

MANAGING CLAIMS AGAINST GENERAL LIABILITY INSURANCE POLICIES

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Introduction and Overview

- Overview of Role of General Liability Insurance on Construction Projects
- Coverage for “Occurrences”
- Managing Repairs of Defective Work
- Standard (and unstandard) Exclusions
- Occurrence before and after completion
- Duty to Defend All Claims
- Insurer’s right to recover defense costs

Role of CGL Insurance

- Role of General Liability Insurance
- Covers “occurrences”
- Generally, means property damage and personal injury
- “We will pay those sums that the Insured becomes legally obligated to pay as damages because of ‘bodily injury’ or ‘property damage’ to which this insurance applies.”

Role of CGL Insurance

- Intent is not to provide coverage for damage to the work while it is under construction
- That is the function of the All Risk Property Policy
- So CGL policy is structured to avoid coverage for damage to the work prior to completion
- This generally means that during construction, if there is damage to the work, the CGL policy will not provide coverage, but the Builder's Risk policy will provide coverage.
- Some exceptions to this rule

Date of Risk Transfer

- Coverage under the Builder's Risk Insurance normally ends upon substantial completion of the project.
- At this point, the Owner needs to procure a Property Policy, and coverage may also be more available under the CGL insurance
- This date of risk transfer can be important
- Royal Palm Resort Case Study

Coverage is Limited to “Suits”

- “We will have the right and duty to defend the insured against any ‘suit’ seeking those damages.”
- Typical policy provision
- “Suit” is defined as a civil action including arbitration
- For years it was unclear whether CGL policies covered “claims”
- *Foster Gardner v. National Union Fire Ins. Co.* (1998) 18 Cal. 4th 857 clarified that CGL policies cover lawsuits, not claims.

Managing Repairs

- There is no coverage if there is no lawsuit.
- If an insured conducts repairs for a covered loss, there is no coverage for the repair costs, as this violates the clause that provides “no loss expenses or legal expenses shall be incurred on behalf of the company without its prior consent.”
- Jamestown Builders, Inc. v. General Star Indemnity Co. (1999) 77 Cal. App. 4th 341

Managing Repairs, cont.

- So when a general contractor is faced with claims for construction defects, it can either invite the Owner to file a lawsuit, and tender the lawsuit and trigger coverage, or it can conduct repairs, for which the insurer will not pay because there was no lawsuit.
- Sophisticated insureds can obtain coverage even where there is no lawsuit.
- Some Contractors choose to conduct repairs rather than invite a lawsuit from an Owner.

Managing Repairs, cont.

- In such a case, if the process is managed properly, money can be obtained from the CGL insurer for the general contractor.
- The process can be managed in several ways.
- The Contractor needs to develop and price a proposed scope of repair.
- The Contractor then provides notice to its CGL insurer of the claim and scope of repair.
- The Contractor then notifies its CGL insurer that it intends to conduct the repairs and that if it does not, a lawsuit will likely be filed.

Managing Repairs, cont.

- Two scenarios are then possible.
- The Contractor negotiates with the CGL carrier for a contribution to the scope of repair.
- In exchange, the Contractor will be required to provide the CGL carrier with at least an issue release, and the CGL insurer will ask for a project release.
- The Contractor then undertakes the work and files a lawsuit against the subcontractors who performed the defective work.
- Manage the process so that the Contractor actually makes money.

Managing Repairs, cont.

- Second scenario, Contractor does not undertake repairs.
- The Contractor allocates the estimated costs of repair to the subcontractors and negotiates with the responsible subcontractors and their CGL insurers for contributions to the scope of repair.
- At some point in time the Contractor goes back to its CGL insurer for a contribution to cover the shortfall in money that can be obtained from the Subcontractors.

Managing Repairs, cont.

- In either scenario, stress the fact that the damages are covered losses, that the CGL insurers are going to have to pay for the repairs, and it is in the interests of all parties to avoid expensive and protracted litigation.
- Either scenario requires a sophisticated general contractor, and the process needs to be managed closely.
- Letters explaining in detail why the losses are covered losses are crucial.
- The process will usually only work when you have obvious covered losses, i.e. a leaking building.

Exclusions

- CGL policies in California contain a number of standard, and several non-standard, exclusions.
- OCIPs exclusion all policies
- Residential Construction – Condos and SF Homes
 - Case study: Excluded “new residential construction”
 - Policy was issued on condo project a year after construction was completed
 - Issue was whether the exclusion applied to construction that was newly constructed by the insured, or newly constructed during the policy period.
- More recent versions are much broader and specify “newly constructed by the insured”.

Exclusions, cont.

- Independent Contractors Endorsement
 - This takes different forms
 - One approach, requires the Contractor to obtain insurance from subcontractors at least as broad as the insurance issued to the Contractor, to have the Contractor named as an additional insured under the policy, and to include an indemnity clause in the Subcontract that is “as broad as is allowable under applicable law.”
 - There is a case that holds that the failure of the Contractor to do so precludes coverage under the Contractor’s CGL policy

Exclusions, cont.

- Independent Contractors Endorsement
 - Another approach, requires the Contractor to obtain insurance from subcontractors in specified amounts, to have the Contractor named as an additional insured under the policy and a written indemnity agreement.
 - The exclusion provides that there is only coverage for work performed by Subcontractors if these conditions are met.
 - This means that if the Contractor fails to meet these conditions, there is no coverage for the Subcontractor's work.

Exclusions, cont.

- Independent Contractors Endorsement
 - For a general contractor who does not self-perform a great deal of work, these provisions are very unfair.
 - The general contractor pays general liability insurance premium based on its total revenues.
 - The vast majority of a general contractor's revenues are paid to its subcontractors.
 - Under these types of clauses, the Contractor is effectively paying premium on costs for which there is no insurance coverage under its general liability insurance policy.

Exclusions, cont.

- EIFS exclusion
- Land and soils movement
- Asbestos
- Respirable dust

Endorsements

- Contractor's Rework Endorsement
- OCIP issued to LAUSD for \$1 billion of new construction
- Public works contractor completed one project and was terminated on two other projects
- Tendered defense of Owner's claims for defective work
- Insurer denied on completed and incomplete projects

Coverage Before and After Completion

- Concept of claims before and after completion is important, not just in context of the special endorsement discussed above.
- “Business risks” or “operations” exclusions.
- Are found in exclusion j, damage to property.

Coverage Before and After Completion, cont.

- J5: Excludes coverage for 'Property Damage' to "that particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the 'property damage' arises out of those operations."

Coverage Before and After Completion, cont.

- J6: Excludes coverage for 'Property Damage' to "that particular part of any property that must be restored, repaired or replaced because 'your work' was incorrectly performed on it."
- There is a clause under j that provides that "Paragraph (6) of this exclusion does not apply to 'property damage' included in the 'products-completed operations hazard.'"

Coverage Before and After Completion, cont.

- For the general contractor's CGL policy, it is difficult to imagine a situation where either j5 or j6 would not apply. j5 excludes coverage for ongoing operations. j6 excludes coverage for work that was incorrectly performed.
- For a subcontractor's CGL policy, you can still get coverage for damage caused by the subcontractor to another trade's work.
- Atherton mansion case study.

Coverage Before and After Completion, cont.

- Where the work has been substantially completed, coverage is afforded under the “completed operations” exclusion.
- J5 no longer applies because the contractor and subcontractors are no longer performing operations.
- J6 no longer applies because there is an exception for work included in the “products completed operations hazard.”

Coverage Before and After Completion, cont.

- Exclusion I excludes coverage for

“Property damage” to “your work” arising out of it or any part of it and included in the “products-completed operations hazard.”

This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.

Coverage Before and After Completion, cont.

- “Products-completed operations hazard is defined to include “bodily injury” and “property damage” occurring away from premises you own or rent and arising out of “your product” or “your work”.
- The exception from exclusion I in the last sentence restores “coverage” for many completed operation related liabilities.

Coverage Before and After Completion, cont.

- In summary, for property damage to the work prior to substantial completion, there is probably no coverage under the Contractor's CGL policy
- The coverage under the Subcontractor's CGL policies is probably limited to situations where there is damage to work of other trades with fairly extreme fact patterns.

Coverage Before and After Completion, cont.

- For post completion defect claims, there should be coverage under the Contractor's general liability insurance policy.
- There should also be coverage for the general contractor as an additional insured under the CGL policies issued to the Subcontractors.

Duty to Defend All Claims

- Where there is a duty to defend ANY claim by a CGL carrier, the duty extends to all claims, both covered and un-covered.
- *Presley Homes v. American States Ins. Co.* (2001) 90 Cal.App. 4th 571.
- This can lead to some anomalous results.
- Case study.

Duty to Defend All Claims, cont.

- In practice, the general tenders to all of the subcontractors' general liability insurers where it is an additional insured, the insurers agree to accept the defense, but the general continues to employ its own attorney.
- The general submits invoices to the subcontractor's insurers for reimbursement of the subcontractors' share of the general's defense costs.

Insurer's Reimbursement of Defense Costs

- Buss v. Superior Court (1997) 16 Cal. 4th 35; Aerojet-General Corp. v. Transport Indem. Co. (1997) 17 Cal. 4th 38.
- In a “mixed” action (some claims covered and some not) the insurer can seek reimbursement from insured for defense costs so long as the claim is not even potentially covered.
- In order to do so, insurer must have issued a reservation of rights.

Insurer's Reimbursement of Defense Costs, cont.

- The insurer carries the burden of proof and it may only seek reimbursement of costs *solely* allocable to claims not potentially covered under the policy.
- The insured must decide whether it wants to mount its own defense of claims not potentially covered by the policy, knowing that if the insurer defends such claims, it may have to reimburse the insurer for the costs incurred.

Insurer's Reimbursement of Defense Costs, cont.

- The Supreme Court in Buss suggested that it will be very difficult for an insurer to prove up costs incurred SOLELY to defend claims for which there was no potential for coverage, using the word “infeasible”.
- Thus, as a general matter the insured incurs little risk in simply tendering the defense of all of the asserted claims.

Additional Insured Endorsements

A. Used to be handed out like candy, now difficult to get, and various limitations

1. Some policies for general contractors require that general obtain additional insured (AI) endorsements from subcontractors, otherwise no coverage under general policy
2. ISO 2009 – no coverage for completed operations
3. Pre-1993 ISO 2010 – coverage for completed operations
4. Post-1993 ISO 2010 – may or may not provide coverage for completed operations

Additional Insured Endorsements

B. PURPOSE

1. Adds an additional party as insured under someone else's policy
2. Accomplished via an endorsement to the policy
3. Benefits
 - a. No deductible
 - b. More available limits
 - c. No claims history

Additional Insured Endorsements

C. Scope of coverage is defined by additional insured endorsement

1. ISO 2009 – no completed operations coverage
2. ISO 2010 – may include completed operations coverage
3. Endorsements to incorporate contractual obligations
4. Coverage limited to liability arising out of the named insured's work
 - Note important difference between “arises out of” and “results from”

Additional Insured Endorsements

C. Scope of coverage is defined by additional insured endorsement (*cont.*)

5. How long should additional insured status be maintained?
6. Impact of ongoing operations to additional insureds
7. Is contribution between two primary carriers allowed:
Rossmoor Sanitation v. Pylon, Inc. (1975) 13 Cal.App.3d 622
8. Is an excess policy naming a party as an additional insured excess to the insured's own primary policy? *Reliance National Indemnity Co. v. General Star Indemnity Co.* (1999) 72 Cal.App.4th 1063

Additional Insured Endorsements

C. Scope of Coverage is defined by the additional insured endorsement (cont.)

Additional Insured Coverage Under CG 20 10 11 85

Name of Person or Organization

WHO IS AN INSURED (Section II) is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of "your work" for that insured by or for you.

Additional Insured Endorsements

C. Scope of Coverage is defined by the additional insured endorsement (cont.)

2004 CG 20 10

- A. Section II – Who Is An Insured is amended to include as an additional insured the person(s) or organization(s) shown in the Schedule, but only with respect to liability for “bodily injury,” “property damage” or “personal and advertising injury” caused, in whole or in part, by:
1. Your acts or omissions; or
 2. The acts or omissions of those acting on your behalf; in the performance of your ongoing operations for the additional insured(s) at the location(s) designated above.

Additional Insured Endorsements

D. Additional insured coverage extends to additional insured's negligence

1. Additional insured covered for its sole negligence
2. Insurance Code § 11580.04 – public entity cannot receive additional insured coverage for its active negligence

Additional Insured Endorsements

E. AI contract provisions

1. Require AI coverage with specific endorsement
2. Specify criteria for insurer, limits, policy form, or required coverage
3. Require copy of endorsement
 - Contrast certificates of insurance and AI endorsements
4. Require additional insured coverage to be primary to coverage maintained by additional insured
5. Require named insured to act as insurer if policy contains layers of self insurance