Expert Commentary

Additional Insured Issues 2016—Part One

Traditionally, the prime risk transfer mechanism used between owners and general contractors or between general contractors and subcontractors was contractual indemnity.

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Liability Insurance

In trade contracts, the project owners typically require that the general contractor indemnify the owner. In turn, general contractors typically require contractual indemnity from subcontractors (as well as requiring subcontractors to indemnify the project owner). Similarly, higher tiered subcontractors require indemnity from lower tiered subcontractors as well as indemnity for the project owner or general contractor.

In other words, the financial consequences for certain liabilities at jobsites historically were shifted by the use of an indemnity provision in the trade contracts. Additional insured coverage (originally referred to as "additional interest" coverage) served as a backstop or safety net that applied only if the indemnity was partially or wholly unenforceable. Consequently, the premium charge made for additional insured coverage was minimal, if any charge was made at all.

For the most part, the only limitation on risk transfer via contractual indemnity was the clarity with which the indemnity obligation was drafted. In some cases, courts had deemed that an indemnitee (the person receiving indemnification) could transfer its *sole negligence* to the indemnitor (the person providing indemnification) only if such transfer was clearly and unequivocally stated in the indemnity provision. However, when states began to enact "anti-indemnification" statutes, everything started to change.

As states enacted statutes that specifically limited the scope of contractual indemnification (i.e., an anti-indemnity statute), the indemnitees looked to the safety net—additional insured coverage—to defend and pay damages on behalf of the indemnitee, also an additional insured. Understanding this shift in reliance to additional insured coverage and away from contractual indemnity due to the proliferation of anti-indemnity statutes[1] is necessary as context to lend perspective on today's additional insured issues.

Pre-2004 ISO Additional Insured Endorsement

The Insurance Services Office, Inc. (ISO), additional insured endorsements prior to 2004 provided coverage for the additional insured's liability "arising out of" the operations performed for the named insured. Much to the dismay of many insurers, courts generally found that "arising out of" was to be broadly interpreted and required only minimal causal connection between the acts of the named insured and the additional insured. One result was that courts found the phrase "arising out of" extended liability coverage to the sole negligence of the additional insured. Here is a typical example of such a finding:

> Royal Indemnity and United States Fire maintain that because the language extends coverage for liability arising out of Soneco's [named insured] work, there is no coverage for Konover [additional insured] where Konover's liability could arise only from its own negligence. [I]t is generally understood that for liability for an accident or an injury to be said to arise out of [an occurrence or offense], it is sufficient to show only that the accident or injury was connected with, had its origins in, grew out of, flowed from, or was incident to [that occurrence or offense], in order to meet the requirement that there be a causal relationship between the accident or injury and [that occurrence or offense]. I find, then, that Konover's motion for partial summary judgment is granted and Royal Indemnity's motion for summary judgment is denied.

Royal Indem. Co. v. Terra Firma, Inc., 948 A.2d 1101 (Conn. Super. Ct. 2006)

As insurers began to pay damages on behalf of additional insureds for whom the insurer had performed no underwriting and had charged a minimal premium, it became clear that the "arising out of" wording was providing much broader coverage than the insurers had intended. Additional insured coverage, stated differently, was no longer functioning as a safety net—it was the prime source of coverage and included coverage for the sole negligence of the additional insured.

ISO Additional Insured Endorsement Changes—2004

In early 2004, ISO filed revised additional insured endorsements to address the "arising out of" problem. "Arising out of" was replaced with "caused in whole or in part" by the "acts or omissions" of the named insured or by those acting on behalf of the named insured. In its circular promulgating these changes, ISO stated (in pertinent part) the coverage intended to be provided (and the coverage not intended to be provided):

> Some courts have ruled that, in the absence of specific language limiting coverage, the current additional insured endorsements do respond to injury or damage arising from the additional insured's sole negligence.
>
> Because the phrase "arising out of" has been interpreted broadly by some courts, we are revising several of the additional insured endorsements to add specific language to provide an additional insured with coverage *for their vicarious or contributory negligence only*. The additional insured will only have coverage for bodily injury, property damage or personal and advertising injury that is caused in whole or in part by the acts or omissions of either the named insured or those acting on behalf of the named insured. *A major effect of that wording will be to prevent any alleged coverage for the additional insured's sole negligence*. [Emphasis added.]

ISO Circular—General Liability LI-GL-2004-147, "Multistate Revisions to Additional Insured Endorsements," filed March 12, 2004.

Caused in Whole or in Part

There are some in the insurance industry that insist additional insured endorsements, regardless of the actual coverage wording, never provide any more coverage than for the vicarious liability imposed on the additional insured by the named insured's negligence. Here are pertinent portions of recent litigation that captures this view (and the court's rejection of that view):

> *First Mercury contends that the coverage under the Policy is limited to vicarious liability claims, i.e., for injuries caused by Fast Trek's acts or omissions*, and that the state court actions do not spell out a theory of vicarious liability because the complaints did not name Fast Trek as a defendant. *As to whether the Policy is so limited, we again find no language in the Policy supporting First Mercury's interpretation*. [Emphasis added.]

First Mercury Ins. Co. v. Shawmut Woodworking & Supply, Inc., 2016 U.S. App. LEXIS 16152 (2d Cir. Conn. Aug. 29, 2016)

A more detailed analysis of "caused in whole or in part" relative to vicarious liability is found in a recent Maryland case:

> Notably, the "liability ... caused, in whole or in part, by" language used in the Policy Additional Insured Endorsement indicates that the coverage afforded to Davis, as an additional insured, cannot be limited exclusively to claims of vicarious liability for Tricon's acts. In our view, it is unreasonable to interpret the term "liability" as used in the 2004 version of the ISO standard form additional insured endorsement as referring to "vicarious liability" because vicarious liability is an all or nothing proposition and thus a party could not be vicariously liable "in part" for [the named insured's] acts.
>
> *Indeed, because vicarious liability is used to impute liability to "an innocent third party," such liability cannot be caused merely "in part."* The third party to whom liability is imputed would not be "innocent" unless the wrongdoer's acts caused the liability "in whole." We, therefore, hold that the word liability in the policy at issue relates to proximate causation and not vicarious liability. [Emphasis added.]

James G. Davis Constr. Corp. v. Erie Ins. Exch., 126 A.3d 753 (Md. Ct. Spec. App. 2015)

Certainly, this does not end the debate as to whether "caused in whole or in part" is the equivalent of only vicarious liability coverage. However, there seems to be little support for this restrictive interpretation of ISO's "caused in whole or in part" wording.

Acts or Omissions—Negligence of Named Insured Required

Even though it has been over 12 years since ISO introduced the "acts or omission" wording in its additional insured endorsements, there does not appear to be any clear consensus as to whether "acts or omissions" requires a finding of negligence on the part of the named insured for the additional insured to be granted coverage. Some commentators' general reference to "fault-based" additional insured coverage suggests that bodily injury or property damage proximately caused by the named insured is not sufficient to result in coverage for the additional insured—that fault or wrongdoing by the named insured is required in addition to the named insured proximately causing the injury or damage.

The fault-based approach does have a basis in the findings of some courts:

> The language of the additional insured provision indicates that ECI's coverage under the additional insured endorsement cannot be divorced from the concept of fault. We therefore decline to interpret the additional insured endorsement in the manner urged by ECI, and instead conclude that the meaning of the additional insured endorsement is that it limits coverage to those instances in which the acts or omissions (i.e., negligence) of Bolduc [named insured] leads to ECI's liability.

Engineering & Constr. Innovations, Inc. v. L.H. Bolduc Co. Inc., 825 N.W.2d 695 (Minn. 2013)

If a finding of negligence is required to trigger coverage for an additional insured, then the "acts or omissions" wording has within it an obvious flaw. A very common claim against an additional insured is made by an employee of the named insured who is injured at the jobsite while in the course of employment for the named insured.

Most states' workers compensation statutes' exclusive remedy provision prohibits the injured employee (or members of the employee's family) from bringing a negligence claim directly against his or her employer. In many instances, workers compensation exclusive remedy also prohibits a common law indemnity claim or a common law contribution claim[2] against the named insured employer by the additional insured. Under these circumstances, the named insured employer will not be a party to the lawsuit brought by the employee or in an action over claims against the employer by the additional insured. Without being a party to a suit, there will not be a court finding or adjudication of negligence against the named insured employer.

In other words, if the phrase "acts or omissions" means that a court must find negligence on the part of the named insured to trigger payment of damages on behalf of the additional insured, one of the prime reasons for requiring additional insured status on the liability policies of a general contractor or subcontractor would

be frustrated. This outcome is quite vexing, particularly when considering the main purpose of additional insured endorsements.

Defense of an Additional Insured

In a state in which the duty to defend an insured is determined solely by the pleadings and the consideration of extrinsic evidence is strictly prohibited (the so-called "four-corners" or "eight-corners" states), certain claims will not trigger an insurer's duty to defend the additional insured. As above, this situation may arise when a claim is made by the named insured's employee against the additional insured. Because the pleadings by the employee will likely not include allegations of fault against the named insured employer, the insurer's duty to defend is not triggered.

> Admiral owes Gilbane a duty to defend only if the underlying pleadings allege that Empire, or someone acting on its behalf, proximately caused Parr's injuries. Applying the correct standard, the allegations in the pleadings do not implicate either Parr's or Empire Steel's fault. Gilbane asks us to create an exception to the eight-corners rule because, it argues, a plaintiff would never allege his own negligence. We are without authority to create an exception where the Texas Supreme Court has specifically declined to do so.

Gilbane Bldg. Co. v. Empire Steel Erectors LP, 664 F.3d 589 (5th Cir. Tex. 2011)

Insurers may *elect* to defend an additional insured in a "four-corners" or "eight-corners" state if the insurer believes they may have to pay damages on behalf of the additional insured, but this action is usually to protect the insurer's own interest and is not acting to discharge a duty to defend the additional insured. In some instances, additional insureds may seek either a pre-2004 ISO additional insured endorsement or an insurer's proprietary non-ISO endorsement to obligate the insurer to defend.

Acts or Omissions—Negligence of Named Insured Is Inferred

A less harsh outcome for the above situations is for the court to infer fault or negligence on the part of the named insured. While this may preserve some coverage for the additional insured, including defense (in states that allow consideration of extrinsic evidence in determining an insurer's duty to defend its insured), the inference of negligence does seem to diminish its meaning.

> The district court found that Parr was injured when he slipped while descending a ladder carrying an extension cord. He told a coworker immediately after he fell that his "feet got wrapped up in the extension cord." The district court concluded that "Parr's own conduct was a contributing proximate cause of his damages claimed in the Underlying Lawsuit" and that "[a] jury in the Underlying Lawsuit would have found Michael Parr or his employer, Empire Steel [named insured], 1 percent or more responsible for causing the occurrence and/or injuries at issue." Thus, under the terms of the policy, the district court concluded that Admiral had a duty to indemnify.

Gilbane, supra.

In the above case, in which defense was *not* afforded the additional insured, payment of damages on behalf of the additional insured *was* awarded by the court. The injured employee, Michael Parr, settled the claim against Gilbane absent any court finding of Mr. Parr's actual negligence while acting on behalf of his employer, Empire Steel, the named insured. Nonetheless, the court required damages payments on behalf of the additional insured, Gilbane, based on the district court's determination that a jury would find Mr. Parr or his employer at least 1 percent at fault.

Acts or Omissions—Only Proximate Causation Required

Considering the phrase "acts or omissions" is not modified by "negligent," it seems that the plain meaning would require only that the named insured (or those acting on behalf of the named insured) have proximately caused the bodily injury or property damage—no fault or negligence of the named insured need be determined to trigger coverage for the additional insured.

Certainly, fault plays a role—the insurer will not be required to pay damages on behalf of an *additional insured* that has no fault or negligence. But, in the first instance, the concern is triggering coverage for the additional insured—if coverage for the additional insured is not triggered unless and until a court determines actual negligence by or on behalf of the named insured, additional insured coverage is limited indeed.

One court case addresses this issue squarely:

> While it is true that, because NYCTA had not warned the Breaking Solutions' operator of the cable's presence, Breaking Solutions' "act" did not constitute negligence, this does not change the fact that the act of triggering the explosion, faultless though it was on Breaking Solutions' part, was a cause of Kenny's injury. The language of the relevant endorsement, on its face, defines the additional insured coverage afforded in terms of whether the loss was "caused by" the named insured's "acts or omissions," without regard to whether those "acts or omissions" constituted negligence or were otherwise actionable.

Burlington Ins. Co. v. NYC Transit Authority, 132 A.D.3d 127 (N.Y. App. Div. 1st Dep't 2015)

Conclusion

Risk transfer mechanisms continue to evolve from diminishing reliance on contractual indemnity, driven in large part by the spread of state anti-indemnity statutes, to heavy reliance on additional insured coverage endorsements. The coverage issues surrounding additional insured endorsement are also changing, ranging from coverage for the sole negligence of the additional insured to changes promulgated by ISO in 2004, including whether coverage is limited to the vicarious liability of the additional insured or whether the named insured must be found negligent to trigger coverage for the additional insured. While far from settled, understanding the context in which the ISO additional insured changes were made provides some insight into the coverage nuances.

The second article in this series will examine further coverage issues found in ISO's April 2013 additional insured endorsements, including the fact that some states have expanded their anti-indemnity statutes to apply to additional insured coverage. The implications and vastly different predictions as to the interpretation of the 2013 additional insured endorsements, including the new "to the extent permitted by law" and "no broader than" limitations, are important and need to be considered.

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[1]Today, 46 states have enacted construction anti-indemnity statutes—see *Construction Anti-indemnity Statutes*, a 50-state survey by Saxe Doernberger & Vita, P.C.

[2]A few states also prohibit a contractual indemnity claim against the employer named insured unless the indemnity specifically provides for the indemnification of the injuries to the named insured employer's employees.

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