

## WHO PAYS NEXT?

### **Analysis of the Role of Excess and Umbrella Coverage in Large Construction Loans, Including a Discussion of the Impact of Additional Insured Status and Contractual Indemnity Obligations**

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#### **I. Introduction**

This paper is designed to give the construction lawyer, coverage counsel, and insurance professional an overview of the issues implicated by a large construction loss that triggers excess and umbrella coverage. First, the applicable provisions of the construction contract and the insurance policies will be discussed. Second, issues regarding the order and extent of triggering of excess and umbrella policies and other special issues will be explored.

Before moving to the substance of the paper, I must give credit where it is due. A thorough discussion of most of the issues presented in this paper can be found in several excellent reference books published by the International Risk Management Institute, Inc. (“IRMI”). IRMI’s reference books include *Contractual Risk Transfer*, Patrick J. Wielinski, W. Jeffery Woodward, and Jack P. Gibson; *The Additional Insured Book*, Donald S. Malecki, Jack P. Gibson, and Pete Ligeros, and *CGL Reporter*, Jill B. Berkeley, Editor. These materials are a “must have” for any attorney, adjustor, or risk manager who handles large construction losses.

Additionally, numerous provisions of the form insurance policies promulgated by the Insurance Services Office, Inc. (“ISO”) are quoted throughout this paper. Use of ISO policies and policy language is subject to copyright.

## **II. Analyze the Construction Contract - Determine the Parties' Respective Contractual Obligations**

Due to the volume and variety of risks encountered on a construction project, construction contracts always contain various risk transfer clauses, typically passing risk to the contractor in the best position to guard against the risk or secure insurance to cover the risk. Under the construction contract, risk may be transferred to an insurance carrier through various insurance requirements, or it may be transferred to one of the contracting parties through an indemnity agreement. Although insurance requirements and indemnity agreements are often intended to describe independent contractual obligations, a poorly worded contract may result in a court holding the two provisions are inextricably tied, the consequences of which will be discussed. Finally, a contractual *Flow Down Clause* may implicate additional insurance policies and indemnity agreements that affect risk transfer analysis.

For the sake of simplicity, the examples discussed in this paper assume a General Contractor/Subcontractor relationship with the construction contract containing an insurance requirement (including an Additional Insured coverage requirement) and an indemnity agreement in favor of the General Contractor.

### **A. Insurance Coverage Requirements**

An indemnity agreement alone is often insufficient to guarantee an effective risk transfer because the indemnitor may not have the financial wherewithal to satisfy its indemnity obligation. As a result, most General Contractors require their Subcontractors to purchase insurance coverage covering the risks transferred by the indemnity agreement. As added protection for the General Contractor, the construction contract often requires the General Contractor be named as an *Additional Insured* in the Subcontractor's policy or policies.

Although construction contracts may require the Subcontractor to purchase commercial general liability ("CGL") coverage with certain minimum policy limits, many contracting parties realize the better approach is to specify the risks to be covered and the amount of coverage to be purchased, while allowing the Subcontractor to choose the mix of CGL, excess, and umbrella coverage that achieves the required minimum limits in the most cost effective manner. As a result, excess and umbrella policies are often in place to cover the insurance requirements of the construction contract. Although this paper focuses on excess and umbrella coverage, certain principles discussed herein are equally applicable to analyzing primary coverage issues.

**1. Is the Subcontractor Required to Provide Coverage as an Additional Insured?**

The benefits the General Contractor derives from Additional Insured status under the Subcontractor's policy or policies include:

- a. reduction of the uncertainty surrounding enforceability of contractual indemnity obligations, an issue discussed in greater detail below;
- b. protection of its own insurance coverage; and
- c. direct entitlement to a defense and the other obligations owed to a first party to the insurance policy.

As this paper suggests, the General Contractor may not be successful in attaining the first two goals, no matter how diligently the intent is expressed in the construction contract and the insurance policies.

As noted, one of the primary motivations for requiring Additional Insured status is to hedge the uncertainty surrounding enforceability of the Indemnity agreement. However, it does not necessarily follow that once the General Contractor is named as an Additional Insured under the Subcontractor policy, the General Contractor is entitled to coverage for any loss caused by an insured peril under the Subcontractor policy, *regardless* of whether the indemnity agreement in the construction contract is enforceable under applicable state law. *cf. Transcontinental Ins. Co. v. National Union Fire Ins. Co.*, 662 N.E.2d 500 (Ill. App. Ct. 1996) and *Getty Oil Co. v. Insurance Co. of N. Am.*, 845 S.W.2d 794 (Tex. 1992) discussed in detail *infra*.

**2. Is the Subcontractor Required to Purchase Coverage to Fund the Indemnity Agreement?**

Even if the construction contract does not require the Subcontractor to name the General Contractor as an Additional Insured, the Subcontractor's policies may still provide coverage for the indemnity agreement through "contractual liability coverage." The wording of the standard CGL general coverage agreement is broad enough to encompass the Subcontractor's liability to the indemnitee (General Contractor) by virtue of indemnity obligations assumed by the Subcontractor in the construction contract. However, the issue is typically addressed in an exclusion. Sample wording from ISO CGL form CG 00 01 96 follows:

**1996 ISO CGL Form CG 00 01 01 96**  
**Contractual Liability Exclusion**

This insurance does not apply to:

- b. “Bodily injury” or “property damage” for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:
  - (1) that the insured would have in the absence of the contract or agreement; or
  - (2) assumed in a contract or agreement that is an “insured contract”, provided the “bodily injury” or “property damage” occurs subsequent to the execution of the contract or agreement.

To summarize, if the construction contract contains an indemnity agreement and insurance requirement, but the insurance requirement does not require the General Contractor be named as an Additional Insured, contractual liability coverage contained in the Subcontractor’s policy will cover the Subcontractor’s indemnity obligation, *but only* if the indemnity agreement is enforceable and *only to the extent* of indemnification required by the construction contract.

Most umbrella policies take a very broad approach to covering contractual liability. However, certain risks are excluded when the policy is issued to an insured involved in the construction industry. The exclusion comes in the form of an endorsement called *Contractor’s Limitation Endorsement*. The Contractor’s Limitation Endorsement typically addresses contractual liability by either excluding it entirely, or limiting contractual liability to the extent of such coverage afforded by the underlying insurance. Obviously, the Contractor’s Limitation Endorsement and its effect on contractual liability coverage should be closely examined when a large construction loss implicates umbrella coverage. *Contractual Risk Transfer*, Ch. XVII, p. XVII.F.1.

**B. Contractual Indemnity Requirements**

In addition to contractual requirements to procure insurance, construction contracts typically contain an indemnity agreement whereby the Subcontractor (indemnitor) agrees to indemnify and defend the General Contractor (indemnatee) for any loss arising from the

Subcontractor's work. In spite of the prevalence of contractual insurance requirements, indemnity agreements are probably the most widely used form of risk transfer between the contracting parties in the construction industry. As noted previously, the indemnity agreement must be read in connection with the insurance policies due to issues related to contractual liability coverage, and other issues discussed herein. Two issues to be mindful of in analyzing an indemnity agreement and its effect are whether the agreement purports to require indemnification for the General Contractor's own negligence and, if so, whether the indemnity agreement is enforceable under the applicable jurisdiction's statutory and common law scheme for construing and applying indemnity agreements.

### **1. Does the Contract Require Indemnity for the General Contractor's Own Negligence?**

An indemnity agreement may attempt to require the Subcontractor to indemnify the General Contractor for damages arising from the Subcontractor's work, even when the General Contractor's own negligence is a contributing or sole cause of the loss.

An example of a *broad form* indemnity agreement (*broad form* meaning the Subcontractor agrees to indemnify the General Contractor even if the General Contractor's own negligence is a contributing or sole cause of the loss) follows:

Subcontractor agrees to hold harmless and indemnify General Contractor against all liability, costs, expenses, claims and damages General Contractor may at any time suffer or sustain or become liable for by reason of any accidents, damages or injuries to persons or property or both, in any manner arising from the work performed under this subcontract, *including liability, costs, expenses, claims and damages caused in whole or in part by any negligent act or omission of General Contractor, its officer, agents, or employees.*

*See generally Atlantic Richfield Col. v. Petroleum Personnel, Inc.*, 768 S.W.2d 724 (Tex. 1989).

An example of an *intermediate form* indemnity agreement (*intermediate form* meaning the Subcontractor agrees to indemnify the General Contractor for loss caused by the General Contractor's own contributory negligence but not for the General Contractor's sole negligence, follows:

Subcontractor agrees to hold harmless and indemnify General Contractor against all liability, costs, expenses, claims and damages General Contractor may at any time suffer or sustain or become liable for by reason of any accidents, damages or injuries to persons or property or both, in any manner arising from the work performed under this subcontract, *regardless of whether such liability, costs, expenses, claims and damages are caused*

*in part by any negligent act or omission of General Contractor, its officers, agents, or employees.*

When a broad form or intermediate form indemnity agreement is encountered which addresses the type of risk causing the construction loss, you must first determine whether the agreement is enforceable under applicable state law. The parameters for enforcing indemnity agreements are discussed in the next section.

Before reviewing the enforceability of *express* indemnity agreements, it should be briefly noted that an *implied* right of indemnity is recognized to some extent in all jurisdictions. The classic example is where one party has purely vicarious liability for the negligence of another, such as an employer seeking indemnity from his negligent employee. However, an express indemnity agreement between contracting parties usually becomes the sole right of indemnity between those parties, thereby foreclosing any implied right of indemnity that may have arisen.

An example of how this principal may work to the disadvantage of the General Contractor is found in *Regional Steel Corp. v. Superior Court*, 32 Cal. Rptr. 2d 417 (Cal. Ct. App. 1994). In *Regional*, the court held the General Contractor had bargained away its right to common law indemnity when it entered into the more restrictive express indemnity agreement.

## **2. Is the Indemnity Agreement Enforceable?**

Courts and state legislative bodies have long cast a leery eye toward indemnity agreements requiring indemnity for the General Contractor's own negligence under the public policy rationale that such agreements sanction reckless behavior on the part of the General Contractor. In recent years, this public policy rationale has been rejected by most courts and indemnity for one's own negligence will be upheld in the non-construction context if such an intent can be derived from the terms of the applicable contract. However, state legislatures have been slower to act and most states still have construction anti-indemnity statutes on the books. For this reason, it is important to examine both common law and statutory law affecting indemnity agreements.

### **a. Court Imposed Limits on Indemnity Agreements**

There is tremendous variance among the states regarding the circumstances under which a broad form or intermediate form indemnity agreement will be enforced. The approach taken by many states is to apply the "clear and unequivocal" standard or some variation thereof. Under this approach, the indemnity agreement will be strictly construed and it must contain wording clearly and unequivocally spelling out the intent to indemnify the General Contractor for its own negligence. Such an obligation will not be implied. The "clear and unequivocal" standard received the approval of the U.S. Supreme Court in *United States v. Seckinger*, 397 U.S. 203 (1970).

A more recent trend has been to apply an even stricter standard, as is the case in Texas. In *Ethyl Corp. v. Daniel Constr. Co.*, 725 S.W.2d 705 (Tex. 1987), the Texas Supreme Court adopted the “express negligence” standard for interpreting indemnity agreements requiring indemnity for the indemnitee’s (General Contractor’s) own negligence. *Ethyl* overruled the “clear and unequivocal” standard in Texas and imposed the “express negligence” standard which the court described as follows:

The express negligence doctrine that parties seeking to indemnify the indemnitee from the consequences of its own negligence must express that intent in specific terms. Under the doctrine of express negligence, the intent of the parties must be specifically stated within the four corners of the contract.

Over the last twelve years, Texas courts have continued to develop and refine the express negligence doctrine, including the addition of a conspicuity requirement mandating the indemnity agreement to be conspicuously contained within the contract in order to give the indemnitor “fair notice” of the indemnity obligation. *Enserch Corp. v. Parker*, 794 S.W.2d 2 (Tex. 1990); *See also Dresser Indus., Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505 (Tex. 1993) (holding fair notice requirements of conspicuity and the express negligence doctrine apply to both indemnity agreements and releases relieving a party in advance from liability for its own negligence).

Irrespective of the standard applied in the applicable jurisdiction, there can be variations on the requirement, and the inquiry can often be fact specific. It is therefore important to research thoroughly the enforceability of the indemnity agreement. Citations to state court opinions imposing limits on indemnity agreement follows:

Arizona – Arizona courts strictly construe indemnity agreements pursuant to the “clear and unequivocal” standard. *Washington Elementary Sch. Dist. No. 6 v. Baglino Corp.*, 917 P.2D 3 (Ariz. 1991).

California – California has held the indemnity agreement should “expressly and unequivocally” state its intent to impose a duty to indemnify the General Contractor’s own negligence “so that the contracting party is advised in definite terms of the liability to which it is exposed.” *Ralph M. Parsons Co. v. Combustion Equip. Assoc.*, 218 Cal. Rptr. 170 (Ct. App. 1985).

Colorado – Colorado courts apply the “clear and unequivocal” standard. *Public Serv. Co. v. United Cable Television, Inc.*, 829 P.2D 1280 (Colo. 1992).

Florida – Florida applies the “clear and unequivocal” standard. *Cox Cable Corp. v. Gulf Power Co.*, 591 So.2d 627 (Fla. 1992).

Illinois – In *Harder v. St. Louis Southwestern Ry. Co.*, 566 N.E.2D 736 (Ill. App. Ct. 1991), the Fifth District Appellate Court of Illinois held indemnity for the General Contractor’s own negligence will only be upheld when it is required by the “clear and explicit” wording of the agreement or such an intent is “expressed in unequivocal terms”.

Nevada – Nevada applies the “clear and unequivocal” standard. *Calloway v. City of Reno*,. 939 P.2d 1020 (Nev. 1997).

New York – In *Facilities Dev. Corp. v. Miletta*, 584 N.Y.S.2D 491 (App. Div. 1991), the New York court held, “An indemnification agreement between sophisticated business entities will be construed as intending to indemnify either party for its own wrongdoing only when the language of the agreement clearly connotes an intent to provide for such indemnification.

Texas – In *Dresser Indus., Inc. v. Page Petroleum, Inc.*, 853 S.W.2D 505 (Tex. 1993), the Texas Supreme Court affirmed the “express negligence doctrine” and the “conspicuity” requirement.

Utah – Utah applies the “clear and unequivocal” standard. *Freund v. Utah Power & Light Co.*, 793 P.2D 362 (Utah 1990).

For a table containing each state’s common law approach to enforcing indemnity agreements, see *Contractual Risk Transfer*, Ch. IV, p. IV.F.1.

#### **b. Statutory Imposed Limits on Indemnity Agreements**

Many states have enacted legislation preventing or severely limiting broad form and/or intermediate form indemnity agreements when the contract at issue relates to construction. Again, the ostensible policy underlying such legislation is a desire to deter careless conduct on the part of General Contractors who know another party is contractually obligated to pick up the bill for all loss. Although state laws vary widely, one common theme is to prevent indemnification for intentional or willful conduct. Variations include whether the statute covers contracts for both public and private sector construction projects or just public sector construction projects, and whether the statute covers all players in the construction project or just design professionals such as architects and engineers.

An important point to recognize is state common law and statutory law can potentially act in concert to defeat a broad form or intermediate form indemnity agreement. This point is highlighted in a case styled *Heat & Power Corp. v. Air Products & Chemicals, Inc.*, 578 A.2d 1202 (Md. 1990). Maryland has adopted a statute voiding broad form indemnity agreements related to construction. In *Heat & Power*, the court first held the agreement was not clear enough to determine whether broad form indemnity was required. The court was therefore unable to determine whether it fell under the

Maryland construction anti-indemnity statute. After determining the statute was inapplicable, the court still refused to enforce the indemnity provision because, as noted, it was so unclear it did not meet the clear and unequivocal standard applied to such agreements by Maryland courts.

A final point regarding construction anti-indemnity statutes: most states have determined an insurance agreement requiring the Subcontractor to purchase insurance covering the General Contractor for its sole or contributory negligence does not offend an anti-indemnity statute. *See, e.g. United States Fidelity & Guar. Co. v. Farrer's Plumbing and Heating Co.*, 762 P.2d 641 (Ariz. Ct. App. 1988). Furthermore, many construction anti-indemnity statutes expressly exclude insurance.

Citations to some of the state construction anti-indemnity statutes follow:

Arizona – Ariz. Rev. Stat. §§ 34-226 and 32-1159 (1999).

California – CAL. CIV. CODE §§ 2782.6 (1999).

Colorado – COL. RV. STAT. § 03-50.5-102 (1999).

Florida – FLA. STAT. CH. 725.06 (1999).

Illinois – ILL. STAT. ANN. CH. 740 ¶35/1 (1999).

Nevada – NEV. REV. STAT. § 616B.609 (1997).

New York – N.Y. GEN. OBLIG. LAW § 5-324 (1999)

Texas – TEX. CIV. PRAC. & REM. CODE § 130.001-130.005 (1999).

Utah – UTAH CODE ANN. § 13-8-1 (1999).

For a table containing each state's statutory approach to enforcing indemnity agreements, see *Contractual Risk Transfer*, Ch. IV, p. IV.L.1.

### **C. Separation of Coverage and Indemnity Obligations**

It is generally understood that the insurance requirements and indemnity agreements of the construction contracts are independent covenants with one not affecting the other. Therefore, an unenforceable indemnity agreement would not necessarily relieve an insurance carrier from its obligation to cover the General Contractor as an Additional Insured. Likewise, the risks and limits of coverage under the express wording of the insurance policy are neither expanded nor limited by contrary wording in an indemnity agreement. However, a poorly worded insurance or indemnity provision can lead to a

court holding the indemnity agreement and insurance requirement of a construction contract are “inextricably tied”. Even if the indemnity agreement and insurance requirement are carefully worded to provide for the independence of the two provisions, some courts have looked to the wording of the indemnity agreement when resolving issues related to the insurance requirement. The following is a brief discussion of the manner in which indemnity agreements and insurance requirements have been inextricably tied, and the way in which this link can affect insurance coverage.

**1. Do the Heightened Scrutiny Standards Applied to Indemnity Agreements Also Apply to Contractual Insurance Requirements?**

Are the court imposed indemnity standards (e.g. clear and unequivocal) also applicable to the insurance requirement when the Subcontractor is required to purchase insurance covering the General Contractor’s own negligence? Although the indemnity agreement and insurance requirement are usually considered separate and independent contract obligations, case law has gone both ways on this issue and it is important to check the applicable jurisdiction for precedent.

**a. No Heightened Scrutiny**

In *Jokich v. Union Oil Co. of California*, 574 N.E.2d 214 (Ill. App. Ct. 1991), the court concluded a contractual obligation to purchase insurance is fundamentally different from a contractual indemnity agreement. Therefore, the clear and unequivocal standard did not apply to the former.

**b. Heightened Scrutiny Applied**

In *Fowler v. Boise Cascade Corp.*, 948 F.2d 49 (1st Cir. 1991), a different result was reached under the facts involving coverage for injury to the Subcontractor’s employee. The court, applying Maine law, held that when a contractual insurance requirement renders an employer responsible (through his liability carrier) for injury to its employee beyond the liability set out in the state’s worker’s compensation scheme, the contractual insurance requirement must be strictly read, and waiver of the exclusive nature of the worker’s compensation remedy is only permitted by explicit language. In other words, an employer waives its statutory immunity from suit by its injured employee only when the contractual insurance requirement contains such an explicit waiver.

**2. If the Indemnity Agreement is Void, is the Insurance Requirement Necessarily Void?**

Typically, no. However, if the insurance requirement is referenced in the text of the indemnity agreement, a court may conclude the two contractual obligations are

inextricably tied, and a void indemnity agreement will render the insurance requirement void as well.

This result was reached in Illinois in *Transcontinental Ins. Co. v. National Union Fire Ins. Co.*, 662 N.E.2d 500 (Ill. app. Ct. 1996). In *Transcontinental*, the construction contract contained both an indemnity agreement and an insurance requirement. The court first determined that the indemnity agreement was void under Illinois' construction anti-indemnity statute. As for the insurance requirement, it stated the required insurance "shall include Contractual Liability Coverage in accordance with Contractor's obligations" under the indemnity agreement. The court found the indemnity agreement and insurance requirement to be interdependent and "inextricably tied" to one another because the insurance requirement specifically referenced the indemnity agreement. As a consequence, the insurance requirement was declared void because the indemnity agreement was void.

As further support for its holding, the *Transcontinental* court noted the Additional Insured Endorsement to the Subcontractor's policy stated an "insured" included "anyone for whom you have agreed prior to a loss to provide insurance." Because the insurance requirement under the construction contract was void, the court reasoned the wording of the Additional Insured Endorsement could not operate to name the General Contractor as an Additional Insured.

A similar analysis was undertaken in the Texas case of *Getty Oil Co. v. Insurance Co. of N. Am.*, 845 S.W.2d 794 (Tex.1992). *Getty Oil* involved an indemnity agreement in which the last sentence required the indemnitor (Subcontractor) to purchase "insurance covering this indemnity agreement." When the indemnity agreement was declared void, the indemnitor's (Subcontractor's) insurance carrier tried to prevent the indemnitee (General Contractor) from filing a claim as an Additional Insured under the indemnitor's (Subcontractor's) insurance policy. However, the court rejected this argument because the contract specifically stated the insurance requirement was an independent obligation separate from the indemnity agreement. The indemnitee (General Contractor) was therefore allowed to recover under the policy as an Additional Insured.

#### **D. Is there a Flow Down Clause?**

A *Flow Down Clause* (also referred to as a *Flow Through Clause*) is a provision attempting to apply the contractual requirements imposed upon the upper tier parties to the project to contracts between the lower tier parties to the project. This is accomplished by the lower tier contract's incorporating by reference the terms of the upper tier contract. An example of a Flow Down Clause is as follows:

Subcontractor's work will be performed in strict accordance with General Contractor's contract with the Owner including all applicable plans, general conditions, specifications, and addenda thereto and Subcontractor agrees to be bound by the provisions of these documents and any other document to

which General Contractor is bound, to the same extent General Contractor is bound.

There are countless variations on the wording of a Flow Down Clause, some of which simply list the upper tier contract as an exhibit or addendum to the contract between the General Contractor and Subcontractor. When a court is faced with the argument that a Flow Down Clause incorporates an upper tier indemnity agreement into a lower tier contract, the court will most often strictly construe the Flow Down Clause making it ineffectual to support indemnity between the lower tier parties. *See, e.g., Howe v. Lever Bros. Co.*, 851 S.W.2d 769 (Mo. Ct. App. 1993).

An interesting case involving a Flow Down Clause is *Derr Constr. Co. v. City of Houston*, 846 S.W.2d 854 (Tex.App. – Houston [14<sup>th</sup> Dist.] 1992, no writ). In *Derr*, the General Contractor's contract with the Owner included an indemnity agreement wherein the General Contractor agreed to be responsible for its own negligence. However, the contract between the General Contractor and the Subcontractor included a broad form indemnity agreement protecting the General Contractor from any negligence arising from the Subcontractor's work. The General Contractor/Subcontractor contract also included a Flow Down Clause incorporating the terms of the Owner/General contract.

The Subcontractor used the Flow Down Clause to argue the indemnity agreement in the upper tier contract rendered ambiguous the indemnity agreement in the lower tier contract due to conflicting allocation of the risk both to and then away from the General Contractor. The court rejected this argument stating while the General Contractor had agreed in the upper tier contract to be generally liable for damages, in the subcontract the General Contractor had shifted liability to the Subcontractor for damages arising from the Subcontractor's work. Therefore, there was no conflict or ambiguity and the Subcontractor was obligated to indemnify the General Contractor.

### **III. Analyze the Parties' Respective Insurance Policies**

When determining the policies' order of payment or level of contribution, the key clauses are the *Other Insurance Clauses* of each policy and the *Additional Insured Endorsements* extending coverage to the General Contractor under the Subcontractor owned policy or policies. Before you can accurately interpret and apply these policy provisions, you must also analyze the layers of coverage, the types of coverage, and the effect of the *Separation of Insureds Clause*.

#### **A. Determine the Layers of Coverage**

Depending upon the limits of coverage required to be purchased by the terms of the construction contract, the Subcontractor will often purchase a mix of primary, excess, and/or umbrella coverage. Additionally, the General Contractor and sometimes the Subcontractor, has coverage in place in addition to that required by the construction

contract, and such coverage may be implicated by a particularly large construction loss. Determining “layers” of coverage can be a complex undertaking requiring an analysis of the Other Insurance Clauses contained in each of the policies.

Other Insurance Clauses and the problems they present will be discussed in greater detail below. However, determining “layers” of coverage is essential in ascertaining contribution rights among insurance carriers. For example, does the Other Insurance Clause elevate the General Contractor’s primary CGL coverage to the excess layer? When this happens, is the General Contractor’s primary CGL policy now providing the same lawyer of coverage as the Subcontractor’s excess or umbrella policy?

In *Carrabba v. Employers Cas. Co.*, 742 S.W.2d 709 (Tex.App.–Houston [14th Dist.] 1987, no writ) a coverage dispute arose out of a truck accident. Employers had issued a \$250,000 primary auto policy to Gooseneck Trailer Company, owner of the tractor/trailer. Mission Insurance Company had a \$1,000,000 umbrella policy which was excess to the Employers’ policy. Carrabba, employer of the truck driver, was covered under a Gulf Insurance Company policy with \$500,000 primary limits. For simplicity, the coverage is graphically represented as follows:

Carrabba - Driver’s Employer

Gulf Insurance Company	Comp. Auto. Policy	\$500,000
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Gooseneck - Tractor Owner

Employers Casualty Ins.	Comp. Auto. Policy	\$250,000/person – \$500,000/occ.
Mission Ins. Co.	Umbrella	\$1,000,000

The underlying wrongful death case was settled for \$1.25 million with Employers paying its \$250,000 policy limits, Mission paying \$600,000 of its \$1 million limits, Gulf paying \$300,000 of its \$500,000 limits, and Carrabba contributing \$100,000. Gulf contended its policy should be considered excess to the umbrella policy issued by Mission, based upon the policies’ Other Insurance Clauses. The Gulf policy provided primary coverage for owned automobiles, plus an endorsement for hired vehicles which stated, “The insurance afforded by this endorsement shall be excess coverage over *any* other valid and collectible insurance available to the insured.” (emphasis added).

The Mission policy provided umbrella coverage with a specifically listed primary policy. Mission’s Other Insurance Clause stated:

If other valid and collectible insurance with any other insurer is available to the insured covering a loss also covered by this policy, *other than insurance that is specifically stated to be excess of this policy*, the insurance afforded by this policy shall be in excess of and not contribute with such other insurance.

(emphasis added).

Based upon the Other Insurance Clauses, Gulf contended its primary policy was excess to Mission’s umbrella policy. The Court disagreed, holding when the contest is between a primary policy and an umbrella policy, “the policies are not of the same character” and “do not supply coverage at the same level.” In other words, the primary policy’s (Gulf’s) excess clause did not operate to elevate the primary policy to the same level as a true excess or umbrella policy.

Other recent cases holding a primary policy with a similar Other Insurance Clause is not on the same level as an excess or umbrella policy are *Smith v. Wausau Underwriters Ins. Co.*, 977 S.W.2d 291 (Mo. Ct. App. 1998), and *New Hampshire Ins. Co. v. Hanover Ins. Co.*, 696 N.E.2d 22 (Ill. App. Ct. 1998).

However, the specifics of the occurrence must be considered. For example, *U.S. Fire Ins. Co. v. Aetna*, 781 S.W.2d 294 (Tex.App.–Houston [1st Dist.] 1989, no writ) involved a dispute arising out of a wrongful death claim. A Brown & Root employee was killed in an accident involving an employee of ICI Americas. ICI was insured under an Aetna policy with limits of \$2 million. ICI was also insured under Brown & Root’s Highlands policy with U.S. Fire. U.S. Fire contended that as a primary insurer, Aetna’s policy was “not the same level of coverage” as the U.S. Fire policy. The coverage is graphically represented as follows:

Brown & Root

Highlands	Primary Policy	\$250,000/person - \$500,000/occ.
US Fire	Excess (to apply after Highlands)	\$5,000,000/occ.

ICI Americas

Aetna	\$2,000,000
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The underlying death case settled for \$1.5 million with Highlands paying its \$250,000 policy limits and U.S. Fire paying \$1.25 million. U.S. Fire sued Aetna to recover the \$1.25 million arguing Aetna, as a primary policy insurer, was required to pay the excess over Highland’s \$250,000 limits before U.S. Fire was required to contribute.

Both the U.S. Fire and Aetna policies contained Other Insurance Clauses. U.S. Fire’s policy contained a standard clause and a manuscript endorsement (i.e., an endorsement that does not follow a standard form) amending the clause as follows:

Condition K: If other valid and collectible insurance is available to the insured which covers a loss also covered by this policy, other than insurance that is specifically purchased as being excess to this policy, this policy shall operate in excess of, and not contribute with, such other insurance.

Endorsement No. 2: In consideration of the premium charged, it is agreed that this policy *shall apply regardless of the existence of other insurance that would apply on the same basis*.

(emphasis added). Aetna's Other Insurance Clause stated:

It is agreed that if any other valid and collectible insurance applicable to any loss or expenses covered by this policy is available to the insured, the insurance afforded by this policy shall be in excess of and shall not contribute with such other insurance, except where such other insurance specifically applies as excess over this insurance.

U.S. Fire contended its manuscript endorsement did not convert the policy from excess to primary coverage; rather, the manuscript endorsement merely referred to "insurance that would apply on the same basis" (i.e. other umbrella or excess coverage). The court rejected this argument, and refused to interpret the endorsement in such a manner.

Thus, although the U.S. Fire policy was *designated* as an "excess policy", and the Aetna policy was a "primary policy" with an excess clause, the court ruled U.S. Fire was required to provide primary coverage. The court based its ruling on the language contained in the U.S. Fire's manuscript endorsement. The court held this language converted the U.S. Fire policy into a primary policy, which allowed the Aetna clause to take effect.

The foregoing cases illustrate the importance of correlating the wording of the Other Insurance Clauses to the case law of applicable jurisdiction in order to determine layers of coverage.

## **B. Types of Coverage**

In analyzing upper level coverage, you should examine whether the policy is an *excess* or an *umbrella* policy, and also whether the coverage is *following form* or *stand alone*.

### **1. Excess Coverage vs. Umbrella Coverage**

Excess coverage and umbrella coverage are similar in that both provide coverage above that provided by an underlying primary policy. The difference between the two policies is as follows.

An excess policy provides excess limits of insurance, typically for the same risks covered by the underlying CGL policy. Comparatively, an umbrella policy acts in two ways relative to the CGL policy beneath it. First, it provides excess limits – an additional

*amount* of insurance – for losses also covered by the underlying policy. Second, it applies to certain risks – as an additional *kind* of insurance – when those risks are not insured, or are excluded by the underlying policy. *Contractual Risk Transfer*, Ch. X, p. X.E.1.

## **2. Following Form Coverage vs. Stand Alone Coverage**

Excess and umbrella policies will be written on one of two forms – *following form* or *stand alone*.

A following form policy typically provides coverage pursuant to the same terms and conditions as the underlying policy, “except where inconsistent.” When a following form policy is present, you can interpret the underlying policy and merely apply its terms to the excess or umbrella policy as well, except where an inconsistency is present. An example of a following form coverage clause follows:

The company shall indemnify the insured for loss sustained by the insured in excess of the underlying insurance in accordance with the insurance agreements, exclusions and other terms and conditions of the immediate underlying policy. All of the provisions of the immediate underlying policy are incorporated as a part of this policy except when such provisions or parts thereof are inconsistent with this policy.

Stand alone, as the name implies, means the policy form supplies its own terms and conditions of coverage, rather than incorporating the terms and conditions of the underlying policy.

## **C. Other Insurance Clause**

The Other Insurance Clause is the policy’s attempt at allocating risk between or among multiple policies which may cover the same insured for the same risk of loss. Although the construction contract will purport to allocate risk among the parties, the wording of the Other Insurance Clause (and applicable state law) may operate to defeat the intent of the contracting parties.

### **1. Types of Other Insurance Clauses**

Although Other Insurance Clauses take on countless variations, they function in one or more of the following three ways.

#### **a. Excess Clause**

The Other Insurance Clause may state the policy is excess to any other insurance available to the insured. An Other Insurance Clause functioning in this way is sometimes also called an *Excess Other Insurance Clause*, or simply an *Excess Clause*.

## **b. Escape Clause**

The Other Insurance Clause may state the policy has no liability whatsoever if other insurance is available to cover the same insured for the same loss. In other words, the insurer who uses this type of Other Insurance Clause is attempting to avoid liability completely if other insurance is in place. This type of approach is sometimes referred to as an *Escape Clause* because it allows (or attempts to allow) the insurance carrier to escape liability.

## **c. Pro Rata or Contribution by Equal Shares Clause**

The Other Insurance Clause may specify the manner in which the policy will contribute to any payment of settlements or judgments if other insurance covering the loss is also available to the insured. Although there are two broad methods of contribution, contribution by equal shares and contribution by policy limits, Other Insurance Clauses usually adopt contribution by policy limits (also referred to as a *Pro Rata Clause* because each insurer contributes pro rata in accordance with its policy limits as compared to the total amount of insurance available). Equal shares means each policy contributes dollar for dollar until the lower policy limit is reached, at which point the policy with the higher limit pays.

## **2. Examples**

Simplistic examples of each type of Other Insurance Clause are as follows:

### Excess other Insurance Clause

The insurance afforded under this policy shall be excess over any other valid and collectible insurance available to the insured.

### Escape Clause

This insurance does not apply to any liability for such loss as is covered on a primary, contributory, excess or any other basis by insurance in another insurance policy.

### Pro Rata Clause

If the insured has other insurance against liability or loss covered by this policy, the company shall not be liable for a greater proportion of such liability or loss than the applicable limit of liability bears to the total limit of liability of all collectible insurance against such liability or loss.

*Appleman, Insurance Law and Practice*, Berdal, Ed, vol. 8A, § 4906, p. 4906, p. 345 (Supp. 1998); *See also Pioneer State Mut. Ins. Co. v. TIG Ins. Co.*, 581 N.W.2d 802 (Mich. Ct. App. 1998); *United Farm Bureau Mut. Ins. Co. v. Nationwide Mut. Fire Ins. Co.*, 678 N.E.2d 1165 (Ind. Ct. App. 1997).

Although the 1996 edition of the ISO form CGL (CG 00 01 01 96) has been supplanted by the 1998 edition (CG 00 01 07 98), the 1996 edition is still in wide use. The approach of the Other Insurance Clause incorporated into CG 00 01 01 96 is to specify the policy is excess over other insurance. The Other Insurance Clause contained in CG 00 01 01 96 is quoted, in relevant part, follows:

**1996 ISO CGL Form CG 00 01 01 96  
Other Insurance Clause**

b. Excess Insurance

This insurance is excess over any other insurance, whether primary, excess, contingent or on any other basis.

(1) that is Fire, Extended Coverage, Builder's Risk, Installation Risk or similar coverage for "your work";

\* \* \*

We will share the remaining loss, if any, with any other insurance that is not described in this Excess Insurance provision and was not bought specifically to apply in excess of the Limits of Insurance shown in the Declarations of this Coverage Part.

c. Method sharing

If all other insurance permits contribution by equal shares, we will follow this method also. Under this approach, each insurer contributes equal amounts until it has paid its applicable limit of insurance or none of the loss remains, whichever comes first.

If any other insurance does not permit contribution by equal shares, we will contribute by policy limits. Under this method, each insurer's share is based on the ratio of its applicable limit of insurance to the total applicable limits of insurance of all insurers.

### **3. Methods of Reconciling Conflicting Other Insurance Clauses**

In a large construction loss, the General Contractor may find itself covered by its own primary, excess and/or umbrella policies, as well as the Subcontractor's primary, excess, and/or umbrella policies under which the General Contractor is named as an Additional Insured. Invariably, these policies contain conflicting Other Insurance Clauses. As a result, issues often arise as to who pays next, requiring reconciliation of competing or conflicting Other Insurance Clauses.

#### **a. Enforce the Express Wording of the Policies, If Possible**

The majority of jurisdictions will first attempt to apply the express wording of the policies by reading the Other Insurance Clauses and reconciling them, if at all possible. Although courts occasionally follow the General Contractor's intent and hold the Subcontractor's coverage is primary, courts do not necessarily construe coverage to follow the apparent intent of the underlying construction contracts.

##### **i. Construction Contract Intent Not Followed**

An example of a court not following the intent of the underlying construction contract is *National Union Fire Ins. Co. v. Hartford Ins. Co.*, 677 N.Y.2d 105 (App. Div. 1998). In this case, the Subcontractor's insurance carrier sought equitable contribution from the insurance for the General Contractor on whose behalf the Subcontractor's insurance carrier had paid a settlement. The defendant carrier attempted to rely upon the indemnity agreement contained in the underlying construction contract as evidence of an intent to shift all risk of loss to the Subcontractor. The Court rejected this argument and held the indemnity agreement could not "override the other insurance clauses in the policies." The court adhered to the principle that the respective obligations of the insurers are determined by the policies, not by extrinsic contracts.

##### **ii. Construction Contract Intent Followed**

A case which followed the contracting parties' intent when attempting to reconcile Other Insurance Clauses is *Rossmoor Sanitation, Inc. v. Pylon, Inc.*, 119 Cal. Rptr. 449 (1975). In *Rossmoor*, the General Contractor agreed to indemnify the project Owner as well as obtain liability insurance naming the Owner as an Additional Insured. Following the death of one worker on the project and the injury of another, the Owner's own liability policy defended and settled the personal injury lawsuits which ensued. The Owner's insurance carrier then sought indemnity from both the General Contractor and the General Contractor's insurance carrier which had issued the policy naming the Owner as an Additional Insured.

The General Contractor's insurance carrier argued for apportionment of the loss between the Owner's policy and the General Contractor's policy based upon identical Other Insurance Clauses contained in both policies which stated:

If the insured has other insurance against a loss covered by this policy, the company shall not be liable under this policy for a greater proportion of such loss than the applicable limit of liability stated in the declarations bears to the total applicable limit of all valid and collectible insurance against such loss[.]

Despite the inclusion of a Pro Rata Other Insurance Clause in each policy, the court held the Contractor's policy applied on a primary basis. In so holding, the court reasoned that to give effect to the Other Insurance Clauses "would effectively negate the indemnity agreement," and it would impose liability on the Additional Insured Owner's own insurance carrier even though the Owner had bargained with the General Contractor to avoid that very result as part of the consideration for the construction contract. The *Rossmoor* court therefore approved looking beyond the express wording of the insurance policies to ascertain the intent of the contracting parties. *See also J. Walters Constr. Co. v. United Capitol Ins. Co.*, 539 N.W.2d 144 (Iowa 1995) (both approving an analysis of the intent of the construction contract as an appropriate analysis in addressing the "other insurance problem").

Needless to say, the Other Insurance Clause and the problems it presents are a very dynamic part of insurance law, and courts produce a large number of cases each year on this topic. When faced with a large construction loss, it is important to carefully examine the wording of the Other Insurance Clause, then research approaches taken to the other insurance problem in the applicable jurisdiction.

#### **b. Mutually Repugnant Other Insurance Clauses**

Despite efforts to reconcile Other Insurance Clauses and effectuate the intent of the insurance carriers (and possibly the intent of the insureds), it is often the case Other Insurance Clauses simply cannot be reconciled. In such a scenario the Other Insurance Clauses are described as "mutually repugnant." When this occurs some jurisdictions have employed fact intensive methods of resolving the competing clauses, e.g. the once favored "closer to the risk" rule and "primary tortfeasor" rule. *See, e.g. Interstate Fire & Cas. Co. v. Auto-Owners Ins. Co.*, 433 N.W.2d 82 (Minn. 1988) (closer to the risk); *Branchel v. Safeco Ins. Co.*, 738 P.2d 1315 (N.M. 1987) (closer to the risk); *Universal Underwriters Ins. Co. v. Dairyland Mut. Ins. Co.*, 425 P.2d 866 (Ariz. Ct. App. 1967) (primary tortfeasor); *Cole v. Standard Fire Ins. Co.*, 880 P.2d 714 (Ariz. Ct. App. 1994) (primary tortfeasor).

In addition to the foregoing, many states have adopted rules of construction such as an Excess Clause trumps a Pro Rata Clause and the policy containing the Pro Rata

Clause must be exhausted first. *See, e.g. Farmers Ins. Exch. v. Hartford Cas. Ins. Co.*, 907 F.Supp. 234 (S.D. Miss. 1995); *Rutgers Cas. Ins. Co. v. State Farm Mut. Ins. Co.*, 560 A.2d 722 (N.J. App. 1989). If the applicable jurisdiction follows such a rule, there may be no need to look to the construction contract for the intent of the parties. However, many jurisdictions now require pro rata contribution from all applicable policies when Other Insurance Clauses are mutually repugnant. For a discussion of various approaches to resolving mutually repugnant Other Insurance Clauses, see Richmond, Douglas R., *The Additional Problems of Additional Insureds*, 33 Tort & Ins. L.J. 945 (1998).

Although insurance policies with mutually repugnant Other Insurance Clauses are typically required to contribute to the loss on a pro rata basis, courts continue to fashion new approaches to resolving such issues. For this reason, it is difficult to make generalizations regarding each state's approach. With the exception of those jurisdictions which strictly follow the *Lamb-Weston* Rule, the best approach is to carefully examine the recent case law trends of the applicable jurisdiction.

### c. The *Lamb-Weston* Rule

A minority of jurisdictions use the *Lamb-Weston* Rule to solve the other insurance problem. In *Lamb-Weston* jurisdictions, courts automatically deem Other Insurance Clauses mutually repugnant and call on all applicable policies to prorate coverage irrespective of the particular terms of their Other Insurance Clauses. No attempt is made to apply the express wording of the policies, even when it is possible. As a consequence of this approach, in *Lamb-Weston* jurisdictions it is impossible to insulate the General Contractor's own policies from sharing losses with policies under which the General Contractor also has coverage as an Additional Insured. The *Lamb-Weston* Rule derives its name from the decision of the Oregon Supreme Court which first adopted this method of dealing with overlapping insurance coverage. *Lamb-Weston, Inc. v. Oregon Automobile Ins. Co.*, 341 P.2d 110 (Or. 1959), *rehearing en banc*, 346 P.2d 643 (Or. 1959).

When examining coverage in a *Lamb-Weston* jurisdiction, if the limits of the Subcontractor and General Contractor owned primary policies are sufficient to cover the loss, the loss will be prorated between the two primary policies. If the limits of the two primary policies are not sufficient to cover the loss, the primary policies will be exhausted and the remaining loss will be prorated between or among any excess or umbrella policies available to both the Subcontractor and the General Contractor.

Jurisdictions appearing to regularly following the *Lamb-Weston* rule include Alaska, Delaware, Idaho, Indiana, Nevada, Oregon, and Rhode Island. Maine, Michigan, Louisiana, and Tennessee have applied the rule, but inconsistently.

**d. Modified *Lamb-Weston* – Coverage Usually Prorated**

Some jurisdictions follow what might be described as a modified *Lamb-Weston* Rule, because they prorate coverage unless a fair reading of the competing Other Insurance Clauses clearly indicates a different result. Such is the case in Texas, where competing Other Insurance Clauses contained in policies at the same layer are typically deemed mutually repugnant and the loss prorated. Texas first applied this rule in *Hardware Dealers Mut. Life Ins. Co. v. Farmers Ins. Exch.*, 444 S.W.2d 583 (Tex. 1969), wherein the Texas Supreme Court stated:

When, from the point of view of the insured, she has coverage from either one of two policies but for the other, and each contains a provision which is reasonably subject to a construction that it conflicts with a provision in the other concurrent insurance, there is a conflict in the provisions.

\* \* \*

The liability is equally prorated between the two companies and each has an obligation to defend the insured.

In so holding, the Texas Supreme Court did not cite *Lamb-Weston* and the court's reasoning falls short of the full scale *Lamb-Weston* approach. As a result, carriers can still argue for reconciliation of Other Insurance Clauses in limited circumstances, as was the case in *Carrabba* and *U.S. Fire v. Aetna, supra*. However, Texas courts generally hold Other Insurance Clauses are mutually repugnant and coverage is prorated. Similarly, some jurisdictions have taken the approach that coverage will be prorated when certain types of Other Insurance Clauses complete. See, e.g. *State Farm Mut. Auto. Ins. Co. v. Bogart*, 717 P.2d 449 (Ariz. 1986) (Other Insurance Clauses are mutually repugnant when Escape Clause competes with an Excess Clause).

This past year, California appears to have embraced this reasoning in *Fireman's Fund. Ins. Co. v. Maryland Cas. Co.*, 77 Cal. Rptr. 2d 296 (Ct. App. 1998). The *Fireman's Fund* court faced the issue of how to allocate loss between the insurers in light of the Excess Other Insurance Clause contained in the Fireman's Fund policy. The court ultimately decided to prorate the loss among all applicable policies rather than enforce the Excess Other Insurance Clause contained in some of the policies. The court rationalized its disregard of the Excess Other Insurance Clauses in part by noting the Fireman's Fund claim was based upon equitable principles, and therefore not dependent upon the terms of its insurance contract with the policyholder. The court explained the equitable nature of rights to contribution between co-insurers as follows:

the reciprocal rights and duties of several insurers who have covered the same event do not arise out of contract, for their agreements are not with each other . . . their respective obligations flow from equitable principles designed to accomplish ultimate justice in the bearing of a specific burden. As these principles do not stem from agreement between insurers their

application is not controlled by the language of their contracts with the respective policyholders.

By so holding, *Fireman's Fund* embraces the notion Other Insurance Clauses contained in all policies will generally be ignored in favor of equitable principles. However, in so doing the court noted "the contractual terms of the insurance coverage are honored whenever possible." *Id.* at 311. Therefore, *Fireman's Fund* appears to move California toward the proration approach, but reconciliation of the Other Insurance Clauses is not completely abandoned. The extent to which California will embrace *Lamb-Weston* and abandon the principles applied in *Rossmoor*, *supra*, will continue to develop.

#### **D. Additional Insured Status Under Excess and Umbrella Policies**

Additional Insured status in excess and umbrella policies often creates controversy and disputes because these types of policies rarely arrange Additional Insured coverage through specific endorsements. Rather, most excess and umbrella policies address Additional Insureds within the body of the policy by extending Additional Insured coverage to any party named as an Additional Insured under the underlying policy *and* any party the Named Insured contractually agrees to include as an Additional Insured under its liability insurance. This approach is similar to the blanket Additional Insured Endorsement often used on CGL policies.

Example Additional Insured wording from umbrella and excess policies is as follows:

Anyone for whom you have agreed in writing to provide insurance such as is provided by this policy is an insured but only for operations performed by you or on your behalf or at facilities you own or use.

*or*

Any person, organization, trustee, or estate to whom or to which the Named Insured is obligated by virtue of a written contract to provide insurance such as is afforded by this policy, but only with respect to operations by or on behalf of the Named Insured or to the facilities of or used by the Named Insured.

See *The Additional Insured Book*, 3<sup>rd</sup> Ed., Exhibit 14.2, p. 195.

#### **E. Separation of Insureds Clause**

A *Separation of Insureds Clause*, also known as a *Severability of Interests Clause*, affords coverage to each insured as if that insured is the only insured named in the policy. The Separation of Insureds Clause can have profound effects on the operation of various

policy provisions, as well as the Additional Insured's (General Contractor's) rights vis a vis the Named Insured (Subcontractor). A typical Separation of Insureds Clause states, "the coverage afforded applies separately to each insured who is seeking coverage or against whom a claim is made or 'suit' brought."

One purpose of the Separation of Insureds Clause is to verify the insurance will answer any suit filed by one insured against the other. This often occurs in the construction context when the General Contractor files suit against the Subcontractor for damages asserted against the General Contractor by the injured party.

Separation of Insureds is common in CGL policies unless excluded by endorsement. Treatment of Separation of Insureds varies among excess and umbrella policies because, as noted, there are no standard forms for excess and umbrella coverage. Following form coverage will apply the Separation of Insureds Clause contained in the underlying CGL policy. The majority of umbrella policies treat Separation of Insureds the same way CGL policies do, but some umbrella policies specifically exclude coverage for suits between the insureds.

One effect of the Separation of Insureds Clause can be seen in *Centennial Ins. Co. v. Ryder Truck Rental, Inc.*, 149 F.3d 378 (5th Cir. 1998). The ISO commercial auto policy at issue in *Centennial* contained an exclusion for "bodily injury to an employee of the insured arising out of and in the course of employment by the insured." The Additional Insured, Ryder, sought coverage for a claim by the Named Insured's employee. Ryder argued the Separation of Insureds Clause must be read in conjunction with the employee exclusion and thus applied to each insured only for claims by that insured's employees. After reviewing the numerous cases supporting Ryder's argument, the Fifth Circuit concluded Ryder was correct and held Ryder was covered for the claim by the Named Insured's employee.

#### **IV. Other Considerations**

##### **A. The Election Doctrine**

The *Election Doctrine* is being developed by a recent line of cases in Illinois. The Election Doctrine allows an Additional Insured General Contractor to place the entire burden for any loss on the Named Insured Subcontractor's policies simply based upon the way in which the General Contractor tenders the loss to the Subcontractor's insurance carrier. The Election Doctrine first appeared in *Institute of London Underwriters v. The Hartford Fire Ins. Co.*, 599 N.E.2d 157 (Ill. App. Ct. 21992). In *Underwriters*, the Subcontractor's carrier was attempting to collect part of a settlement paid on behalf of the General Contractor from the General Contractor's own liability insurer.

In the underlying suit, the General Contractor was sued following the death of an employee of the Subcontractor. The General Contractor tendered defense of the claim to

the Subcontractor's insurer, Underwriters, and also informed its own insurer that the suit had been filed. However, the General Contractor never asked its own insurer, The Hartford, for defense or indemnity.

Following Underwriter's settlement of the claim, it requested reimbursement for one-half of the settlement amount from The Hartford. The Hartford refused, stating it had no liability. Underwriters filed a declaratory judgment action based upon the doctrine of equitable contribution. The court ultimately ruled Underwriters was not entitled to contribution from The Hartford because coverage is not triggered until a tender of defense is made by the insured. In its review of the facts, the court placed great significance on the fact the General Contractor never asked The Hartford for defense or indemnity and had in fact specifically indicated The Hartford should not become involved in the claim.

The Illinois Supreme Court refined the Election Doctrine in *Cincinnati Ins. Co. v. West American Ins. Co.*, 701 N.E.2d 499 (Ill. 1998). In *Cincinnati*, the Illinois Supreme Court held where the insured has not knowingly decided against an insurer's involvement, an insurer's duty to defend is triggered by actual notice of a claim against its insured regardless of the level of the insured's sophistication. In dicta, *Cincinnati*, affirmed the continuing validity of the Election Doctrine.

Two subsequent Illinois intermediate appellate court decisions cited *Cincinnati*, as affirming the continued validity of the Election Doctrine. *Alcan United, Inc. v. West Bend mut. Ins. Co.*, 707 N.E.2d 687 (Ill. App. Ct. 1999); *Bituminous Cas. Corp. v. Royal Ins. Co.*, 704 N.E.2d 74 (Ill. App. Ct. 1998).

However, the fate of the Election Doctrine is now pending as the Illinois Supreme Court has agreed to hear the case of *John Burns Constr. Co. v. Indiana Ins. Co.*, 700 N.E.2d 763 (Ill. App. Ct. 1998). In *John Burns*, which was issued 13 days before the Supreme Court's decision in *Cincinnati*, the intermediate appellate court ignored the insured's right of election by permitting the Subcontractor's insurance carrier to seek equitable contribution from the Additional Insured General Contractor's insurance carrier, even though this was contrary to the wishes of the General Contractor. *John Burns* may ultimately decide the validity of the Election Doctrine.

So far, the Election Doctrine has only been accepted in Illinois. Commentators have criticized the Election Doctrine because it overlooks the fact the right of equitable contribution among insurers is wholly independent of the insured's rights and thus arguably should not be defeated by an action on the part of the insured. On the other hand, a General Contractor's desire to protect its own coverage by seeking Additional Insured coverage under the Subcontractor's policies is rendered essentially meaningless if it cannot bind the elected insured by precluding the elected insured from seeking contribution from the non-elected insurer.

**B. Strategies for Exhausting the Subcontractor’s Coverage Before the General Contractor’s Coverage is Triggered.**

One strategy for a General Contractor to achieve its goal of protecting its own insurance coverage by requiring Additional Insured status under its Subcontractor’s policies is for the General Contractor to examine and modify its own insurance policies. Specifically, the General Contractor, through a manuscript endorsement or otherwise, can incorporate an Other Insurance Clause into its primary policy similar to the Other Insurance Clause adopted by the 1998 edition of the ISO form CGL – CG 00 01 07 98. The Other Insurance Clause in CG 00 01 07 98 states in relevant part as follows.

**1998 ISO CGL Form 00 01 07 98**  
**Other Insurance Clause**

This insurance is excess over:

\* \* \*

(2) Any 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.

This clause expressly states the General Contractor’s primary policy is excess to, and triggered only after exhaustion of, the Subcontractor’s primary policy. The General Contractor can ensure its primary policy is excess to the Subcontractor’s umbrella coverage by requesting its carrier modify its primary policy, through manuscript endorsement or otherwise, to strike the word “primary” from the phrase “other primary insurance available to you . . . as an Additional Insured[.]” The General Contractor’s carriers should be more than willing to accommodate this request because it only serves to limit the exposure under the General Contractor’s policies.

A word of caution, however, is the 1998 ISO Other Insurance Clause only operates when the General Contractor is named as an Additional Insured through *attachment of an endorsement*. The General Contractor is rarely added as an Additional Insured to the Subcontractor’s umbrella policy through attachment of an endorsement. Therefore, a manuscript endorsement to the General Contractor’s CGL may be necessary to insure the General Contractor’s CGL only responds after the Subcontractor’s umbrella coverage is exhausted. Two such manuscript endorsements are presented in *Contractual Risk Transfer*, Ch. XI, beginning on page XI.C.15. Paraphrased, these endorsements state the General Contractor’s CGL is “excess over any of the other insurance, whether primary, excess, contingent, or on any other basis . . . that is valid and collectible insurance available to you

as an Additional Insured[.]” a similar endorsement can be added to the General Contractor’s umbrella policy specifying the umbrella policy only responds after exhaustion of all Subcontractor coverage.

Another word of caution is the above quoted clause states the General Contractor’s primary policy is excess to other *primary* insurance of the Subcontractor. If the Subcontractor’s CGL policy contains an Excess Other Insurance Clause (which is no longer standard in ISO form CGL policies), the 1998 Other Insurance Clause will not create the desired coordination between policies because the Subcontractor’s CGL purports to be *excess* insurance not *primary* insurance. Again, this can be remedied by striking the word “primary” from the Other Insurance Clause.

It should be noted the foregoing suggestions will still not achieve the General Contractor’s goal of protecting its own coverage in a *Lamb-Weston* jurisdiction because a *Lamb-Weston* jurisdiction will simply ignore all Other Insurance Clauses and prorate coverage.

**C. The Additional Insured Endorsement May Not Provide Coverage for the Additional Insured’s Sole Negligence**

**1. Is Derivative Liability for the Subcontractor’s Conduct Required?**

The extent of coverage afforded under an Additional Insured Endorsement has been the source of much litigation. Some carriers have taken the position coverage extended to Additional Insureds is limited to the Additional Insured’s vicarious or derivative liability for the Named Insured’s negligence, and in the absence of negligence on the part of the Named Insured, the carrier has no liability to the Additional Insured. To the extent excess and umbrella policies adopt the Additional Insured Endorsement of the underlying policy, this same argument is available to the excess and umbrella carrier.

The argument Additional Insureds are covered only for vicarious or derivative negligence and not for the Additional Insured’s own negligence was apparently first given support in *Harbor Ins. Co. v. Lewis*, 562 F.Supp. 800 (E.D. Pa. 1983). The *Harbor* opinion stated Additional Insured Endorsements, “are intended to protect parties who are not named insureds from exposure to vicarious liability for acts of the named insured.”

What is often forgotten about *Harbor* is the Additional Insured Endorsement in that case was in manuscript form and therefore not at all typical. The endorsement clearly limited the Additional Insured’s coverage to vicarious liability because it stated:

It is agreed the insurance afforded by this policy shall apply to the following additional insureds but only to the extent of liability resulting

from occurrences arising out of the negligence of [the Named Insured] and/or its wholly owned subsidiaries.

In *McIntoch v. Scottsdale Ins. Co.*, 992 F.2d 251 (10th Cir. 1993), the Tenth Circuit rejected the insurer's reliance on *Harbor* specifically because *Harbor* involved an atypical manuscript Additional Insured Endorsement expressly limiting the coverage available to the Additional Insured. However, some courts have automatically applied *Harbor's* narrow reading of Additional Insured Endorsements, despite different wording of the endorsement at issue.

*Harbor* was recently quoted in dicta in *Maryland Cas. Co. v. Nationwide Ins. Co.*, 76 Cal. Rptr. 2d 113 (Ct. App. 1998), in the context of a discussion of indemnity. The sole issue before the court was the insurer's duty to defend the Additional Insured. The Subcontractor's insurance carrier argued it had no duty to defend because the Additional Insured Endorsement stated the insurance applied only to the extent the General Contractor is "held liable" for the Subcontractor's acts or omissions. *Maryland* held the narrow wording of the Additional Insured Endorsement did not negate the duty to defend, but in reaching this conclusion, the *Maryland* court cited *Harbor* for the proposition the "well established meaning" of Additional Insured provisions is to "protect parties who are not named insureds from exposure to vicarious liability for acts of the named insured." *Id.* at 119. Shortly after the *Maryland* opinion, the California Court of Appeals issued its opinion in *Acceptance Ins. Co. v. Syufy Enter.*, 81 Cal. Rptr. 2d 557 (Ct. App. 1999). *Acceptance* limited *Maryland* to its particular facts, i.e. the otherwise broad coverage afforded by an Additional Insured Endorsement is only limited by a manuscript Additional Insured Endorsement.

The confusion the *Harbor* opinion has generated regarding the scope of Additional Insured coverage is due in part to the fact most Additional Insured Endorsements require a casual nexus between the liability of the Additional Insured General Contractor and the operations of the Named Insured Subcontractor. The casual nexus requirement is demonstrated by the 1993 ISO form Additional Insured Endorsement CG 20 10, which states in relevant part:

**1993 ISO Additional Insured Endorsement Form CG 20 10**

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 ongoing operations performed for that insured.* (emphasis added).

## 2. “Caused By” vs. “In the Course of” the Subcontractor’s Work

The casual nexus requirement was recently discussed in *Tishman Constr. Corp. v. CNA Ins. Co.*, 652 N.Y.S.2d 211 (App. Div. 1997). In *Tishman*, a Subcontractor’s employee was injured on the job site and filed suit against the General Contractor. The employee was injured when he fell on a ramp covered with masonite sheets while walking toward his employer’s (the Subcontractor’s) job site shanty to pick up materials or speak to his foreman. The ramp was used by various subcontractors on the job site, including the injured employee’s employer. The injured employee did not know who had placed the masonite sheets on the ramp.

The General Contractor sought coverage from the Subcontractor’s insurance policy with CNA, under which the General Contractor was named an Additional Insured. The specific wording of the Additional Insured Endorsement was:

the insurance for [the] Additional Insured is limited as follows: 1. [The scheduled] person or organization is only an Additional Insured for its liability arising out of the premises you own, rent, lease or occupy, or for “your work” for or on behalf of the Additional Insured.

CNA argued, in part, the General Contractor was not covered for the employee’s injury because the injury was not caused by the Subcontractor’s work. The appellate court reversed the denial of the General Contractor’s motion for summary judgment and held CNA was required to cover the General Contractor to the extent of CNA’s policy limits. In so doing, the court quoted New York case law as stating the focus on the Additional Insured Endorsement is “not . . . the precise cause of the accident, as [the insurers] urge, but upon the general nature of the operation in the course of which the injury was sustained.” Applied to the facts, because the injured employee was acting in the course of his employment with the Subcontractor at the time of his injury (i.e. walking toward the Subcontractor’s shanty to pick up materials or speak to his foreman), the General Contractor was covered under the Additional Insured Endorsement to the Subcontractor policy.

A side note to *Tishman* is the dissenting opinion. Justice Sullivan argued summary judgment in favor of the General Contractor was inappropriate because the evidence developed in the case to that point did not place the General Contractor within the ambit of the CNA Additional Insured Endorsement. Justice Sullivan stated:

The majority interprets the endorsement to provide additional insured coverage as long as the party making a claim against the additional insured sustained injuries *in the course of* [the Subcontractor’s] work . . . What is required to trigger the endorsement’s coverage is an injury giving rise to liability on the part of the [General Contractor] resulting from the work

performed by [the Subcontractor] for or on behalf of [the General Contractor] at the site.

(emphasis added).

The point Justice Sullivan made is very subtle. Under the facts of *Tishman*, it was fairly clear the employee had been acting in the scope of his employment with the Subcontractor at the time of his injury. Conversely, it was not clear whether the employee's injury had resulted from the work performed by the Subcontractor, e.g. whether or not the Subcontractor had placed the masonite sheets on the ramp which caused the employee to fall. Justice Sullivan suggested Additional Insured coverage is not triggered merely by the fact the employee was injured during the course of his work for the Subcontractor; rather, Additional Insured coverage is triggered only when the General Contractor is held liable for an injury resulting from the Subcontractor's work. Despite Justice Sullivan's reasoning, it is doubtful the drafters of the endorsement intended it to impose such a restrictive limitation upon coverage.

**D. What if the Actual Coverage Limits are Greater than Those Required Under the Construction Contract?**

As previously discussed, most umbrella policies contain a provision stating any person or entity with insured status in the underlying policy will be considered an insured under the umbrella policy. Sometimes this automatic extension of Additional Insured coverage is contrary to the intentions and interests of the Subcontractor because of the applicable umbrella policy limits, which may be significantly higher than the amount of insurance the Subcontractor is required to provide the General Contractor by the terms of the construction contract. Regardless, when there is an automatic inclusion of underlying Additional Insureds in the coverage of the umbrella, the full umbrella limits are arguably available to the General Contractor despite the lower amount of coverage the Subcontractor is contractually required to provide.

To avoid this result, some umbrella insurers have resisted paying claims to General Contractors in excess of the Subcontractor's contractual obligation to provide insurance coverage. Due to the position taken by umbrella insurers, many General Contractors demand Additional Insured status and specify a *minimum* amount of coverage (e.g. "Subcontractor shall provide liability coverage with limits of *at least* \$1,000,000," compared to "Subcontractor shall provide liability coverage with limits of \$1,000,000."), implying a right of the General Contractor to access umbrella limits above the minimum requested.

This issue was addressed in *Valentine v. Aetna Ins. Co.*, 564 F.2d 292 (9th Cir. 1997). In this case, the Subcontractor was required by the contract to provide coverage for the General Contractor in an amount "not less than \$300,000 per occurrence." When a claim was brought against the General Contractor in excess of that amount, the General

Contractor looked to the Subcontractor's general liability policy "with a per occurrence limit of \$100,000" and an umbrella policy "with a limit of \$1,000,000" for defense and indemnity. The umbrella carrier denied any obligation to the General Contractor for more than \$200,000, since that amount plus the primary coverage equaled the amount of coverage required in the construction contract. The Ninth Circuit rejected this argument ruling the contract language stipulating *not less than* \$300,000 of coverage does not support a restriction on the umbrella policy because the construction contract only sets a floor, not a ceiling, for coverage.

Subcontractors sometimes attempt to modify their umbrella policy language in order to cap the applicable limits available to the Additional Insureds in order to bring that cap in line with the contractual insurance requirement. An example is wording that restricts the automatic coverage for underlying Additional Insureds to the policy limit of the umbrella policy, or the amount of coverage required by the construction contract, whichever is less.

The efficacy of such efforts can be thwarted when the General Contractor also has a direct right of recovery against the Subcontractor by reason of an indemnity agreement between the two. Because there is no monetary cap on the Subcontractor's obligation under the indemnity agreement, the Subcontractor's umbrella policy may, pursuant to coverage for contractual liability, be required to respond to that portion of contractual liability arising out of the indemnity agreement in an amount greater than the applicable limits of the Subcontractor's primary policy. In other words, the Subcontractor will call on the contractual liability coverage portion of its umbrella policy limits to satisfy any contractual obligation to the General Contractor, if the General Contractor's claim exceeds the limit of the Subcontractor's primary insurance.

#### **E. What is the Remedy for Failure to Provide Coverage as Required Under the Construction Contract?**

When contractual insurance requirements, including Additional Insured requirements, are imposed on a Subcontractor, most General Contractors carefully monitor the insurance coverage of this Subcontractors through Certificates of Insurance and notice requirements communicated to the insurance carriers. However, a loss occasionally occurs where the Subcontractor has failed to obtain insurance coverage in strict conformity with the construction contract or has failed to obtain coverage at all.

##### **1. Damages Equal the Amount Which Would Have Been Covered**

In such a scenario, the General Contractor will have the right to pursue a breach of contract claim against the Subcontractor wherein the amount of damages sought will be the sum paid by the General Contractor to defend and settle, or satisfy a judgment, related to any claim that would have been covered by the contractually required insurance. *See generally Adams v. Fred Weber, Inc.*, 849 F.2d 1018 (7th Cir. 1988).

## **2. Damages Equal the Premium for the Insurance that Should Have Been Purchased**

Another view of the measure of damages for breaching the insurance requirement was presented in dicta in *Standard Oil Co. v. Wampler*, 218 F.2d 768 (5th Cir. 1955). In *Wampler*, one of the indemnitor's (Subcontractor's) employees was injured and sued the indemnitee (General Contractor) with the indemnitee's insurance carrier defending and settling the case. Subsequently, the indemnitee sued the indemnitor under the indemnity agreement and for breach of the contract requirement to purchase insurance naming the indemnitee as an Additional Insured.

Although the indemnitor failed to name the indemnitee as an Additional Insured, when the indemnitor furnished the indemnitee with a Certificate of Insurance, the indemnitee did not object to the fact it was not named as an Additional Insured under the policy. The court first determined the indemnity agreement was unenforceable under applicable Texas law at that time. As for breach of contract for failing to name the indemnitor as an Additional Insured, the Fifth Circuit stated:

As for the insurance provision, even if it could be construed as requiring [the indemnitor] to furnish a policy covering [the indemnitor's] negligence, we doubt that, under the facts here, the measure of damages would be payment of the [underlying personal injury] judgment. [The indemnitor] furnished a certificate of insurance to which [the indemnitee] made no objection. But [the indemnitee] had provided insurance of its own. *Under these circumstances, it seems to us the proper measure of damages would be the premiums paid for this insurance.*

(emphasis added).

*Wampler* therefore supports a Subcontractor's argument it should only be held liable for the premiums it would have paid for the contractually required insurance.

## **3. There Is No Breach When the Insurance Requirement Is Inextricably Tied to a Void Indemnity Agreement**

As previously discussed, if the contractual insurance requirement is ruled "inextricably tied" to an invalid indemnity agreement, the Subcontractor may successfully defend against a breach of contract action for failing to procure the required insurance. Such was the case in *Emery Air Freight Corp. v. General Transp. Sys., inc.*, 933 S.W.2d 312 (Tex.App.–Houston [14th Dist.] 1996, no writ), a little known and seldom cited opinion from a Texas appellate court. In *Emery*, Emery sued General Transport for breach of contract after General Transport failed to add Emery as an Additional Insured to General Transport's insurance policy as required by the contract between the two. One of General Transport's employees had already successfully sued Emery for a work related

injury. Emery discovered it had not been added as an Additional Insured when it called General Transport's carrier to report the claim. Emery then sued General Transport seeking damages in the amount of the judgment taken against Emery by the injured General Transport employee.

The *Emery* court first determined the indemnity agreement contained in the contract did not expressly state General Transport was to indemnify Emery for Emery's own negligence and was therefore insufficient. Second, the court examined the wording of the insurance requirement and held the actual purpose of the insurance requirement was "to support the indemnity agreement". Because the indemnity agreement did not require indemnity for Emery's own negligence, neither did the insurance requirement coverage require coverage for Emery's own negligence. General Transport could therefore not be held liable for breach of contract.