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Transferring Risk With Contracts, Insurance Coverage and Sometimes, Litigation

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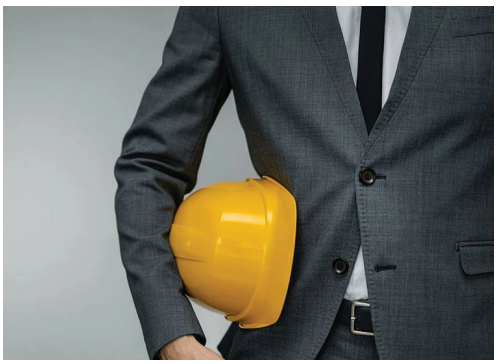
A recent decision from the U.S. District Court for the Eastern District of New York illustrates an effective approach for an owner or general contractor to receive defense coverage as an additional insured to a subcontractor's liability insurance.

In *Axis Construction v. Travelers Indemnity Company of America*, 2:20-cv-01125 (DRH) (ARL) (E.D.N.Y. Sept. 1, 2021), a general contractor was found to be entitled to such defense coverage as an additional insured, even though the original lawsuit did not name the subcontractor as a party. The original lawsuit was brought by an employee of that subcontractor, claiming injury on the jobsite for a gravity-related injury. As is commonly seen, the employee sued the general contractor, the property owner, and the property manager, asserting claims for an unsafe workplace under New York's Scaffold Law [N.Y. Labor Law §§240 and 241], among others. Worker's compensation laws precluded the employee from suing his employer, the subcontractor.

While specific to New York law, the approach in *Axis Construction* should be applicable in other jurisdictions for additional insureds seeking to effectuate the intended transfer of risk from a construction contract.

The Scaffold Law

The Scaffold Law is likely familiar to those involved in some aspect of construction law in New York. Among other things, the Scaffold Law holds property owners, contractors, and agents with authority to supervise and control a job strictly and absolutely liable for *any* injury to a worker that involves gravity—that is, a fall involving any change in elevation, be it the person or an object that falls—during a construction project. *Sanatass v. Consol. Investing Co.*, 10 N.Y.3d 333, 338-39 (2008). Comparative negligence is not a defense against claims within the Scaffold Law; therefore, if any violation of the Scaffold Law proximately caused the worker's injuries, it is irrelevant that the injured worker's own negligence contributed to the injury. See *Stankey v. Tishman Const. Corp. of N.Y.*, 131 A.D.3d 430, 430 (1st Dept. 2015). Duties created under the Scaffold Law are non-delegable. *Barreto v. Metro. Transp. Auth.*, 25 N.Y.3d 426, 433 (2015). Because liability imposed by the Scaffold Law is nearly inescapable, even dubious claims can



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lead to expensive, drawn out litigation.

A worker who brings a lawsuit might also file a worker's compensation claim to seek medical benefits from that worker's direct employer. In this situation, the worker's direct employer would not be named as a defendant in the lawsuit due to the statutory prohibition against suing an employer when the worker accepts workers' compensation benefits. See N.Y. Workers Comp. L. §11 *and* comparable statutes in other states. Additionally, the worker's compensation carrier may have a lien on the claimant's recovery. That discourages a claimant from settling for less than the amount of the worker's compensation lien.

Risk Transfers for Construction Projects

Prevent this dilemma from happening. Parties in a construction project often seek to contractually

transfer the risk of loss down a hierarchical chain starting from the owner to the general contractor to each service provider (i.e., a subcontractor) before undertaking the project. Such written contracts should require that a service provider defend, indemnify, and hold the contractor and owner harmless from claims for bodily injury or property damage caused in whole or in part by the acts or omissions of the service provider, or by those acting on the service providers' behalf.

The contract should also require that the owner and contractor be named an additional insured to the service provider's general liability insurance policy—particularly valuable in that such policies include a duty to defend. See *BP Air Conditioning v. One Beacon Ins. Grp.*, 8 N.Y.3d 708, 714 (2007) (describing duty to defend). The additional insured status can be made primary and noncontributory. This means the service provider's insurance fully exhausts before other insurance covers a loss.

Fighting for Coverage: the 'Axis Construction' Decision

The original lawsuit underlying *Axis Construction* was brought in New York State Supreme Court by an employee of general contractor Axis Construction's subcontractor. The employee sought compensation for a jobsite injury, alleging he was injured due to violations of the Scaffold Law when he tripped and fell at the jobsite. The subcontractor was not a named defendant in the employee's lawsuit due to the bar under the worker's compensation law.

This factual scenario demonstrates a serious problem for projects located in New York: The worker's compensation laws prevent a subcontractor's employee from suing the subcontractor for a jobsite injury, while the Scaffold Law incentivizes such suits against property owners and general contractors by imposing nearly inescapable liability on them for jobsite injuries. In other states, similar absolute liability laws have been repealed. Nonetheless, in other states where there is no Scaffold Law, owners and contractors can face similar situations as that in *Axis Construction*. An employee's claim, as pleaded in the underlying tort action, may precipitate an insurance company's denial of coverage even where the parties intended to transfer the risk by written contract.

In the *Axis Construction* fact pattern, each subcontract required a subcontractor to produce commercial liability insurance naming Axis as an additional insured on a primary and noncontributory basis "for claims caused in whole or in part by the [s]ubcontractor's negligence or omissions." Slip Op. at 3. In accordance with its subcontract, the subcontractor purchased a general liability policy from Travelers that contained a "Blanket Additional Insured (Contractors)" endorsement that extended additional insured status to Axis. When Axis was sued by the subcontractor's employee, Axis sought a defense from Travelers. Travelers denied coverage on the purported bases that (1) there was no evidence demonstrating the loss arose out of the subcontractor's work, and (2) there was no finding of negligence on the part of the subcontractor. Indeed, there was not even an allegation attributing negligence to the subcontractor recited in the injured employee's complaint.

Axis then served a third-party complaint in the state court action against the subcontractor alleging that the employee's injuries arose from the acts or omissions of the subcontractor. Even though the employee did not make such allegations in the original complaint, the general contractor's third-party complaint against the subcontractor did make those allegations. Based on the third-party complaint's allegations, the federal court held that the insurance company's duty to defend Axis had been triggered. Specifically, the federal court recognized that the allegations in Axis's third-party complaint established the possibility that liability on the part of the general contractor might have been caused, at least in part, by the acts or omissions of the subcontractor. The subcontractor itself therefore faced potential liability through that third-party complaint.

In its ruling, and perhaps with an appreciation of the policyholder's reasonable expectations of coverage, the federal court acknowledged the "realities of New York litigation practice." *Axis Construction*, Slip Op. at 13. Those realities include the statutory prohibition under the Workers' Compensation Law of the employee naming the subcontractor as a negligent party in the underlying lawsuit. Additionally, the federal court noted that the insurance company cannot limit its analysis of the duty to defend to only the original allegations in the employee's complaint; the insurance company must look to the third-party litigation connected to the original lawsuit. Finally, the

federal court considered Axis's Bill of Particulars in the third-party action, which furnished factual predicates to purported legal conclusions in the third-party complaint and supported finding the duty to defend to be triggered.

The Takeaway

Owners or contractors facing similar situations should consider the availability of third-party complaints against an injured worker's employer as a way to trigger additional insured status that could protect them. Such third-party actions, also called impleader or joinder actions, are not limited to New York practice. See, e.g., Fla. R. Civ. P. 1.180; N.J. R. 4:8-1; Pa. R. Civ. P. 2252; Tex. R. Civ. P. 38. If possible, the third-party complaint should contain sufficiently stated factual allegations regarding acts or omissions of a subcontractor that caused, in whole or in part (or using language in line with the terms of the insurance policy's additional insured endorsement), the injury suffered by the subcontractor's employee. Policyholders should also provide appropriate updates and information to the subcontractor's insurance company, even if there has been a denial, because facts might be developed in discovery in an action that support the duty to defend. See *Continental Cas. Co. v. Rapid-American*, 80 N.Y.2d 640, 648 (1993); see also, e.g., *City of Kingston v. Harco Nat. Ins. Co.*, 46 A.D.3d 1320, 1322 (3d Dept. 2007) (looking to complaints and examinations before trial to support finding of duty to defend).

Making Risk Transfer Effective

Of course, the foregoing is moot if an owner or contractor does not properly contract for risk transfer prior to the start of a construction project. In connection with this early transfer, the owner or contactor should ask for a copy of the service provider's general liability policy that extends additional insured coverage. Certificates of Insurance are insufficient to demonstrate the actual coverage available under a policy. An inspection of the actual policies should be done to ensure that bad exclusions do not frustrate the risk transfer that is intended by the contract.

For example, some insurance policies add an exclusion for "No Action Over," which excludes coverage for liability assumed under a contract when it involves an employee's claim for bodily injury. This exclusion seeks to preclude coverage for bodily injury claims such as those under New York's Scaffold Law. That exclusion could prevent a general contractor or owner from tendering the defense of an employee's claim back to the subcontractor, even when the subcontractor is contractually obligated to indemnify that owner or general contractor. In such circumstances, they may still have recourse against the subcontractor for breach of contract, but there may be no insurance backing it up. The construction contract should prohibit the "No Action Over" exclusion from being in any insurance policy on the project.

Finally, as a matter of course, a policyholder—be it an owner, contractor, or otherwise—nearly always should provide notice to each and all possibly obligated insurance companies. Even where a contract requires naming the contractor as an additional insured to be primary and noncontributory, insurance policies tend to include "other insurance" provisions. When those provisions are present, the subcontractor's insurance company might attempt to skirt its obligations by arguing that other insurance owing a duty to defend is available and thus the insurance policy is excess. Although priority of coverage is an issue that might have to be determined in litigation when all applicable policies are before a court, see, e.g., *Paramount Ins. Co. v. Fed. Ins. Co.*, 174 A.D.3d 476, 477 (1st Dept. 2019), the policyholder should not delay in providing notice. Multiple insurance companies might be co-obligated to cover costs to an additional insured, and improper notice might impair that coverage.

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