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TOP 2018 INSURANCE COVERAGE DECISIONS IMPACTING GENERAL CONTRACTORS AND CONSTRUCTION MANAGERS

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As insurance continues to play a pivotal role in the resolution of construction-related claims, general contractors and construction managers should be keenly aware of risk transfer opportunities. Conversely, obstacles to such transfer should be reviewed in an effort to develop strategies to circumvent them. The following recent decisions identify key coverage issues affecting general contractors and construction managers and should prove insightful in developing an effective strategy to maximize insurance recovery for the myriad of risks facing contractors.

1. *Wrap Exclusions*

Continental Casualty Co. v. Amerisure Ins. Co., 886 F.3d 366 (4th Cir. 2018)

Key Facts: The general contractor, KBR Building, entered into a subcontract for the steel infrastructure on a hospital project. The steel subcontractor then further subcontracted out the steel erection work to another contractor (sub-contractor). An employee of the sub-subcontractor was seriously injured on site and commenced a lawsuit against the general contractor and prime subcontractor. The general contractor was enrolled in a rolling OCIP program, however, the two relevant subcontractors were not enrolled. As an additional insured, KBR tendered the suit to the liability carriers of the subcontractors, Continental Casualty Company and Amerisure Insurance Company. While Continental accepted the tender, Amerisure denied coverage and argued that a wrap-up exclusion (CIP exclusion) applied to bar coverage. Continental settled the claim on behalf of the general contractor and prime subcontractor and commenced this action against Amerisure for reimbursement. The court considered whether the wrap-up exclusion applied to bar additional insured coverage for the general contractor where the subcontractor is not enrolled in the OCIP.

Holding: The wrap-up exclusion at issue barred coverage for "bodily injury…arising out of the insured's ongoing operations…if such operations were at any time included within a 'controlled insurance program' for a construction project in which you are or were involved." The court interpreted the exclusion to state that "only injuries arising from the sub-subcontractor's operations were excluded…[and] any injuries allegedly arising out of the operations of [the general contractor] or [subcontractor] were not subject to the wrap-up

exclusion." In construing the "arising out of" language, the court read the underlying plaintiff's complaint to suggest that there was at least a possibility that the injuries resulted from the operations of other contractors. Therefore, the exclusion did not apply to bar additional insured status for the general contractor and Amerisure was required to indemnify Continental.

Impact for General Contractors/Construction Managers: In a wrap-up setting, while this decision suggests that a general contractor may be able to obtain coverage under an unenrolled subcontractor's CGL policy containing a wrap-up exclusion, it is by no means a guarantee. General contractors should seek to enroll key subcontractors in the wrap-up program. Similarly, for any unenrolled subcontractors, it would be wise for general contractors to review their policies to make themselves aware of any potential wrap-up exclusions. In the event that these issues are unavoidable, however, *Continental Casualty Co. v. Amerisure Insurance Co.* may prove useful in helping general contractors secure additional insured coverage from unenrolled subcontractors.

2. *Construction Defect as an "Occurrence"*

Ohio Northern University v. Charles Construction Services, Inc., 2018 WL 4926159 (Ohio 2018)

Key Facts: Ohio Northern University hired general contractor Charles Construction Services, Inc. ("CCS") to construct a university inn and conference center. CCS obtained CGL insurance from Cincinnati Insurance Company. CCS delivered the project to Ohio Northern University who subsequently initiated a lawsuit for various construction defects. According to the suit, the damage was predominately the result of faulty subcontractor work which caused water infiltration and damage to otherwise non-defective work. Cincinnati Insurance Company offered a defense under a reservation of rights, but subsequently filed a declaratory judgment action against CCS for a determination that it had no duty to defend or indemnify CCS for the alleged construction defects.

Holding: The Ohio Supreme Court sided with Cincinnati, holding that faulty workmanship did not meet the definition of "occurrence" under CCS' policy. The court viewed faulty workmanship more as the consequence of business risks as opposed to a fortuitous event. According to the court, "…the policies do not insure an insured's work itself; rather, the policies generally insure consequential risks that stem from the insured's work…Here, we cannot say that the subcontractors' faulty work was fortuitous."

Impact for General Contractors/Construction Managers: This decision makes the insurance landscape for construction defects much less favorable for general contractors in the state of Ohio. Based on this decision, general contractors cannot rely on CGL policies for coverage for claims of defective workmanship, even if the damage is predominately the result of a subcontractor's work. General contractors should carefully consider these risks

when evaluating the costs associated with construction work in Ohio. Importantly, this decision is contrary to the law in the majority of states where courts have held that construction defect claims can constitute "occurrences" under a CGL policy. At the end of the opinion, the court suggested that the legislature can abrogate the ruling by passing a statute which includes faulty workmanship in the definition of "occurrence," though it is unclear whether or not there has been any serious effort by the Ohio legislature to do so. In the meantime, general contractors working in Ohio should seek to obtain an endorsement on their CGL policies to clarify that "occurrences" include any circumstance where a defect or deficiency in "your work" results in damages because of "property damage" so long as the "property damage" was not intended by them.

3. *Additional Insured Endorsements and Contractual Privity*

Gilbane Bldg. Co./TDX Constr. Corp. v. St. Paul Fire & Marine Ins. Co., 97 N.E.3d 711 (N.Y. 2018)

Key Facts: In a laboratory construction project, Gilbane Building Company and TDX Construction Corporation were retained by the Dormitory Authority of the State of New York as construction managers, while Samson Construction was retained by the owner as general contractor. After adjacent buildings began to settle due to faulty foundation work by Samson, the owner filed suit against Samson and the architect and the architect brought a third-party claim against Gilbane/TDX for its alleged involvement. The construction contract required Samson to name Gilbane/TDX as additional insureds, though there was never any direct contractual relationship between Samson and Gilbane/TDX. After the architect filed its claim against Gilbane/TDX, they tendered the claim to Samson's CGL insurer and requested additional insured coverage. Relying on the additional insured endorsement language, Samson's insurer argued that it had no duty to defend or indemnify Gilbane/TDX as additional insureds because Samson had no direct contract with them.

Holding: The decision of the New York Court of Appeals hinged on the language of the AI endorsement in Samson's policy which defined an additional insured as "any person or organization *with whom* you have agreed to add as an additional insured by written contract." The court first rejected Gilbane/TDX's argument that the provision was ambiguous. It then analyzed the specific language of the endorsement, focusing in particular on the phrase "with whom." The court explained that to read the language in the manner that Gilbane/TDX suggested would render the word "with" meaningless: "[H]ere, the 'with' can only mean that the written contract must be 'with' the additional insured." Thus, parties must be in direct contractual privity with each other in order to obtain additional insured status based on this particular language.

Impact for General Contractors/Construction Managers: Construction managers should be aware of the specific wording of both their contracts and subcontracts as well as the language contained in the additional insured endorsements of those entities with whom they

do business. There are AI endorsements available, such as CG 20 38 04 13, for example, which do not require contractual privity. In the event that the AI endorsements contained in any downstream parties' policies contain language requiring privity, construction managers should reject these endorsements and explain why such language is contrary to the parties' intent.

4. *Statutory Notice of Defects and Right to Repair as a "Suit"*

Altman Contractors, Inc. v. Crum & Forster Specialty Insurance Company, 232 So.3d 273 (Fla. 2017)

Key Facts: Florida is among approximately thirty states that require owners to serve contractors with notice of defects before filing a suit. The contractor is then given an opportunity to cure the defects before formal suit is filed. Altman Contractors was responsible for the construction of a condominium in Broward County, Florida. After construction was completed, the owners served Altman with notice of hundreds of defects and demanded that Altman cure them (558 notice). Shortly after, Altman notified its CGL carrier, Crum & Forster, of the demands and requested a defense and indemnification under the terms of the policy. Crum & Forster denied any defense or indemnification responsibilities on the basis that the 558 notices did not constitute a "suit." Altman Contractors then commenced this coverage action.

Holding: The Florida Supreme Court first reviewed the policy's definition of "suit," which defined it to include a civil proceeding, arbitration, or any other alternative dispute resolution proceeding. Focusing on "alternative dispute resolution proceeding," the court referenced Black's Law Dictionary and defined the term as "[a] procedure for settling a dispute by means other than litigation." The court held that Florida's statutory notice was a form of alternative dispute resolution, falling within the policy's definition of "suit" and therefore trigged coverage for Altman Contractors.

Impact for General Contractors/Construction Managers: A statutory notice-to-repair is a necessary prerequisite to instituting construction defect litigation against a contractor in the state of Florida. Under this holding, an insurer's duty to defend a contractor under a CGL policy is triggered by such a notice and demand to cure; not at the point that formal litigation ensues. Contractors are now entitled to a defense earlier, which means potentially significant savings for contractors in disputes with owners. Contractors should be mindful that, upon receipt of such a statutory notice to repair, they should promptly tender this notice to their CGL insurer and demand defense and indemnity. Since thirty states have similar statutes or requirements, this case is likely to have influential impact beyond the state of Florida.

5. *Negligent Hiring, Retention and Supervision Claims*

Liberty Surplus v. Ledesma & Meyer Construction, 418 P.3d 400 (Cal. 2018)

Key Facts: L&M Construction contracted with the San Bernardino Unified School District to renovate a school building. While work was being performed on the building, an employee of L&M allegedly sexually assaulted a student on the job site. This conduct became the subject of the underlying suit against the contractor for negligent hiring, supervision, and retention of the employee. L&M tendered the suit to its CGL carrier who defended under a reservation of rights arguing that the employee's intentional conduct did not constitute an "occurrence." The insurer subsequently filed a declaratory action on the coverage issue.

Holding: The coverage action made its way to the Ninth Circuit which then certified the following question to the California Supreme Court:

> "*When a third party sues an employer for the negligent hiring, retention, and supervision of an employee who intentionally injured that third party, does the suit allege an 'occurrence' under the employer's commercial general liability policy?*"

The court relied on the negligence language within the complaint, holding that the CGL policy provided coverage for the insured's negligent acts despite the employee's intentional conduct. The complaint sought to hold the contractor liable for its negligent conduct in hiring and retaining the employee, rather than for any intentional conduct that the employee himself might have committed. As to the duty to defend, the insured need only show that the underlying claim may fall within policy coverage while the insurer must prove it cannot. Accordingly, L&M was entitled to coverage under the CGL policy.

Impact on General Contractors/Construction Managers: Even though the suit arises from conduct which may be intentional in nature, it is the allegations against the insured contractor which determine coverage. In this case, those allegations related to alleged negligent acts, and not intentional conduct. Of course, contractors should be fastidious and careful in the manner in which they hire, train, and supervise employees. However, they should not—and will not under this case—be deprived of coverage because of an employee's intentional conduct.

6. *Number of Occurrences in Property Damage Context*

AIG Specialty Ins. Co. v. Liberty Mut. Fire Ins. Co., 2018 WL 18630569 (D. Nev. Apr. 18, 2018)

Key Facts: Approximately three years after the new Palazzo Hotel was completed, the owners noticed significant corrosion of steel support framing in various areas of the hotel. It became clear through investigation that moisture leaked into a crawl space which corroded the steel framing. The investigation further revealed that the contractor did not use galvanized steel as required and that the steel support system in certain areas of the hotel would have to be replaced. The owner sued the contractors involved in the project, resulting in a dispute between the primary and excess insurers over the number of occurrences and the liability under each policy. The underlying suit settled for under $4,000,000, making the dispute between the primary and excess insurers ripe for adjudication. On one side, Liberty issued a primary policy with limits of $2,000,000 per occurrence and $4,000,000 in the aggregate and argued that there was only one occurrence. On the other side, AIG as the excess insurer argued that there were multiple occurrences and that Liberty's aggregate limit covered the entire settlement. Both parties moved for summary judgment on the issue.

Holding: The court applied the "causal" approach to determine the number of occurrences in this construction defect setting. Under this approach, "the inquiry focuses on the cause or causes of the injury, not on the number, magnitude or time of the injuries. Thus, as long as the injuries stem from one proximate cause there is a single occurrence." *AIG Specialty Ins. Co. v. Liberty Mut. Fire Ins. Co.*, 2018 WL 1863056, at *3 (internal citations omitted). However, it cautioned that "the test is more easily stated than applied, particularly in this case." *Id*. In denying both motions for summary judgment, the court stated that the interpretations proposed by both parties would lead to improper results. Liberty's interpretation was too expansive and would "make almost all construction defects a single occurrence." *Id.* at 4. AIG's interpretation, on the other hand, was far too broad and conflated acts of negligence with an "occurrence." Avoiding the issue, the court expressed no opinion on whether the defects asserted constituted one occurrence or multiple occurrences.

Impact for General Contractors/Contract Managers: While the decision of the district court does not provide a precise answer to the question, it does provide some guidance on the occurrence issue for general contractors. This debate is an important one particularly in the property damage context where there is limited case law. The outcome of this debate is determinative of whether the primary insurer's aggregate limits come into play or whether excess insurance is triggered. This decision suggests that courts are largely undecided on how to analyze the number of occurrences issue- an interpretation suggesting one occurrence for multiple independent causes is not inclusive enough, while an interpretation suggesting that each independent incident of negligent conduct constitutes a separate occurrence is too broad. Contractors should be mindful of this issue in an effort to maximize insurance recovery taking into account deductibles, SIR's and limits.