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To Defend or Not to Defend: The Dilemma for Carriers, Subcontractors and Their Counsel

I. Duty to Defend

The carriers analysis for duty to defend involves the review of the Complaint, and the insurance policy by looking at the plain language of the policy sometimes' known as the "eight corners rule": 4 corners of the insurance policy and 4 corners of the complaint Chestnut Assoc v. Assurance Co, 17 F. Supp 3d 1203, 1209 (M.D. Fla 2014); Wisznia Co. Inc v. General Star Indemnity Co, (5th Cir Louisiana 2014). If there are amended complaints filed, then the amended allegations control the insured's duty to defend, Nationwide Mutual Fire Insurance Co v. Advanced Cooling and Heating, 126 So. 2d 385, 287 (Fla 4th DCA 2013).

Under Florida law, insurance coverage is available to the insured during each policy period in which damage is alleged to have, in fact, happened. The most recent cases interpreting latent defect construction damage in Florida have uniformly held that the injury-in-fact trigger applies to such losses. Trovillion Const. & Development, In v. Mid-Continent Cas. Co., 2014 WL 201678 (M.D. Fla. Jan. 17, 2014); Axis Surplus Ins. Co v. Contravest Constr. Co., 23 Fla. L. Weekly Fed. D. 279 (M.D. Fla. June 5, 2012); and Johnson-Graham-Malone, Inc. v. Atlantic Casualty, 18 Fla. L. Weekly Supp. 870a (Fla. April 29, 2011). In the west, Supreme Court of Oregon held that the subcontractor's liability insurer had a duty to defend when a complaint alleges claims where liability could be reasonably interpreted to arise from the subcontractor's ongoing operations performed for the general contractor West hills Development Co v. Chartis Claims, Inc, 360 OR. 650 (Oregon 2016).

A contractual indemnity claim is one against the named insured. In some states the duty to defend is limited to matters embraced by the indemnity agreement and does not extend to the entire suit (compared with an insurer's obligation to defend an additional insured from all claims.) See, Presley Homes Inc v. American States Ins. Co, (2001) 90 Cal App 4th 571. An indemnity agreement (a named insured's contractual assumption of third party's liability) versus designation of third party as additional insured under the named insured's policy are separate and independent grounds for a third-party tender that require separate analysis. For the insurer's, if the contractual liability coverage applies to the particular indemnity agreement, the insurer could be obligated to defend potentially indemnify the named insured indemnitor for its liability under the agreement.

Contractual indemnification is not insurance but a risk transfer which does not relieve the indemnitee of its liability for damage to the third party; it merely transfers the financial obligation to the indemnitor. If the indemnitor cannot pay, the indemnitee must.

There are three types of indemnification agreements. First, Broad form indemnity which transfers the entire liability risk to the indemnitor regardless of which party is at fault, which would include the indemnitee's sole negligence.

A majority of states have some form of *anti-indemnity statutes* that limit or eliminate the right to seek indemnification for negligence of developers, owners, general contractors, designers, and other subcontractors specifically for their own negligence. For example in California post January 1, 2009, Broad form indemnity agreements in residential construction contracts which require to indemnify others for their active negligence or willful misconduct are void and unenforceable and parties to residential construction contracts are to share liability for construction defects according to fault **California Civil Code Section 2782.5**. While others like Florida, make sure that in construction contracts, the indemnification provision clearly reflect the intent of the parties that the indemnitor will indemnify the indemnitee for the latter's negligence with clear, specific, explicit, and/or conspicuous language as well as a monetary limitation and relation to the subject matter of the contract **Florida Statute Section 725.06.**
In some states the agreements must have clear and unambiguous to include limitations on the position of the provisions within the contract and including the requirement for insurance within the same paragraph as an indemnity obligation could jeopardize the validity of the obligation **New Jersey Statute Section 2A:40A-1.**

Second, the Medium level of indemnity agreements transfers the risk with the exception of the indemnitee's sole negligence. In these agreements, the indemnitor must indemnify all of the loss, as long as the indemnitor is at fault to some degree. The third final form of agreement obligates the indemnitor to the extent of its fault only.

How indemnification demands work in practice begins simply with a demand. The general contractor or developer is sued or a demand is made against them for construction work. The general contract refers to the subcontract with the trades in which the general contractor has an indemnification agreement to transfer this financial risk to the subcontractor whom is ultimately responsible for the work. The subcontractor will be the indemnitor, indemnifying the contractor pursuant to the agreement as the general contractor who becomes the indemnitee.

This is where the work of the insurer becomes tricky. Whether you are the carrier for the developer/general contractor or the subcontractor the insurer has to ensure that they document their file and keep track of notices and responses on behalf of the insured. Normally, the general contractor will have a large spreadsheet which lists each subcontractor and their insurers with their policy years and numbers. In addition, the same document should have columns which list what type of indemnity is in agreement, if additional insured status is required, and the dates of when tender of defense and indemnity were sent and response from each carrier. As a subcontractor insurer, it is paramount that you have the complete coverage history for the insured from the date of the contract to present. A similar chart can be used to list each carrier with policy number, years, and dates for tenders of defense to carriers and their response dates.

In some states like California, the subcontractor can owe no defense or indemnity obligation to a general contractor/developer for a construction defect claim unless and until the builder provides a sufficient tender of the claim to the subcontractor. The California Supreme Court held that subcontractor has an immediate contractual obligation to defend from the outset, any lawsuit against the developer/builder, even if the subcontractor is later absolved of liability. Crawford v. WeatherShield Manufacturing Inc. 44 Cal. 4th 541 (Cal 2008). The case allowed California court to provide guidance on duty to defend an indemnitee further that such agreements are subject to California's anti-indemnity statute. The indemnitor's duty to defend the indemnitee and to what extent or to reimburse depends on the language in the indemnification agreement.

If you are representing the developer/general contractor upon notice of construction defect claim, they should promptly make a defense demand under the indemnification agreement in writing to the subcontractor. Once made, it is normal to file a motion for summary judgement on the subcontractor's duty to defend and prevail at court to demand participation from the carriers of the insured in the defense of the claim. The date of defense is demanded is important because it is from that date that the liability for attorney fees will begin to accrue. Once an acceptance of defense has been made, the carrier should promptly request the identity of all carriers that are sharing in the defense and the current amount of attorney fees incurred to date and complete copies of all legal bills for the general contractor counsel. In some instances, this number can be significant depending on when the defense was accepted by the carrier and where in the process the case has proceeded to at time of pick up of defense.

If you are representing the subcontractor in matters where you receive an indemnification demand from the general contractor, the subcontractor carrier can defend the general contractor or deny the request. In California, the defense may be with the subcontractor counsel of their choice or pay a reasonable allocated share of the builder's general contractor's defense fees and costs subject to ultimate reallocation based on the proportionate fault that is established. In Florida, there is no such requirement or ability for a subcontractor to pay according to their fault. If a subcontractor accepts a duty to defend in Florida they are responsible for all of the general contractor's defense bill. Under Florida law, insurers are jointly and severally liable for defense fees and costs Miami Battery Mfg. Co. v. Boston Old Colony Ins. Co, 1999 WL 34583205 (S.D.Fla. April 28, 1999) The key for the carriers is always to request and review the copies of all legal bills of the general contractor's defense team.

In states where the subcontractor's carriers are able to pay the defense fees in according to their fault the payments by the carriers are considered paid "as damages" under the insuring agreement, which reduces the policy limit Golden Eagle Ins. Co v. Insurance Co of the West, 99 Cal. App. 4th 837 (2002). Each insurer in Louisiana is liable to indemnify only for its pro rate time on risk and if the insured is not covered for a period of time then, the insured bore its own pro-rate portion of the risk Norfolk So. Corp. v. Cal Union Co, 859 So.2d 167, 192 (La. App. 2003).

Another issue to consider as carriers for the subcontractor is which policy for the insured subcontractor or that of the general contractor is primary and which is excess. Which policy makes payment first? Adjusters need to look at the "other insurance" provisions within

the CGL insurance policies as well as the particular facts of the case Maryland Casualty Co. v. Nationwide Mutual Ins. Co, 81 Cal App. 4th 1082 (Cal 2000).

In assessing these contractual indemnification claims, it is good practice to identify who promised whom to indemnify for what and to determine if there are there more than one indemnitor (subcontractors) that will have to respond. The carriers should identify what the proportion of the defense is and discuss if they have to pay immediately. Does the GC insurer obligated to participate in the defense and indemnity and if so what is the obligation of primary v. excess insurance? Finally, the separate obligation of additional insured should also be determined and addressed by the carriers in negotiating the amount of attorney fees each insurer will be obligated to resolve.

The impact of indemnification is at times the developers and general contractors at mediation or during the life of the case will be hesitant to resolve the indemnity portion of the case with subcontractors. As discussed above, once the defense is acknowledged of the general contractor, the subcontractor carrier will review the legal fees incurred to determine the share owed. Where in the legal process the case is postured at the time of pick up is key to revealing how much will be owed. For instance, in Florida there is a pre-suit statute for construction defect claims known as Florida Statute section 558. The statute requires the claimant, defined as owner or association of the property, to give the general contractor and any others to include insurers' notice of the defects and the statute allows the contractor to perform testing, and notice to subcontractors within a certain timeline to provide a written response to claimant. Under Florida law there is no description as to whether or not the pre-suit notice under Section 558 is deemed to be considered a claim to require an insurer to open a claim, provide a defense, or be responsible for attorney fees and investigation of the defects from the date of the pre-suit loss notice. The Florida Supreme Court heard arguments on the issue in April 2017 on the issue but as of the date of this article the Supreme Court has not made a decision, Altman Contractors v. Crum and Forester Insurance Company, SCS16-1420 Florida Supreme Court, (April 6, 2017). The majority position has been that the indemnification and duty to share in attorney fees do not begin to incur until the litigation is filed against the contractor.

As the general contractor carriers at mediation it is essential that coverage counsel and or defense counsel is prepared to address the concerns of the participating insurers on amount of attorney fees billed and participating co insurers to the defense to determine the appropriate shares. In the perfect world, the information would be provided prior to mediation. At mediation, it is common to have both coverage and liability adjusters present as well as both defense and coverage counsel. Therefore, there can be at times 5 people in attendance for one subcontractor. The sooner the defense team can review all applicable information on coverages, and make an informed decision as to what is owed and by whom, the offers and responses as to settlement to the insured subcontractor will be conveyed. This requires a coordination among carriers and counsel in preparation of attendance at mediation. Also it requires the general contractor/developer's counsel to properly identify and notice the carriers whom they target for indemnity contribution early and often. The counsel needs to have a prepared demand to the insured subcontractor with both a liability damage number as well as an indemnification number and be prepared during negotiations to provide proof of both numbers to subcontractor carrier/counsel. This proof can be attorney fee bills for indemnification which should be current up through mediation attendance and for proof of liability, an expert report or having the expert for contractor present at mediation to offer their observations regarding the insured's scope of work. This requires planning but it is essential if

the mediation is to be a success for all parties. No one like surprises and surprises at the day of mediation does not result in increased payouts. The carriers need the above proof, 30 days before the scheduled mediation with updates provided at mediation to allow the carriers to properly evaluate exposure and set reserves for insured.

One of the pitfalls of not having the information available at mediation to make conveyed offers as to indemnity and liability dollars will prevent the subcontractor from being part of a carve out and early resolution of the matter. The longer the subcontractor stays in the case there is a potential the carrier will owe a larger share in the contribution of attorney fees depending on the state the matter is in.