Construction Faces Coverage Challenges

by Dennis J. Artese and Allen R. Wolff

On three different occasions between 2001 and 2013, the standard forms for additional insured (AI) coverage in commercial general liability (CGL) policies sold to construction industry participants were revised to narrow access to such coverage. At the same time, various court decisions have taken a narrow view of the scope of "insured contract" coverage available to these policyholders under other portions of standard form CGL policies. The convergence of these two developments could portend trouble for the construction industry. Perhaps more than any other industry, construction depends on AI status and the ability to access insurance coverage for contractually assumed tort liabilities as standard risk management practice. These recent trends to narrow the available coverage suggest caution is appropriate for those who rely on AI and insured contract coverage in construction.

Recently, in *Gilbane Building Co./TDX Construction Corp. v. St. Paul Fire & Marine Insurance Co.*, an insurer used loose language in its own policy endorsement to dispute AI coverage sought by a construction company. The AI endorsement in the case specifically extended AI coverage where required by written contract, a practice common in the construction industry. The construction manager's (CM) agreement with the project's financier did indeed require any prime contractor to name the CM as an AI to the prime contractor's insurance, and the prime contractor did, in fact, agree to provide such coverage. It even issued a certificate of insurance to the CM evidencing that such insurance was in place. Yet, after a claim was brought against the CM, the prime contractor's insurance company denied AI coverage for the CM, arguing that the language of its AI endorsement required a direct contractual relationship between the primary policyholder (the prime contractor) and the additional insured (the CM), which did not exist.

The insurer pointed to language that required AI status be extended to someone "with whom you have agreed to add as an additional insured." The insurer successfully argued that this was different from a requirement to give such status to someone "for whom" the primary policyholder had agreed to extend AI coverage. The case was decided because of the preposition used in the insurer's own endorsement ("with" versus "for"), even though it was widely understood that such an interpretation was inconsistent with the custom and practice of the construction industry.

The impact of such a decision is that a direct written contract will now be required for every participant in the project between and among the tangled web of AIs, including owner, construction manager, general contractor, subcontractors, suppliers, consultants, engineer and architect. Such a requirement could inundate every project participant in additional paperwork and contract negotiations, and of course significantly increase the costs of project-contracting while complicating risk management.

Making matters worse, a smattering of federal and state court decisions over the past several years have taken a narrow view of "insured contract" coverage under standard form CGL policies. Insured contract coverage typically arises as an exception to the contractual liability exclusion where, for example, a project owner asserts a claim for contractual indemnity against a general contractor for losses the owner incurs because of bodily injury or property damage caused by the negligence of the general contractor or its subcontractors. Thus, even in instances where an owner is denied AI status under a general contractor's CGL policy, it may still be able to access coverage under that policy through the assertion of contractual indemnity claims against the general contractor.

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Many contractually assumed liabilities are excluded under CGL policies, but the "insured contract" exception recognizes coverage for contracts or agreements pertaining to the policyholder's business under which the policyholder assumes the tort liability of another party to pay for bodily injury or property damage, among other things, to a third person or organization. While the term "another party" is, on its face, quite broad, some courts considering this language outside the construction context (in *APL Co. Pte. v. Valley Forge Insurance Co.*, for example) have taken a restrictive view of the term. They have concluded that insured contract coverage applies only where the policyholder agrees to assume the "other contracting party's" tort liability to a third party.

Thus, under this view, the general contractor would be covered only for damages it incurs because of the owner's own tort liability to a third party. The general contractor would not be covered, for example, for its liability to the owner for bodily injury or property damage caused by the negligence of its subcontractors, even if the general contractor assumed such liability in its contract with the owner, as owners typically demand.

In the APL case, the court's interpretation of "another party" is at odds with several widely accepted rules of insurance policy construction, including that the plain language of a policy should be enforced as written, ambiguous language is construed in favor of coverage, exclusions are strictly and narrowly construed against the insurance company, and a court cannot rewrite the policy. Indeed, at least one court has applied the plain meaning of "another party," finding that the term is not limited to the other contracting party.

This is the only interpretation that makes any sense in the construction context, where most states have enacted anti-indemnity statutes. Such laws render unenforceable any agreement whereby one party to a construction contract agrees to indemnify another for that other party's own negligence. Thus, if "another party" meant the other party to the contract, insured contract coverage sold to construction industry participants would be virtually illusory.

The implications for policyholders are clear. Policyholders should carefully examine their insurance policies and make sure they are getting the coverage necessary for the risks they are undertaking. Do not accept language from insurance companies that includes terms that are unworkable or inconsistent with your custom and practice. There are several standard form AI endorsements that do not contain the problematic "with whom" language at issue in Gilbane. Contracting parties should specify appropriate AI endorsements in their contracts and ensure that such endorsements are in place during the contracting phase. Once a loss occurs, it might be too late.

Additionally, policyholders should consider obtaining a clarifying endorsement to address the view that the term "another party," as it relates to insured contract coverage, means "the other contracting party." ■

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