2020 Construction Conference
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Risk Transfer for Construction Defect Claims: Minimizing and Allocating Costs of Defense and Indemnity

I. Risk Transfer – What Is It, Where to Find It, and How to Evaluate It

There are two main types of risk transfer commonly found in construction defect claims: (1) contractual indemnification provisions, and (2) additional insured rights and obligations.

Plus, one should be mindful that rights and obligations may flow both ways. While your insured/insurer may owe indemnity or additional insured rights to some other parties, others may owe contractual defense of indemnity to your insured. Be consistent in how you treat tenders that you make as compared to those to which you respond.

II. Making the Risk Transfer Tender(s)

The first step in the risk transfer process is to assess your rights and obligations. To do so, you need to collect the relevant documents. These include construction contracts and subcontracts involving your insured as well as those to whom your insured may owe obligations and also those who may owe obligations to your insured. You should also request and obtain the relevant insurance policies, certificates of insurance, the applicable complaint and third party complaints, demand letters, etc.

Once you have these materials, you should then make the appropriate risk transfer tenders – in writing. Be express in what you are seeking. Request both defense and indemnity and, to the extent applicable, do so both pursuant to any contractual defense/indemnity provision and under any additional insured provisions. In your letter, make sure to tender on behalf of your insured and any party who may tender to you. Tender even if the indemnity provision does not appear favorable. Along with the letter, include the complaint, contract(s), and certificate of insurance so that the party(ies) responding to your tender have the information they need and thus there is (hopefully) less delay in getting a response. Also, include language connecting accident to indemnitor's conduct ("the allegations of plaintiff's complaint fall squarely within X's obligations under the contract"),

Request identification of any additional documents needed immediately ("if there are any additional documents needed to respond to this tender, please advise us immediately"). And, finally, request a response within express timeframe (*e.g.*, 15 days, or whatever other deadline you need to impose).

In making the above tenders, the insured's risk manager, the applicable insurer or claim professional and defense counsel, perhaps also assisted by coverage counsel, should coordinate together so that it is clear who is making and who is responding to which tenders.

III. How Risk Transfer Impacts Insurance Coverage

Risk transfers can impact coverage in several ways. First, to the extent that an insured assumes liability to defend or indemnify another in an "insured contract", the insured's policy may provide indemnification – to the insured – for that liability. Most CGL insurance policies contain "insured contract" exceptions to certain policy exclusions, such that the policy may provide coverage for liability assumed by the insured even though the policy would not indemnify the insured if the insured owed that liability to the injured person directly. Common exclusions that contain "insured contract" exceptions are the Contractual Liability exclusion, the Employer's Liability exclusion, and the Aircraft, Auto or Watercraft exclusion.

If an insured is obligated to defend an indemnitee, and if that liability is agreed to in an "insured contract", then the Supplementary Payments provisions typically provide that the costs of that defense are paid within (*i.e.*, those they erode) the policy limits. There often is an exception, however, if both the insured/indemnitor and the indemnitee are parties to the same lawsuit and the carrier can defend both using the same counsel.

Whether a carrier is obligated to defend the indemnitee directly is a different question – the answer to which turns of whether that indemnitee is also an additional insured to the policy. That in turn depends on the Who Is An Insured provision (which include real estate managers and others as insureds), the Additional Insured provisions in the policy (if any), and what specific additional insured rights are promised by the insured to any third parties.

IV. Responding To Risk Transfer Tenders

In responding to risk transfer and additional insured tenders, you need to separately evaluate both the contractual indemnity tender and any additional insured tender.

When evaluating a contractual indemnity tender, look to see if includes defense, or just indemnity. Not all indemnity provisions include a duty to defend. For instance, while some do (*e.g.*, "Subcontractor shall defend, indemnify and hold harmless…"), other do not (*e.g.*, "Subcontractor shall indemnify and hold harmless…").

Next, evaluate scope and enforceability. Does the provision provide for defense or indemnity for the indemnitee's own (or sole) negligence and, if so, is there any statutory or other limitation that may preclude or limit the scope of the indemnity. For instance, Cal. Civ. Code S. 2782.05 (2011) provides that:

> "[A]greements contained in, collateral to, or affecting any construction contract and amendments thereto entered into on or after January 1, 2013, that purport to insure or indemnify, including the cost to defend, a general contractor, construction manager, or other subcontractor, by a subcontractor against liability for claims of death or bodily injury to persons, injury to property, or any other loss, damage, or expense – are void and unenforceable to the extent the claims arise out of, pertain to, or relate to the active negligence or willful misconduct of that general contractor, construction manager, or other subcontractor, or their other agents, other servants, or other independent contractors who are responsible to the general contractor, construction manager, or other subcontractor, or for defects in design furnished by those persons, or to the extent the claims do not arise out of the scope of work of the subcontractor pursuant to the construction contract. This section shall not be waived or modified by contractual agreement, act, or omission of the parties. "

Many other states have similar statutes that limit the enforceability of indemnification provisions, especially in the contraction context. For a comprehensive listing of such statutes, see Chapter 13, Permissible Scope of Indemnification in Construction Contracts, in Randy Maniloff, General Liability Insurance Coverage: Key Issues in Every State, Vol. 4.

Courts will interpret ambiguous terms against the party who drafted the contract. Further, in many states, provisions to indemnify for another party's negligence are to be narrowly construed, requiring a clear and unequivocal agreement before a party may transfer its liability to another party. Bernotas v. Super Fresh Food Mkts., Inc., 581 Pa. 12, 20, 863 A.2d 478, 482 (2004).

Also, if an employee of the indemnitor has been injured, look to see what, if anything, the provision says about possible waiver of Workers Compensation immunity.

Once you understand the extent of the indemnification agreed to by the insured, you then need to see whether and how the policy responds. Make note of "insured contract" exceptions to exclusions, as well as the fact that the definition of "you" refers to the named insured – not to the indemnitee.

Similarly, when evaluating an additional insured tender, start by assessing the relevant documents. Look at policy's additional insured provisions. Look at what the underlying contract requires. And, look at any certificates of insurance ("COI"). While COI's typically state they are for informational purposes only and do not confer coverage not otherwise provided by the actual policy language, COI's both help identify possible sources of additional insured coverage (assuming there is a policy backing up the certificate) and may in certain jurisdictions and certain fact patterns create coverage that otherwise does not exist because a broker may be found to have been the actual or apparent agent of the insurer and thus whose representations may bind the insurer.

In October 2019, the Washington Supreme Court held that an insurer broker that issue a COI stating that a third party was an additional insured, where the policy did NOT provide such additional insured coverage to the third party, had apparent authority to bind the insurer. In T-Mobile USA, Inc. v. Selective Ins. Co. of Am., 194 Wn.2d 413 (2019), T-Mobile NE hired a contractor to construct a cell phone tower on a New York City rooftop. The contract between T-Mobile NE and the contractor required the contractor to obtain a GL policy, to annually provide T-Mobile NE "with certificates of insurance evidencing [that policy's] coverage," and to name T-Mobile NE as an additional insured under the policy. T-Mobile USA was a distinct legal entity and was not a party to the contract.

Selective issued an insurance policy that provided that a third party would automatically become an additional insured under the policy if the contractor and the third party entered into their own contract and that contract required the contractor to add the third party to its insurance policy as an additional insured. Selective's agent issued COI to "T-Mobile USA Inc., its Subsidiaries and Affiliates" stating that those entities were "included as an additional insured [under the policy] with respect to" certain coverage. The agent signed the COI as Selective's "'Authorized Representative. But the COI was issued on an industry-standard form and included preprinted industry-standard disclaimers: noting that certificate "IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE CERTIFICATE HOLDER," "DOES NOT AFFIRMATIVELY OR NEGATIVELY AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE" insurance policy, and "DOES NOT CONSTITUTE A CONTRACT BETWEEN THE ISSUING INSURER(S), AUTHORIZED REPRESENTATIVE OR PRODUCER, AND THE CERTIFICATE HOLDER." The COI also stated: "If the certificate holder is an ADDITIONAL INSURED, the policy(ies) must be endorsed. … A statement on this certificate does not confer rights to the certificate holder in lieu of such endorsement(s)."

Notwithstanding the prominent language in the COI, the Washington Supreme Court addressed the following certified question -- "Under Washington law, is an insurer bound by representations made by its authorized agent in a certificate of insurance with respect to a party's status as an additional insured under a policy issued by the insurer, when the certificate includes language disclaiming its authority and ability to expand coverage?"

The court stated that general rule in Washington is that "an insurance company is bound by all acts, contracts, or representations of its agent, whether general or special, which are within the scope of [the agent's] real or apparent authority notwithstanding they are in violation of private instructions or limitations upon [the agent's] authority, of which the person dealing with [the agent], acting in good faith, has neither actual nor constructive knowledge." As such, under the facts before it, the Washington Supreme Court held that the agent had apparent authority and that the COI's general disclaimers were not effective.

V. Containing/Minimizing Litigation Costs Through Risk Transfers

At the end of the day, risk transfer is about shifting the financial responsibility from one person (the tortfeasor) to another (the insurer, the indemnitor, etc.). In doing so, insured, indemnitors, indemnitees, insurers and even claimants should have an interest in minimizing the costs of making those risk transfers, doing so as expeditiously as possible, and ultimately in resolving the claim in the most efficient way possible.

As such, early identification of risk transfer opportunities and obligations, can lead to a speedier and more cost-effective resolution of claims. Early evaluation of both contractual indemnity and additional insured rights and obligations can assist those ultimately responsible for paying a claim in determining where that liability is most likely to fall, and then to allow those parties having an obligation to defend and/or indemnify to assess the liability and damage issues sooner, and then determine whether an early settlement, mediation – or defensive motion practice – is warranted.