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Covering Your Bases: Ensuring Risk Transfer of Construction Losses

I. CONTRACTING FOR RISK AND RISK TRANSFER

A Crafting Effective and Enforceable Indemnity Agreements

As with any agreement, enforceability is of paramount importance to both contracting parties. The parties may seek to limit their own liability or protect themselves from the consequences of the other's performance, and special attention must be paid to ensure the effectiveness of these clauses within the agreement. Oftentimes, they may rely upon generic form documents under the mistaken belief that their intent – and their interests – will be valid and enforceable. In the context of contracting for services between contractors and their subcontractors, parties sometimes find themselves relying on standard such as those published by the American Institute of Architects ("AIA").

Specifically, AIA Document A401 provides a generic form of agreement between a contractor and subcontractor. Reliance on these generic terms, though, may spell peril for the contracting parties. The AIA documents certainly provide a reasonable foundation for establishing the terms of an agreement for construction services and are intended for broad use across many states; however, in the absence of specific attention to the requirements of the relevant jurisdiction, key portions of an unmodified AIA Document may ultimately be null and void, and therefore unenforceable.

A particular clause that requires special attention and care in the context of construction contracting is the indemnity agreement. The jurisdiction where the contract is performed may contain specific limitations on the type of conduct that may be subject to indemnity, as well as the conditions of the agreement to provide it. For example, Section 725.06, Florida Statutes, provides for limitations on certain types of special indemnity that may be obtained through construction contracts. In its current form, Section 725.06 provides, in pertinent part, as follows:

> Any portion of any agreement or contract for or in connection with, or any guarantee of or in connection with, any construction… wherein any party referred to herein promises to indemnify or hold harmless the other

> party to the agreement…for liability…caused in whole or in part by any act, omission, or default of the indemnitee arising from the contract or its performance, shall be void and unenforceable unless the contract contains a monetary limitation on the extent of the indemnification that bears a reasonable commercial relationship to the contract and is part of the project specifications or bid documents, if any…

See Fla. Stat. §725.06(1). This Section specifically declares that an indemnity provision that attempts to shift the risk of the indemnitee's liability to the indemnitor, shall be void and unenforceable unless the contract contains a monetary limitation on the extent of the indemnification that bears a reasonable commercial relationship to the contract, or unless the contractor gives a specific consideration for the indemnity provision. The contracting parties cannot assume that the generic clauses contained within the AIA Document will provide an enforceable agreement as to their desired scope of indemnity.

Parties to construction agreements, whether they be generic AIA Documents or the product of their own handiwork, may also fall prey to reliance on history as an assurance that their agreements will be valid and enforceable, simply because they were effective in the past. In the case of indemnity agreements, for example, statutory requirements are sometimes subject to amendment and the parties must be aware of the current standard for creating enforceable agreements for indemnity. *See Nat'l R.R. Passenger Corp (Amtrak) v. Rountree Transport and Rigging, Inc.*, 422 F.3d 1275, 1282 (11th Cir 2005) (analyzing a contractual indemnity provision under the version of section 725.06 that was "in place at the time the [agreement] was executed."). Ultimately, an agreement that was valid in the past may not be enforceable in the future.

Indemnity agreements are oftentimes intended to insulate one contracting party from liability arising from the contract of the other. In other cases, though, one contracting party may seek to utilize the indemnity clause as an exculpatory clause as a means to shift liability for *its own* fault. Imposing liability for onto another party has implications of fundamental fairness, and the practice is typically highly scrutinized by both the Courts and legislature.

Again, the criteria for a party's shifting liability for its own fault to another party in a construction contract is controlled by Section 725.06, Florida Statutes. In the case of construction contracts, the agreement that seeks to shift liability for the indemnitee's own wrongful conduct must contain a monetary limitation that "bears a reasonable commercial relationship" to the contract amount, and must be included within the project specifications and bid documents, if any. *See also, Griswold Ready Mix Concrete, Inc. v. Tony Reddick, & Pumpco, Inc*., 134 So.3d 985 (Fla. Dist. Ct. App. 1st Dist. 2012) (holding indemnity contract was void due to absence of monetary limitation on indemnity).

The absence of these criteria may invalidate the agreement. Additionally, many jurisdictions also have some common law precedent disfavoring the enforceability of such exculpatory clauses. For example, Florida courts have held that contracts requiring one party to indemnify and hold the other harmless for

its own wrongful acts are disfavored and will be enforced only if they express such intent in clear, unequivocal terms. *See Skidmore v. Volpe Constr.*, 511 So. 2d 642 (Fla. 3d DCA 1987). (Emphasis added).

B. Contracting for Coverage and Additional Insured Status

As previously noted, it is not uncommon for parties to rely upon standard, generic contract forms to craft their contracts and subcontracts. By reputation or by familiarity, some parties may assume that the form contracts already reflect their intent to, among other things, effectively set forth enforceable insurance requirements. This unfortunately is often not true, as a critical piece of the coverage puzzle is missing at the time the agreement is made.

In many cases, standard form agreements such as the AIA documents will likely require modification to ensure compliance with the requirements of the applicable jurisdiction, as well as the consistency with the insuring agreement sought to be implicated. In the unmodified AIA Document A201 (Article 11) and AIA Document A401 (Article 13), for example, a general framework for contemplated insurance requirements is addressed. However, these generic provisions require specific input by the parties as to the nature and limits of required coverage. Both documents also recognize the general intent to bestow upon one party the status of "additional insured" on the other's general liability policy, but the manner in which this is set forth in the contract may not have the desired effect.

In order to ensure enforceability, and to ensure that the intent of the parties is captured, the provisions regarding coverage and additional insured status must be clear and unequivocal. The parties must clearly state the desired additional insured coverage, including the specific parties to be named as an additional insured and by whom, and for which specific coverages. Simply agreeing to name a party as an additional insured does not create coverage, and a Certificate of Insurance cannot confer additional insured status. The existence and extent of additional insured coverage is determined by the insuring agreement, not by the underlying contract, and it is critical that the party seeking additional insured status obtain and understand the insurance agreement, together with the additional insured endorsement(s), to ensure the enforceability of such coverages.

II. Ensuring and Evaluating Additional Insured Coverage

A. Recent Trends in ISO Additional Insured Endorsements

For a number of years, the construction industry has used the additional insured status as a tool to transfer the risk of loss due to one party's negligence onto another party, in conjunction with a contractual indemnity provision in the underlying contract. In recent years, a number of states have enacted "anti-indemnification" statutes, which are generally designed to prohibit an indemnitee from pushing the risk of loss for the indemnitee's act or omission, onto an indemnitor. Examples of these anti-indemnification statutes, may be found at §151.102 Texas Insurance Code and California Civil Code §§2782, 2782.05. To date, Florida has not adopted an applicable anti-indemnity statute.

Partially in response to the enactment of anti-indemnification statutes, in April 2013, ISO adopted a number of changes to additional insured endorsements. ISO additional insured endorsement form CG 20 10 04 13 was modified in three substantive ways: (1) additional insured coverage only applies to "the extent permitted by law," (2) additional insured coverage limits are the lesser of that which is required by the contract or the policy, and (3) additional insured coverage will not be broader than required by the underlying contract or agreement.

Since a Court is not likely to enforce an endorsement that violates a statute, and since a number of states have not enacted an anti-indemnification statute, this first change operates as more of a clarifying statement, rather than a practical limit on coverage. The remaining two changes however, do have the potential to limit the scope of coverage for additional insureds. For example, if the underlying contract language calls for $1 million in liability coverage, while a subcontractor actually carries a policy with limits of $2 million, the additional insured endorsement on that policy will only pay up to the $1 million called for in the subcontract. Similarly, since the coverage afforded to the additional insured will not be broader than required by the underlying contract, the parties will need to be very clear as to which coverages under the CGL are to be afforded to the additional insured. For example, if an underlying contract only requires the named insured provide coverage for the named insured's vicarious liability to the additional insured, then the additional insured endorsement would only provide the vicarious liability coverage, even though the policy itself may provide broader coverage.

These examples demonstrate one effect of the new endorsement language to increase the degree to which the CGL policy and the underlying contract are interconnected. This increased connection between the CGL policy and the underlying contract make it imperative that the parties have fully and clearly stated the coverage they intend to provide, with clearly stated coverage limits.

In addition to the changes cited above, a pair of other notable new endorsements related to additional insureds were adopted in April, 2013. Form CG 20 38 04 13 provides automatic additional insured status expanded to all parties named in the construction contract's additional insured clause—sometimes referred to as a blanket provision. This change is designed to address the uncertainty as to whether the owner automatically becomes an additional insured where the owner is not in privity with the subcontractor. Modified endorsement CG 20 01 04 13 clarifies the additional insured coverage will be primary and non-contributory, provided the parties have actually agreed, in writing, the coverage will be primary and will not seek contribution. Here again, the new endorsement language increases the degree to which the CGL policy and the underlying contract are interconnected. In order to ensure the additional insured's coverage is primary and non-contributory, the parties must expressly state in the underlying contract that the named insured will provide the additional insured with coverage that is primary and non-contributory.

B. Application and Allocation of Coverage

The April 2013, changes to the ISO CG 20 10 additional insured endorsement follow an evolution in the scope of additional insured coverage. In 1985, the GC 20 10 outlined additional insured coverage through the phrase, "only with respect to liability arising out of 'your work.'" Unfortunately, this phrasing lead to a lot of litigation, and left certain questions unanswered in relation to completed operations coverage and primary/non-contributory status. In 1993, the form was modified so that the additional insured included "any person or organization shown on the Schedule…" but excluded completed operations coverage. This change lead to some questions concerning coverage for "ongoing operations" vs. "completed operations." In 2001, the form was again modified to include "arising out of your operations language," with the addition of the completed work exclusion. In 2004, an amendment to "WHO IS AN INSURED" included coverage for "persons or organizations shown in the Schedule, but only with respect to liability for property damage … caused, in whole or in part, by: Your acts or omissions; The acts or omissions of those acting on your behalf; In the performance of your ongoing operations for the additional insured(s) at the location(s) designated above." This endorsement included the completed operations exclusion which was contained in the 20 10 10 01 endorsement.

In any loss related to a construction project, there are often a number of policies which may be triggered by the loss. The question of the priority of coverage frequently arises in this context. Which policy is primary? Who pays first? In the construction project additional insured context there are two main types of priority questions (1) where there is an additional insured policy versus direct, named insured policy and (2) where there is an additional insured policy versus multiple, similarly aligned policies. When considering the question of priority, one needs to consider any "Other Insurance" clause, or other insurance language in the additional insured endorsement which may steer the priority question. In addition, the reviewer should look for potentially qualifying language in the underlying indemnification agreement. Here again, because the new additional insured endorsement limits the scope of coverage to what is outlined in the underlying contract, it is imperative that drafters clearly outline priority questions in the underlying contract to reflect the true intent of the parties.

Construction defect claims often implicate multiple consecutive policy periods, with multiple insurers. As a result, the question of how defense and indemnity are allocated between and amongst the potentially implicated insurers regularly arises. When allocating defense costs, a minority of jurisdictions have held defense costs, among insurers covering the same loss, are allocable either by dividing cost of defense equally or dividing based on each insurer's time-on-the-risk. Conversely, a majority of jurisdictions follow the indivisible/joint and several view.

The California Court of Appeals has held an insurer must provide a complete defense to its policyholder and also found an additional insured carrier's obligation to be indivisible. *See Haskel, Inc. v. Superior Court*, 33 Cal. App.4th 963, 976 (1995); *Presley Homes, Inc. v. American States Ins. Co.*, 90 Cal. App.4th 571 (2001). The insurer providing the complete defense has a claim for contribution against other insurers obligated to defend. *Id*. The back end allocation can be equal shares, time on risk, or "per subcontractor" (in the

additional insured context). *See e.g. California Civil Code § 2782* (which supports a "per subcontractor" allocation methodology).

In Florida, courts have held "an insurer whose duty to defend has been triggered must provide the policyholder with a complete defense, which means defending the policy holder against all claims, even those that are not covered under the policy." *Sunshine Birds & Supplies, Inc. v. U.S. Fid. & Guar. Co.*, 696 So.2d 907 (Fla. Dist. Ct. App. 1977). To date, no Florida Appellate Court has addressed the issue of whether an additional insured carrier has an indivisible obligation to defend an additional insured.

When allocating indemnity, a minority of jurisdictions have followed an all sums/joint and several view where policies in a particular policy period may respond in full, subject to their limits. This approach is based on the "all sums" language in policies and allows an insured to pick which policy year(s) will respond to a loss. Conversely, a majority of jurisdictions follow the pro rata/time-on-risk view where damages are allocated evenly among the years in which property damage occurred, and then to each policy year with multiple insurers paying their time-on-risk share. *Pub. Serv. Of Colorado v. Wallis & Companies*, 986 P.2d 924, 940 (Colo. 1999). Florida Appellate Courts have yet to address this issue.

As a practical consideration, if an insurer owes a defense to an additional insured, but fails to participate, the participating carriers may have right of subrogation under a contractual indemnity provision.

While it is always advisable to carefully draft contract provisions, recent developments aimed at the construction industry have given the terms of the underlying contract, in regards to risk transfer, a renewed importance. The enactment of anti-indemnification statutes in conjunction with the April 2013, modifications to additional insured endorsements has increased the degree to which the underlying contract and the CGL policy are interconnected. Any analysis of the transfer of risk for construction-related losses, requires a careful review of both the additional insured endorsement and the underlying contract or agreement.