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No Good Deed Goes Unpunished – What Happens after an AI Tender is Accepted

I. Additional Insured (AI) Tender Scenarios Arise in All Types of Construction Defect Claims

Claims professionals and attorneys working in the construction defect arena routinely deal with tenders of defense and indemnity from a party claiming status as an additional insured under a general liability policy. The best practice for a party seeking AI status is to tender as soon as possible, as the date of the tender starts the clock running for the accepting carrier's responsibility for contribution toward attorneys' fees and costs incurred by the party seeking AI coverage. Most state claim handling statutes provide deadlines for responding to tenders, similar to responding to any other sort of claim. In the context of a construction defect claim, additional information such as the contract between the named insured and the additional insured, and the complaint or pre-litigation defect notice are required to evaluate whether the party seeking AI status is entitled to defense and indemnity under the policy.

The types of claim scenarios can be broken down into two main categories:

A. Residential Construction Defect Claims

AI tenders are frequently made by the developer to the general contractor, and, depending on the contracts between the developer and the general contractor, to the subcontractors, and potentially to material suppliers. Most sophisticated developers will require that the general contractor's contract with its subcontractors and material suppliers, and that any subcontractor contracts with sub-subcontractors, include a provision that requires the subcontractors and sub-subcontractors to name the developer/general contractor as an additional insured under their liability policies. The insurance requirement also typically specifies that the policies contain a specific type of endorsement, a waiver of subrogation clause, and specific minimum limits of liability. The contracts may also contain a specific provision requiring the parties to indemnify the developer and/or general contractor separate and apart from the insurance requirement. In addition to the developer-general contractor-subcontractor tenders, the general contractor typically tenders to its subcontractors and sub-subcontractors based on the same contract provisions described above.

B. Commercial Construction Defect Claims

Commercial claims as far as AI tenders and coverage will be similar to residential claims in most instances. Typically, the breadth of who was to be named as an AI under the named insured policy (the subcontractor) will be greater as the Owner, Lender, General Contractor and potentially Joint Venturers will all be required to be named under the terms of the master contract. Oftentimes these entities have potentially conflicting issues with the subcontractor named insured.

C. Wrap Policies Can Complicate the Tender Process

If there is an Owner Controlled Insurance Program("OCIP") in place, it is important to check on who is enrolled. If a subcontractor is enrolled, typically its primary insurance policy will have an exclusion due to the "wrap," but not always. Investigation of the policies issued and who is named as an AI are important steps in the process. To really complicate matters, many projects will end up with portions of the project being covered by a Wrap policy and a portion not covered by the Wrap policy. Under this scenario, the developer/GC will need to tender to each subcontractor, as more likely than not the contract required them to be named as AI's under the subcontractor policies. As discussed below, this presents challenges during the defense of the claim.

II. Claims Professionals Face Multiple Considerations Following Acceptance

A. Split file requirements

Most parties requesting AI coverage also request that the AI file be split from the claim file maintained on behalf of the named insured, and that a separate adjuster be assigned to the AI file. The rationale behind this request is based on the concern that information obtained through the named insured may compromise coverage for the additional insured or that issues raised in the litigation by the additional insured may create a conflict of interest.

B. Choice of counsel

Choice of counsel is typically within the discretion of the carrier accepting the defense; however, in many cases involving tenders that are issued following the onset of litigation, defense counsel has been assigned to the insured by another carrier, or the insured may have retained counsel on its own based on circumstances related to responsibility for payment of a self-insured retention. In those cases, most claimants will typically request that the accepting AI carrier participate in the defense through existing counsel. This type of arrangement can be beneficial in terms of reducing defense costs overall as a result of sharing in one attorney's bill, rather than having another attorney serve as co-counsel, for which the accepting carrier would be responsible for paying one hundred percent of the billing. Additional benefits of using existing counsel include the attorney's existing familiarity with the insured's business practices, employees and officers that may be designated as corporate representatives or lay witnesses, and the insured's records that have been, or are to be, produced in the litigation. In certain

large multiparty cases involving a developer or general contractor, gaining knowledge of the insured, the project, and the parties involved in the litigation is time consuming.

In cases involving both wrap and non-wrap policies, a carrier defending under an AI may need to appoint separate counsel from the Wrap counsel as potential conflicts could arise within the defense of the case. Additionally, in cases where the named insured is a party to the same lawsuit as the additional insured, it may be necessary for the carrier to have separate counsel for the named insured and the additional insured because conflicts may arise between the named insured (subcontractor) and the general contractor additional insured, particularly if the general contractor is asserting crossclaims against the subcontractor.

Certain states, such as Florida, have statutory provisions that require that counsel selected by the insurance company must be "mutually agreeable" to both the insured and the insurer. Fla. Stat. Section 627.426(2)(b)(3). This provision is triggered by a reservation of rights. *See Colony Ins. Co. v. G&E Tires & Service, Inc.,* 777 So. 2d 1034 (Fla. 1st DCA 2000) (discussing obligations imposed on insurer under Section 627.426).

However, it is important to note that not all reservation of rights letters fall within the requirements of the statute. For example, in a case where coverage is denied, or where there is no coverage, the insurer is not required to comply with the statute. *See, e.g, AIU Ins. Co. v. Block Marina Invest., Inc.,* 544 So. 2d 998, 1000 (Fla. 1989) (noting that Section 627.426(2) only applies in situations involving the assertion of a "coverage defense," which is a defense to coverage that otherwise exists, not a disclaimer of liability based on a complete lack of coverage). Usually a "coverage defense" involves a breach of a policy condition. *See, e.g., Arnett v. Mid-Continent Cas. Co.,* 2010 U.S. Dist. LEXIS 71666 (M.D. Fla 2010) (noting that failure to provide proper notice of a claim is a "'classic coverage defense'" and noting that when an insurer argues that coverage is "'expressly excluded or otherwise unavailable under the policy or under existing law,' the carrier is not raising a coverage defense within the meaning of § 627.426(2)"); *see also Embroidme.com, Inc. v. Travelers Prop. Cas. Co. of Am.,* 992 F. Supp. 2d 1259 (S.D. Fla. 2014 (same); *Geico Gen. Ins. Co. v. Rodriguez,* 155 So 3d 1163, 1168 (Fla. 3d DCA 2014) (same, explaining difference between "coverage defense" and "defense of no coverage"); *Scottsdale Ins. Co. v. Deer Run Property Owner's Assn.,* 642 So. 2d 786, 787 (Fla. 4th DCA 1994) (finding insurer not estopped from asserting no coverage for attorneys' fees under policy because of failure to comply with notice requirements of claim administration statute).

California Civil Code Section 2860 and caselaw provides for retention of independent counsel by the insured at the expense of the insurer when the carrier defends under a reservation of rights if the coverage issues result in competing interests between the insured and the insurer. *See Centex Homes v. St. Paul Fire & Marine Ins. Co.,* 19 Cal. App. 5th 789 (2018) (discussing Cal. Civ. Code Section 2860 and *Cumis* counsel requirements). An analysis of the coverage issues in the context of the underlying litigation is required in evaluating the application of Section 2860, as not all reservation of rights situations result in a conflict between the carrier and the insured. *Id.* at 797-98.

Nevada also requires an insurer to provide independent counsel for its insured when a conflict of interest arises between the insurer and the insured. Nevada recognizes that the insurer and the

insured are dual clients of insurer-appointed counsel. *State Farm Mut. Auto. Ins. Co. v. Hansen*, 131 Nev. Adv. Op. 74, 357 P.3d 338, 339 (2015). When the insured and the insurer have opposing legal interests, Nevada law requires insurers to fulfill their contractual duty to defend their insureds by allowing insureds to select their own independent counsel and paying for such representation. *Id.* In *Hansen*, the court further concluded that an insurer is only obligated to provide independent counsel when the insured's and the insurer's legal interests actually conflict. Importantly, a reservation of rights letter does not create a per se conflict of interest. *Id*.

C. Reporting and reserving

Counsel should be expected to conform to the AI carrier's reporting guidelines and billing guidelines. Participating AI carriers should be kept informed of all issues impacting the defense of the AI, just as they would be in a case involving a named insured. Additionally, AI carriers should be provided with a case budget for the defense of the case. Finally, the AI carrier must be advised of issues related to indemnity exposure of the additional insured related to the named insured's scope of work. This information is critical in setting reserves for defense costs and indemnity exposure and in evaluating potential resolution mechanisms.

D. Tenders and Re-Tenders

As the case progresses, it is imperative that Developer/General Contractor counsel follow up on tenders and investigate and verify that all potential carriers who may provide coverage under an AI endorsement have been tendered to, and that they have appropriately provided their coverage position. If the project has homes/units that are not covered by a wrap policy, this is even more important as the subcontractor's primary insurance should be participating, presumably due to an AI endorsement that provides a duty to defend. It is also important to make contractual indemnity demands along with AI tenders.

E. Billing issues

Defending carriers in construction defect cases have a common interest in minimizing their exposure for defense fees and costs by 1) requiring all insurers on the risk to participate in the defense of the named or additional insured and 2) monitoring defense fees and costs billed by independent counsel. These common interests have resulted in formal and informal defense sharing agreements among accepting AI carriers. Issues that may arise when multiple carriers participate in a defense related to billing include:

- May each carrier pay a proportionate share of the additional insured's defense at the rates it ordinarily pays panel counsel?
- Should the defending carriers agree to pay the rates regularly paid by the highest paying defending carrier?
- Should independent counsel be required to split its bill among carriers, even if the carriers are paying different rates?

Once the billing rate is determined, issues arise on how counsel's bill is to be split among multiple participating carriers. Methods include:

Tiered Sharing
Time on Risk Sharing
Equal Shares Participation

Of the methods listed above, tiered sharing is the most complicated, as it requires allocation of responsibility among parties (usually based on a formula tied to a cost of repair or an expert's allocation). Time on risk sharing is based on the applicable policy periods, and can be relatively easily determined once all policy periods are known. Equal shares participation is the easiest formula to follow, but may not be viewed by all carriers as the most fair distribution of financial responsibility for the defense.

Court decisions on allocation have held that the trial court should apply a method that results in an equitable allocation among the insurers in a pro rata proportionate to the respective coverage of the risk. *See Continental Ins. Co. V. U.S. Fire Ins. Co.,* 88 Cal. App. 4th 105 (2001; *see also Maryland Cas. Co. v. Nationwide Mutual Ins*. Co., 81 Cal. App. 4th 1082, 1094 (2000) (discussing methods for apportionment of defense costs).

Regardless of how carriers regard these issues, it inures to the benefit of all defending carriers to negotiate and agree on hourly rates for legal fees up front, before any bills are submitted or, in particular, paid. A carrier that waits a year to accept an additional insured's tender may find itself with a difficult choice: pay a portion of agreed upon rates that may be higher than customarily paid to panel counsel, or insist upon "customary" rates, at a risk of being characterized as "unreasonable" in comparison with other defending carriers in a subsequent bad faith lawsuit. As such, carriers who desire a voice in negotiating rates and wish to minimize bad faith potential should evaluate and decide upon additional insured tenders immediately following the tender. It is important for multiple participating carriers to keep in mind that although defense counsel's hourly rate may be higher than a particular published panel rate, the rate decreases to less than the lowest hourly panel rate when multiple parties are participating in payment.

III. Claims Professionals Need to Develop Strategies for Success After Acceptance of an AI Tender

A. At the Beginning - Getting Others to Participate

The concept of "the more the merrier" rings true in defense participation. However, in practice, carriers faced with an AI tender may be reluctant to accept based on the impression that they will be responsible for the entire cost associated with the defense of the AI. In some circumstances, continued pursuit of outstanding tenders to other carriers results in voluntary agreement to participate. In most cases, however, other carriers will not join in the defense without a threat of a contribution action.

The majority rule is that a carrier that participates in the defense of an insured may seek contribution toward defense costs from nonparticipating carriers. States that allow equitable contribution actions include Arizona, California, Colorado, Georgia, Hawaii, Illinois, Louisiana, Ohio, Oklahoma, Oregon, Pennsylvania, Massachusetts, Michigan, Missouri, Montana, New Jersey, New Mexico, South Dakota, Texas, Washington, West Virginia and Wisconsin, subject to certain conditions related to similarity in coverage and other factors. (See table provided as part of supplemental materials.)

States that do not allow contribution actions among carriers are Florida and Minnesota. *See, e.g., Am. Cas. Co. of Reading Pa. v. Health Care Indem., Inc.,* 613 F. Supp. 2d 1310 (M.D. Fla. 2009) (citing *Argonaut*); *Progressive Express Ins. Co. v. Fla. Dept. of Ins. Servs.,* 125 So. 3d 201 (Fla. Ct. App. 2013); *Jostens, Inc, v. Mission Ins. Co.,* 387 N.W.2d 161 (Minn. 1986). However, as a result of the Florida Legislature's recent passage of an omnibus bill, which creates Fla. Stat. Section 624.1055, Florida will allow contribution actions among liability carriers for defense costs, provided that the other liability insurer owes a duty to defend the insured against the same claim, suit or other action. Contribution cannot be sought for defense costs incurred before the liability insurer's receipt of the notice of claim, suit, or other action. The statute applies to claims and causes of action occurring after January 1, 2020.

Many of the states within the majority cite to California law, which allows equitable contribution actions among primary carriers. *Continental Casualty Co. v. Zurich Ins. Co.,* 57 Cal. 2d 27 (1961); *see also Presley Homes, Inc. v. American States Ins. Co.,* 90 Cal. App. 4th 572 (2001).

Most states, including California, do not allow contribution actions by a primary carrier against an excess carrier. (See table provided with supplemental materials.) *See Fireman's Fund Ins. Co. v. Maryland Cas. Co*., 65 Cal. App. 4th 1279, 1294 n.4, 77 Cal. Rptr. 2d 296 (1988) (stating, "As a general rule, there is no contribution between primary and excess carriers of the same insured absent a specific agreement to the contrary.") Primary and excess carriers are not jointly liable for the same loss. A primary carrier is liable for a covered loss up to its policy limit. An excess carrier is liable for that portion of the loss in excess of underlying coverage. As a consequence, equitable contribution does not directly apply to primary and excess insurance allocation disputes. Nor is an excess carrier interested in "sharing" the defense costs owed by a primary carrier. Primary carriers, however, may look to an excess carrier that unreasonably declines to settle a case, thereby increasing the primary carrier's defense obligation. *See American Alternative Ins. Corp. v. Hudson Specialty Ins. Co.,* 938 F. Supp. 2d 908, 915–16 (C.D. Cal. 2013) (recognizing implied covenant of good faith and fair dealing in insurance policies, which "imposes an obligation on an insurance company to accept a reasonable offer of settlement within the insurer's policy limits when there is a substantial likelihood of recovery in excess of those limits.") The court held that the covenant, which traditionally arises from the agreement between the insured and the insurer, runs between the excess or primary insurer and the insured.

However, even without an underlying agreement, California, and other states, allow primary and excess insurers to recover from one another for their bad faith refusal to accept a reasonable settlement offer under the theory of equitable subrogation. (See table provided with supplemental materials.) Equitable subrogation allows the insurer to stand in the shoes of the insured and assert all

claims against another insurer which the insured himself could have asserted. The California courts have not limited equitable subrogation recovery to excess insurers; primary insurers may also bring a claim under this theory of liability. *Diamond Heights Homeowners Assn. v. Nat'l Am. Ins. Co.,* 227 Cal. App. 3d 563, 277 Cal. Rptr. 906 (Ct. App. 1991) (finding that the primary insurer could proceed on an equitable subrogation theory against the excess insurer where the excess insurer arbitrarily vetoed a reasonable settlement and forced the primary insurer to proceed to trial and bear the full costs of defense).

B. Keep an Eye Toward the End - Resolution and Settlement Considerations

A common issue that arises in settlement discussions involves the release of subcontractor parties in cases where the subcontractor is defending against claims by the plaintiff homeowner/association/owner. The settlement is proposed to the subcontractor/named insured, whereby the subcontractor is dismissed, and the scope of work is released in exchange for payment to the plaintiff. The plaintiff also offers to release its claims against the developer/general contractor for the subcontractor's scope of work. The developer/general contractor has a cross-claim against the subcontractor for indemnity.

In order to have a complete release and close the claim file for the subcontractor, the carrier would need a release from the general contractor. The issue that can preclude settlement in full involves obligation for defense fees and costs to the AI. Ideally, the developer/general contractor should release its claims against the subcontractor, as they are derived from the plaintiff's claims, and agree to a release of the AI carrier's obligations, as there no longer is a need to defend against claims arising out of the work of the subcontractor. Some AI's will agree to a release of the subcontractor, but not the carrier, arguing that the duty to defend goes to all the claims against the AI in the litigation, not just those related to the work of the named insured. Support for this position is found in cases such as *Presley Homes, Inc. v. American States Ins. Co.,* 90 Cal. App. 4th 572 (2001).

The most common way to avoid this scenario is a global settlement. Alternatively, having multiple carriers involved in the defense of the developer/GC is another way to avoid this scenario, assuming those same carriers are not also seeking settlement. In reaching or attempting to reach a settlement with a particular subcontractor, it is important that all participating AI carriers are provided notice and the terms of any agreement must not impair any rights an AI carrier may want to reserve.

Yet another scenario involves the case of a non-accepting AI carrier, who seeks to settle the claims against its named insured with plaintiff. The putative AI also has claims against the subcontractor in the litigation. An offer of funds to the putative AI toward indemnity and defense costs can sometimes resolve outstanding unresolved AI claims, but a settling carrier may want to consider the risk of contribution actions by participating AI carriers, if any, in evaluating settlement under those conditions.