff's pleadings did not claim any negligent acts or omissions on the part of the named insured, the duty to defend the additional insured was not triggered. The court, however, disagreed, holding that there was potential liability on the part of the named insured because the plaintiff was on the job site performing duties for the named insured, the duties required the injured employee to work near the cause of the injury, and his duties for the named insured caused the physical action which led to the injuries.¹⁰ All of these facts, contained within the pleadings, raised the "potential for coverage and, in turn, a potential for coverage is all that is necessary to trigger [the named insured's] duty to defend."¹¹

Other courts have not applied such a broad interpretation to the duty to defend an additional insured under a 2004 form. In *Transport International Pool, Inc. v. Continental Insurance Co.*, No. 2-04-176-CV, 2005 WL 1294392 (Tex. App. June 2, 2005), an injured employee of a construction company filed suit against the lessor of a trailer leased by the construction company for an on-site office. The lease between the construction company and the trailer lessor stated that the construction company was to procure CGL insurance and it was to

⁹ *U.S. Fire Ins. Co. v. Aetna Life & Cas.*, 684 N.E.2d 956, 960 (Ill. App. Ct. 1997).

¹⁰ *Id.* at 962.

¹¹ *Id.*

name the lessor as an additional insured. The policy, however, would not provide coverage to the lessor if bodily injury arose out of the sole negligence of the additional insured.¹² When strong winds blew the trailer over, causing injuries to the plaintiff employee, he filed suit claiming negligence on the part of the lessor for not anchoring the trailer properly. Despite the lessor's argument that the construction company was also negligent, the court refused to look at factors outside of the injured employee's complaint and the insurance policy itself. Determining that the policy excluded coverage for sole negligence on the part of the additional insured (i.e., the lessor), the court held that the lessor was not covered under the policy because based on the injured employee's complaint, no evidence of negligence on the part of the construction company was claimed.¹³ Since negligence was not alleged against the construction company, the court held that the construction company's insurer did not have a duty to defend the lessor.¹⁴

States that Go Beyond the 2004 ISO Additional Insured Endorsements: Proportional Indemnification

Some states have gone beyond the new revisions of the 2004 ISO endorsements, precluding "an insurer from providing defense and indemnity to an additional insured for its own negligence, even when the additional insured is not solely negligent, including Arizona, California, Colorado, Illinois and Texas."¹⁵ Ultimately, this leads to proportional

¹² *Transp. Int'l Pool, Inc. v. Continental Ins. Co.*, No. 2-04-176-CV, 2005 WL 1294392, at 3 (Tex. App. June 2, 2005).

¹³ *Id.* at 5.

¹⁴ *Id.*

¹⁵ Maniloff at 20.

indemnification, where the named insured’s insurer is only liable to the additional insured for the additional insured’s proportionate share of liability.

In *Walsh Construction Co. v. Mutual of Enumclaw*, 104 P.3d 1146 (Or. 2005), the court interpreted the effect of an Oregon statute which applies its anti-indemnity statute to additional insured requirements in construction contracts. The relevant statute states that:

(1) Except to the extent provided under subsection (2) of this section, any provision in a construction agreement that requires a person or that person's surety or insurer to indemnify another against liability for damage arising out of death or bodily injury to persons or damage to property caused in whole or in part by the negligence of the indemnitee is void.

(2) This section does not affect any provision in a construction agreement that requires a person or that person's surety or insurer to indemnify another against liability for damage arising out of death or bodily injury to persons or damage to property to the extent that the death or bodily injury to persons or damage to property arises out of the fault of the indemnitor, or the fault of the indemnitor's agents, representatives or subcontractors.¹⁶

The court held that the statute “prohibits ... ‘additional insurance’ arrangements by which one party is obligated to procure insurance for losses arising in whole or in part from the other’s fault.”¹⁷ The consequence of this interpretation is that named insured’s insurer will only indemnify the additional insured for the named insured’s proportional fault. Furthermore, the

¹⁶ OR. REV. STAT. § 30.140 (1997).

¹⁷ *Walsh Constr. Co. v. Mut. of Enumclaw*, 104 P.3d 1146, 1150 (Or. 2005) (citing *Walsh Constr. Co. v. Mut. of Enumclaw*, 76 P.3d 164 (Or. Ct. App. 2003)).

court in *Walsh* held that an additional insured agreement similar to the 2004 ISO endorsements or the pre-2004 endorsements would violate the statute, causing the entire policy to be void and offering no coverage for the additional insured.¹⁸

It is important to note, however, that anti-indemnity statutes do not necessarily apply to additional insured endorsements. The court in *American Casualty Co. of Reading, Pa. v. General Star Indemnity Co.*, 24 Cal. Rptr. 3d 34 (Cal. Ct. App. 2005), held that a statutory provision precluding indemnity for a party's sole negligence did not apply to an additional insured endorsement because an additional insured endorsement is separate from a contractual indemnification obligation.¹⁹ The critical difference between the two statutory provisions is that the Oregon statute specifically stated that insurers were covered under the statute, whereas the California anti-indemnity statute did not.²⁰

Looking Toward the Future – Suggestions To Consider

The new language of the 2004 ISO additional insured endorsements reflect the insurance industry's intent to limit coverage for additional insureds. This change, however, has made it

¹⁸ *Walsh Constr. Co. v. Mut. of Enumclaw*, 104 P.3d 1146 (Or. 2005).

¹⁹ *Am. Cas. Co. of Reading, Pa. v. Gen. Star Indem. Co.*, 24 Cal. Rptr. 3d 34 (Cal. Ct. App. 2005)

²⁰ CAL. CIV. CODE § 2782 (1990) reads in pertinent part: "(a) Except as provided in [provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract and which purport to indemnify the promisee against liability for damages for death or bodily injury to persons, injury to property, or any other loss, damage or expense arising from the sole negligence or willful misconduct of the promisee or the promisee's agents, servants or independent contractors who are directly responsible to such promisee, or for defects in design furnished by such persons, are against public policy and are void and unenforceable; provided, however, that this provision shall not affect the validity of any insurance contract, workers' compensation or agreement issued by an admitted insurer as defined by the Insurance Code."

more difficult to trigger a duty to defend even when the additional insured is entitled to coverage.

When owners, contractors, and subcontractors negotiate the insurance specifications, and specifically, additional insured coverage, they should consider the following:

1. The requirement to name the additional insured should include coverage “caused, in whole or in part by an act or omission of the named insured.”
2. The additional insured should require the named insured to provide a copy of the additional insured endorsement, not only the certificate, to confirm that the language reflects coverage “caused, in whole or in part, by an act or omission of the named insured.”
3. The indemnity clause should include the duty to reimburse defense costs for any claim by an employee of the indemnitor, until a final adjudication that the indemnitee is solely negligent.
4. The insurance specifications should expressly contain a requirement that the additional insured’s insurer should defend the additional insured if any employee of the named insured is injured.
5. For insureds who must provide additional insured endorsements, negotiate for a blanket additional insured endorsement, specifying that any person or entity shall be added as an additional insured for its liability caused, in whole or in part, by an act or omission on the named insured if you are required by any contract or agreement to name that person or entity.

A sample Insurance Specification is set forth below:

Contractor shall name Owner as additional insured in its policies, as set forth below, and agrees to waive and will require its insurers to waive all rights of subrogation against the other party, as it relates to this Agreement on all of the insurance coverage required under this Agreement.

- (1) On Contractor’s Commercial General Liability policy required above, Contractor will add Owner as an additional insured using an endorsement which provides coverage for: “liability for ‘bodily injury’, ‘property damage’ or ‘personal and advertising injury’ caused, in whole or in part, by your acts or omissions or the acts or omissions of those acting on your behalf: (a) In the performance of your ongoing operations; or, (b) for claims brought by or on behalf of your employees, agents, or subcontractor; and their employees.”

- (2) Contractor's insurance policy with respect to coverage maintained pursuant to this Section must:
- (a) Be placed with insurance companies with A.M. Best's rating of A- or better, unless coverage is provided under a program of self-insurance (each party hereby approves the program of self-insurance maintained by the other as of the date hereof and waives any argument that self-insurance shall not be considered insurance).
 - (b) State that it is primary, or excess only with respect to the specified primary policy provided by the same party for such coverage, and not excess or contributing with respect to any other insurance and that all provisions thereof, except the limits of liability, will operate in the same manner as if there were a separate policy covering each insured under each such policy.
 - (c) Provide that there will be no recourse against the additional insured (other than the party obtaining such policy) for the payment of premiums, additional premiums or assessments, it being understood that these are obligations of the party providing such insurance pursuant to this Agreement.
 - (d) Waive any right of the insured to any set-off or counterclaim or any other deduction, whether by attachment or otherwise, in respect of any liability of any such person insured under such policy.
 - (e) Provide that it may not be cancelled, non-renewed without giving the other party thirty (30) days prior written notification thereof.
- (3) Upon written request of Owner, Contractor will furnish certificates of the applicable insurance policies, and endorsement required under this Article, to Owner evidencing the insurance required pursuant to this Agreement.

CONCLUSION

The issues relating to additional insured endorsements affect multiple parties, each with its own interests. The goal of providing coverage should be to balance the interests of and effectuate

the intent of the parties. With some additional safeguards, the 2004 ISO revisions will have a chance to succeed.

September 2005

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Additional Insured

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