FEATURE

Avoiding Dangerous Gaps Between Contracts and Insurance

by Daniel F. McLennon and Marc L. Sherman

Risk abounds for subcontractors in whether and how they comply with contractual indemnity and insurance requirements.

Indemnity Requirements Risk

The primary risk is the "Type 1" indemnity clause, whereby the subcontractor assumes liability for the general contractor's and owner's own active negligence, whether or not the subcontractor did anything wrong. Many states have outlawed Type 1 indemnity clauses. California has chipped away at these clauses, most recently by enacting a commercial construction indemnity reform bill, S.B. 474. (For detailed analysis of this bill, please go to: **http://mclennonlaw.com/blog/?page_id=1144**.) In states that allow Type 1 clauses, it is essential the subcontractors negotiate to limit their indemnity exposure or ensure that their own insurance covers this contractual exposure.

In discussing with their brokers and carriers coverage for contractual indemnity obligations, subcontractors will want to be sure that the coverage provided includes coverage for the active fault of the hiring general contractor, and not just coverage for the damage caused by the subcontractor itself. If complete coverage is not provided, the subcontractor may be left paying out-of-pocket for damage caused by the general contractor that is somehow connected with the subcontractor's work.

Insurance Requirements Risk

Another key risk is the potential for a subcontractor to fail to comply with a general contractor's insurance requirements. If a subcontractor fails to cause its insurance carrier to provide coverage called for in the subcontract, the subcontractor itself may be called upon to pay what the insurance carrier would have paid, had proper insurance been provided.

Potential pitfalls are many. General contractors' insurance requirements are often quite detailed, consisting of several pages of single-spaced specifications for the coverage to be provided. Subcontractors should provide their brokers with the complete insurance requirements and ensure that the broker is procuring insurance that meets these requirements.

Areas to examine closely include:

- Coverage amounts (typical policy limits are $1 million, but general contractors may require more — subcontractors have been left exposed for damages well in excess of the $1 million base limit).
- "Per project" aggregates (where coverage must be provided on each of specified projects).
- Deductible and self-insured amounts (requirements may limit these to a certain amount, such as no more than $25,000).
- Who is required to or prohibited from paying the deductible or self-insured retention.
- Completed operations coverage (subcontractors do not want to be surprised to learn that their coverage lasts for only one year following completion).

Additional insured requirements present a huge trap for the unwary. General contractors often require subcontractors to provide the "gold standard" ISO CG 20 10 11 85 additional insured endorsement " or equivalent." Providing an "equivalent" may be harder than you imagine.

An additional insured, or "AI" as it is often called, is a person or entity that is specifically covered by another's insurance policy. The extent of such coverage is often limited by endorsements or certificates by which a carrier provides insurance to a third party. Subcontractors must understand that AI coverage is subject to both the

IN THIS ARTICLE . . .

- ***The primary risk is the "Type 1" indemnity clause.***
- ***Review the GC's insurance requirements.***
- ***Additional insured requirements can be a trap.***

limitations contained in its granting document — the applicable AI endorsement (generally not the ACORD certificate, which does not change the insurance policy terms) — as well as the relevant underlying insurance policy. In other words, AI coverage is usually no more extensive than the coverage a policy provides to the named insured — and it is often more limited.

The generally accepted gold standard Form 20 10 11 85 provides that an AI is covered for injury or damage arising out of the named insured's work, without stated limitations. It broadly provides that "an insured is a person or organization shown in the Schedule, but only with respect to liability arising out of 'your work' for the insured by or for you." Such AI coverage is usually also primary and other insurance is excess over it and non-contributory. This means that the insurance carrier issuing this form becomes the general contractor's primary carrier and should not be able to avoid providing coverage just because the additional insured general contractor has other insurance.

Form 20 10 11 85 does not have the limitations found within other AI endorsement forms. For instance, AI endorsement 18 16 01 06 provides AI coverage only for the named insured's ongoing operations performed for the AI, and it specifies there is no coverage for property damage occurring after completion. In contrast, AI endorsement 20 37 07 04 limits coverage to damages included within the products-completed operations hazard, that is, work that has been completed. Some insurance carriers or agents may take the position that forms 18 16 01 06 and 20 37 07 04, taken together, provide coverage "equivalent" to the Form 20 10 11 85. However, because of the specific language of each of these endorsements, the issuing carrier might avoid coverage for particular claims that would otherwise be covered under the Form 20 10 11 85. In other words, the combined forms may not be sufficiently equivalent to the Form 20 10 11 85 to satisfy contractual insurance requirements. They may leave gaps in coverage for which the subcontractor becomes responsible.

For instance, if an underlying policy has a provision that excludes damage arising from work completed before the policy's inception, as many policies do, there would be no coverage for the AI for damage occurring after the named insured's operations have been completed either in the inception year of the policy or subsequently. While other insurance in place when the operations occurred may provide coverage, such insurance is not always available.

Similarly, when work was completed before damage manifested, and damage was

Change in Insurance Practices Presents Potential Risk for Subcontractors

by Marc Ramsey

Construction contracts typically require at least 30 days advance notice of insurance cancellation, but a recent change in insurance practices could make subcontractors and contractors non-compliant with their contracts.

The Association of Cooperative Operations Research and Development (ACORD), the licensing company for insurance forms, has amended its certificate of insurance requirements so that certificates of insurance cannot promise that an insurance company or insurance broker will provide advance notice of insurance policy cancellation. Altering the form may run afoul of state laws.

"Subcontractors should carefully review all of their subcontracts and up-tier contract flow-down provisions pertaining to requirements to provide notice of cancellation of any insurance policy," said ASA member Richard B. Usher, Hill & Usher Insurance and Surety, Phoenix, Ariz.

The ACORD form change affects all standard contract documents and most manuscripted construction contracts that contractually require a 30-day advance notice of cancellation.

"The ACORD form change impacting certificates of insurance came out of nowhere and potentially puts contractors, subcontractors, design-builder and construction managers in breach of their contracts on Day 1," said Brian Perlberg, executive director for ConsensusDOCS.

ConsensusDOCS has developed model contract language for the ConsensusDOCS 200 prime contract that provides timely third-party notification of cancellation by the insurance company and creates an obligation on a party to give notice of cancellation to the owner or other upstream party:

"To the extent commercially available to the Constructor from its current insurance company, insurance policies required under subsection 10.2.1 shall contain a provision that the insurance company or its designee must give the Owner written notice transmitted in paper or electronic format: (a) 30 Days before coverage is nonrenewed by the insurance company and (b) within 10 Business Days after cancellation of coverage by the insurance company. Prior to commencing the Work and upon renewal or replacement of the insurance policies, the Constructor shall furnish the Owner with certificates of insurance until one year after Substantial Completion or longer if required by the Contract Documents. In addition, if any insurance policy required under subsection 10.2.1 is not to be immediately replaced without lapse in coverage when it expires, exhausts its limits, or is to be cancelled, the Constructor shall give Owner prompt written notice upon actual or constructive knowledge of such condition."

"The coalition-crafted solution is yet another example how ConsensusDOCS are the only standard contract documents that are updated for today's design and construction industry," Perlberg added.

Marc Ramsey is the ASA communications manager. He can be reached at (703) 684-3450, Ext. 1321, or **mramsey@asa-hq.com**.

not discovered before the policy's inception, coverage would be excluded under Form 18 16 01 06 because it excludes damage occurring after the named insured's operations have been completed. The subcontractor would have to look for AI coverage for its general contractor under a different policy or policy year. On the other hand, many policies exclude coverage for damage occurring before work has been completed, so the AI may end up with no coverage for the claim.

Likewise, work that was not completed and is ongoing when damage is discovered or manifested might be excluded by business risk provisions contained in most policies. These exclusions remove coverage for property damage arising during operations. On the other hand, Form 20 37 07 04 limits coverage to damages included within the products-completed operations hazard, i.e., work that has been completed. Again, the AI may end up with no coverage.Thus, for a subcontractor required to provide Form 20 10 11 85 or equivalent, the safest practice is to insist on AI coverage through Form 20 10 11 85. If the broker insists that alternative AI forms it recommends are equivalent to the Form 20 10 11 85, the subcontractor should get that recommendation in writing, so that the subcontractor might look to the broker's errors and omissions coverage if the recommendation proves wrong.

Conclusion

The informed subcontractor needs to work closely with its insurance broker to ensure that the subcontractor's insurance program protects the subcontractor for contractual indemnity exposure, as well as provides the insurance called for in the subcontract.

*Daniel F. McLennon is managing partner and Marc L. Sherman is of counsel with McLennon Law Corporation, San Francisco, Calif. Mr. McLennon can be reached at (415) 394-6688 or **dmclennon@mclennonlaw.com**. Mr. Sherman can be reached at (415) 394-6688 or **msherman@mclennonlaw.com**.*