



THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

2300 Wilson Boulevard, Suite 400 • Arlington, VA 22201
Phone: (703) 548-3118 • FAX: (703) 548-3119 • www.agc.org

SAMUEL P. HUNTER, President

HARRY L. MASHBURN, Senior Vice President

STEVE L. MASSIE, Vice President

VICTOR WESTON, Treasurer

STEPHEN E. SANDHERR, Chief Executive Officer

DAVID R. LUKENS, Chief Operating Officer

AGC White Paper On Additional Insured Endorsements

February 2006

“Additional insured” endorsements have become one of the hottest topics in construction risk management. The insurance industry has narrowed the standard form of this endorsement three times since 1985 and one of the leading writers on the subject now reports that “several state legislatures are considering limiting coverage for additional insureds even further.”

Following is a quick overview of the reasons why property owners, general contractors and other upstream parties to the construction process seek additional insured endorsements from downstream parties. Also following are:

- an equally quick overview of reasons why downstream parties often oppose these endorsements;
- a summary of the typical responses to the downstream parties’ concerns;
- a few words on the several changes in the standard form of the additional insured endorsement; and
- a note on the new legislation that some states are apparently considering.

Attached is a table comparing the various versions of the standard form of the endorsement. Also attached is a detailed article on the new legislation. The author of the article is Randy Maniloff, a Philadelphia lawyer who frequently represents insurance carriers. AGC of America has reproduced this article with his express permission.

Why Upstream Parties Seek AI Endorsements

Additional insured endorsements give project owners, general contractors and other upstream parties, such as first-tier subcontractors, at least some degree of insurance coverage under the commercial general liability (CGL) policies that downstream parties carry. The upstream parties use that coverage to finance at least a portion of the liability they risk whenever they construct a project, including liability:

- for any damages resulting from defects in the downstream parties’ work;
- for any injuries to those parties’ employees while working on or near the jobsite; and
- for any injuries to anyone else (such as a project owner’s guest) while on or near the jobsite.

Building Your Quality of Life

Upstream parties, and particularly general contractors, explain that they bear a great and still growing risk of liability for defects in their subcontractors' work. The relatively recent wave of mold litigation is just one piece of the larger problem that upstream parties have to manage. Even when given an additional insured endorsement, general contractors cannot normally recover the costs of correcting defects in their subcontractors' work from the latter's insurance carriers. General contractors normally have to file claims for such costs under their own insurance policies, or depend on their subcontractors to have the financial strength to bear them. As additional insureds, general contractors frequently can, however, file claims under their subcontractors' policies for the cost of repairing any property damage (as defined by the relevant policy) resulting from defects in their subcontractors' work, protecting themselves from the risk that their subcontractors will either refuse or lack the financial strength to pay for at least those repairs.

Upstream parties add that the workers compensation laws generally prevent the men and women working for their subcontractors only from suing their own employers for any bodily injuries that those employees may suffer in the course of their employment. In most states, the law permits such employees to bring "third-party-over actions" against project owners, general contractors and other parties -- other than their employers -- for such injuries.⁰ Upstream parties also seek additional insured endorsements from downstream parties to protect themselves from the risk of such "third-party-over actions," explaining that:

- as upstream parties, they risk tort liability for jobsite injuries to construction workers only if and to the extent that they subcontract work to the downstream parties, and do not perform the work with their own employees;
- the downstream parties are primarily responsible for protecting their employees, and should bear the total cost of injuries that their employees suffer, and not simply the portion that their workers compensation premiums cover; and
- jobsite safety will improve if the downstream parties have a financial incentive to protect their employees from all risks of injury, including risks that other parties to the construction process may either create or tolerate.

According to one insurance lawyer, "general contractors contend that most subcontractor employee injuries arise from the means and methods of that trade's jurisdictional work and are not the result of an overt act by the general contractor." This lawyer adds that "[a]s a result, the general contractor does not want its insurance loss record to be tagged with the third-party costs of the claims."⁰

⁰ For general contractors, the problem is often worse, because they often have a contractual obligation to defend the project owner against the third-party-over actions, and to indemnify the owner for any liability that may result.

⁰ All quotations are taken from short essays that were written for a special workshop that the International Risk Management Institute sponsored and held in conjunction with its 24th annual Construction Risk Conference in Orlando, Florida on November 8-11, 2004. The title of that workshop was "Allocating Risks in Construction Contracts."

A general contractor similarly writes that “standard construction agreements” merely “require each subcontractor to take control of its work and be responsible for claims that arise out of the performance of that work.” He maintains that “additional insured status avoids the more cumbersome process of tendering the claim or action to the subcontractor, who, in turn, must tender it to the insurance carrier and request that coverage be provided to the general contractor. . . .”

How Downstream Parties View AI Endorsements

Downstream parties often oppose additional insured endorsements on the grounds that such endorsements are easily abused. They note, for example, that the downstream party’s insurance carrier has a normally indivisible duty to defend the additional insured, and as a result, that carrier may find it necessary to defend every count of a broad multi-count complaint filed against an upstream party even if there is only one count qualifying for coverage under the downstream party’s policy.

Subcontractors also note that construction defects are often difficult to trace, and that several different defects may simultaneously contribute to any property damage that a project suffers. For these reasons, downstream parties maintain that they should have and retain the right to dispute that their negligence caused all or even part of such damage. They consider it simply unfair to require them to give upstream parties the right to go directly to their insurance carriers, without regard to whether, or to what degree, they may be at fault.

These downstream parties add that upstream parties are ultimately liable for any bodily injuries that may result from the construction of a project only if the upstream parties’ negligently caused those injuries. Subcontractors take the position that each of the parties to the construction process should bear the cost of any property damage or bodily injuries that its own negligence may cause, including the cost of insurance coverage for the risk of such damage or injuries.

As one insurance broker has written, the “contractual risk transfer model” that lies at the heart of most of today’s construction contracts “forces responsibility and payment for construction claims to be borne by subcontractors regardless of fault.” He adds that “the primary function of general contractors . . . is the selection, coordination, and supervision of subcontractors, including the scheduling, sequencing, inspection and instructive correction of their work,” and that additional insured endorsements merely “allow[] . . . project leaders to ‘pass the buck’ for their own mistakes to subcontractors.” Further, he complains that “[o]wners and general contractors who can successfully shift the financial consequences of accidental injury losses and defective construction to other parties . . . never face the consequences of their own actions and decisions affecting workplace safety and construction quality.”

Another broker notes that, “[o]ver the years, . . . the interpretations [of the standard form of additional insured endorsement] seemed to stray from the original intent, which was to provide

coverage for the additional insured's vicarious liability for activities or work of the named insured -- not to cover the sole negligence of the additional insured." An insurance carrier echoes that "[m]any courts have found that [the 1985 version of the standard form] confers additional insured status only for the vicarious liability of the additional insured . . ." but "other courts have construed [that version of the form] more broadly to confer additional insured status for the affirmative negligence of the additional insured." He adds that "courts have found coverage under [the 1985 version] even though the named insured was not at fault in the accident." Further, he notes that additional insured endorsements can dilute the available limits of the named insured's policy, and [c]reate a conflict of interest if a lawsuit is brought against both the named insured and an additional insured," requiring the insurance carrier to "appoint separate defense counsel for each party"

How Upstream Parties Respond to the Downstream Parties' Concerns

Upstream parties respond that expensive multiparty litigation would be necessary to allocate the responsibility for every construction defect and jobsite injury with the precision that downstream parties prefer. Upstream parties add that the cost of such litigation would offset any savings that downstream parties -- or more precisely, their insurance carriers -- would be likely to realize from taking a different approach. Upstream parties also note that the necessary litigation would long delay any settlements.

One general contractor writes that legal restrictions on additional insured endorsements "result in more cumbersome and expensive litigation, as multiple parties have to participate in the defense of an action that should clearly be allocated to the primarily responsible party," adding that, "[i]nstead of reducing insurance and litigation costs, such restrictions are most likely to increase those costs"

In direct response to claims that the insurance industry originally intended additional insured endorsements intended to provide coverage only for vicarious liability, one insurance lawyer suggests that limiting the coverage to vicarious liability would make little sense, as "Section 409 of the Restatement (Second) of Torts severely limits vicarious liability exposure in the construction setting." He adds that, "[i]f found liable at trial, general contractors are held *directly* negligent for their acts under traditional tort allegations." He also notes that, "[s]ince the named insured subcontractor is frequently immune from liability due to the . . . state workers compensation statutes, it is unlikely that prior to trial there would ever be a determination as to whether the bodily injury or property damage was caused, in whole or in part, by the named insured."

Overview of the Standard Form of Additional Insured Endorsement

The Insurance Services Office (ISO) is a group that the insurance industry founded and continues to fund for the purpose of developing standard forms of insurance. While many (particularly

regional) insurance carriers do not use all of these forms, many carriers do use them, and many others are influenced by their terms and conditions.

Presentations on the standard forms the additional insured endorsement inevitably begin with the version that ISO adopted in 1985. As the attached table reveals, that version is broad, granting an additional insured coverage for both property damage resulting from construction defects and third-party-over actions. The later versions of the form are, however, narrower. In an effort to cut off coverage for completed operations, and in turn, construction defects, ISO revised the form in 1997 and again in 2001. The 1997 version of the form limits coverage to “ongoing operations,” and the 2001 version further provides that it “does not apply” to events that occur after the named insured has completed its work, or the relevant portion of the project has been put to its intended use.

In 2004, in an effort to limit coverage for third-party-over actions (in not only the construction but also other industries) ISO went further. It revised the standard form to provide an additional insured with coverage “only with respect to” property damage or personal injury that the named insured also causes, at least in part. In other words, the latest version of the form eliminates coverage for the upstream party’s sole negligence, and it continues to provide coverage only if the name insured contributed to the damage or injury.

The practical effects of these changes are more difficult to assess. While the revisions to the form influence the insurance carriers, some continue to offer the older versions of the form, or several versions of it. Insurance brokers report that owners continue to demand, and on occasion, some large general contractors can still get the 1985 version of the form. General contractors are, however, finding it more and more difficult to get that version, and subcontractors are finding it impossible to do so.

More Recent Developments

In the attached article (published in May of 2005), Randy Maniloff reported that subcontractors had started urging state legislators to go even further than the insurance industry. Specifically, he reported that subcontractors were seeking legislation that forbid additional insured endorsements to provide coverage for the additional insured’s negligence even if and when the named insured contributed to the property damage or personal injury. He explained that “bills ha[d] been introduced in Arizona (SB 13230, California (AB 573), Colorado (SB 05-142), Illinois (HB 0704) and Texas (SB No. 445) that would preclude an insurer from providing defense and indemnity to an additional insured for its own negligence, even when the additional insured is not solely negligent.”

Conclusion

With the assistance of the insurance professionals and construction lawyers active in their areas, chapters and members should be able to assess the potential effects of any legislation that their

particular states are considering. In addition to the legislation that the attached article addresses, and perhaps as an alternative, some states have also considered, and in some cases, enacted statutes requiring project owners and subsequent purchasers to give construction contractors an opportunity to inspect and cure any alleged defects, before resorting to litigation. Some states have also expanded the definition of an “employer” for workers compensation purposes to include the project owners, general contractors and other upstream parties for whom subcontractors typically work.

Attachments