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From the Bottom of the Food Chain Looking Up: Subcontractors Are Finding That Additional Insured Endorsements Are Giving Them Much More Than They Bargained For

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**FROM THE BOTTOM OF THE FOOD CHAIN LOOKING UP:
SUBCONTRACTORS ARE FINDING THAT ADDITIONAL INSURED
ENDORSEMENTS ARE GIVING THEM MUCH MORE THAN THEY
BARGAINED FOR**

I. INTRODUCTION

Exploding dynamite, collapsing scaffolds, falling debris . . . construction projects have always been fraught with the possibility of significant risks. Surely no one has thought, however, to add additional insured endorsements to the list of potential risks. Yet, given the courts' recent interpretation of these endorsements, adding any entity as an additional insured on your insurance policy carries with it a huge risk.

The term "additional insured" refers to an entity that has been added to another entity's insurance policy.¹ This former entity then has the benefit of direct rights on the insurance policy and enjoys the same coverage as the purchaser of the policy (the named insured), while enjoying no responsibility to pay any premiums or deductibles. This arrangement has recently become quite typical in construction contracts, with the general contractor requiring his subcontractor to include him as an additional insured on the subcontractor's insurance policy. This is done for a variety of reasons, but overall, general contractors have found it to be an extremely effective method to shift risk away from themselves in both construction defect and injury claims. From the general contractor's standpoint, this is a wonderful arrangement. However, it seems that very few have thought to look at this from the subcontractor's point of view.² The modern trend has been to read these endorsements extremely broadly; thus, only the slightest suggestion that a subcontractor has some fault can force that subcontractor's insurance to pick up the defense of multiple parties. On its face, this does not sound so horrible: is this not what insurance

1. BLACK'S LAW DICTIONARY 811 (7th ed. 1999).

2. Many articles focus on the wonderful benefits general contractors can derive from this relationship and fail to mention the detrimental effects this has on the subcontractors whose insurance is called on to defend. *See, e.g.,* Dennis M. Cusack, *A Broad View: The Additional Insured Endorsement's Scope*, LA DAILY J., Sept. 12, 1996, at 7; Dennis Rolstad & Jordan Stanzler, *Critical Coverage, Insurance Law: Additional Insured Endorsements are a Valuable Source of Protection for Contractors and Project Owners*, LA DAILY J., Jan. 12, 2001, at S2; Scott S. Thomas, *The Endorsers: Aggressively Pursuing Rights Under an Additional Insured Endorsement Can Provide Broad Construction Defect Insurance Coverage in the Event of a Claim*, LA DAILY J., Aug. 13, 1999, at S8.

is for? That is what the courts seem to be saying in their opinions. The problem is that courts do not even consider the impact on the named insured (the subcontractor) when his policy is called on to defend. Every time his insurance becomes involved to defend or pay a judgment, the subcontractor must pay his deductible and further faces the possibility of escalating premiums and diluting policy limits to pay his own costs and judgments.

This note will first give an overview of additional insured endorsements and describe the courts' evolution in interpreting them. It will then provide reasoning and analysis for why the courts' current broad interpretation of these endorsements is flawed. Lastly, it will propose a solution. First, though, consider the following hypothetical.

II. A HYPOTHETICAL: TROUBLE IN PARADISE

Imagine the year is 1995, and you are a small specialty subcontractor who has just submitted a \$20,000 bid to waterproof the decks at the Paradise Condo job. It is a large, new construction project, involving an architect, developer, general contractor (GC), and numerous subcontractors (subs). The GC ultimately chooses you to perform the waterproofing instead of the several other subs bidding on the job, but only if you agree to sign his subcontract. The subcontract requires you to, among other things, name the owner, architect, developer, and GC as additional insureds on your liability policy. Needing the business you comply, and within a year Paradise Condo is completed, and the new unit owners move in. Everyone is happy.

It is now 2004, nine years later, and you have just been slapped with a lawsuit. The unit owners of Paradise Condo have filed suit against the GC, developer, and architect for various construction defects related to the structural components, decks, and balconies of the condos. Although the complaint itself does not allege any specific deficiencies in your work, you are brought into the lawsuit both through a third party claim by the GC and because the developer and GC have decided to tender their defenses to your insurance carrier. Even though there were numerous other subs working on the same project who had also named the developer and GC as additional insureds, they have chosen to tender their defenses to your insurer because, after all these years, you are one of the few subs still in business and able to be located and also because you have one of the best insurance policies. After discovery you find your fault to be about five percent of the total of the two million dollars demanded. Common sense says to settle with the owners for \$100,000 and get out. The problem is that you are never fully released, as your insurer is still paying all the developer's and GC's defense costs. Meanwhile, their attorneys are racking up charge after charge, knowing full well that it is some other insurer, and not their own clients, who is paying the bills. It is not long before your \$250,000 deductible is maxed out, leaving less available for your own costs and judgments.

What allowed this mess to happen? How could it have been prevented? These issues are discussed in this note.

III. ADDITIONAL INSURED V. INDEMNITY PROVISIONS

Additional insured, not indemnity, provisions are the focus of this note. However, before additional insured status can be fully understood it is helpful to understand the similarities and differences between additional insured provisions and indemnity provisions. Indemnity provisions are similar to additional insured endorsements and impact them in many ways.³ An indemnity, frequently referred to as a “hold harmless” agreement, creates an obligation on the indemnitor to pay the cost of any loss or damage that an indemnitee has incurred while acting at the indemnitor’s request.⁴ Essentially, the indemnity agreement establishes which party will bear losses suffered during the performance of the contract.⁵

Indemnity agreements are the most widely used and dependable non-insurance method for transferring the financial consequences of risk to another party.⁶ Liabilities covered by indemnity agreements include defense costs, judgments, settlements, and any other costs related to the resolution of the injured party’s claim.⁷ For example, subcontractors typically agree to indemnify and hold harmless general contractors for liability arising out of their construction operations.⁸ This means that the subcontractor must pay the general contractor’s defense, judgments, and/or settlement costs should the contractor be held vicariously liable for injuries or damages caused by the subcontractor.⁹ This indemnity provision is completely separate from the subcontractor’s insurance.¹⁰ It is a personal agreement by which the subcontractor agrees to reimburse the general contractor. The general contractor is not covered by the subcontractor’s insurance and has no rights

3. See generally DONALD S. MALECKI ET AL., *THE ADDITIONAL INSURED* BOOK 58 (4th ed. 2000).

4. Thomas M. Kurke, *Contract Law — Has Pennsylvania Adopted an Express Negligence Rule for Interpreting Broad, All-Inclusive Indemnity Agreements?* — *Ruzzi v. Butler Petroleum Co.*, 588 A.2d 1 (Pa. 1991), 65 TEMP. L. REV. 679, 679 (1992). Black’s Law Dictionary defines “indemnity” as “[t]o make good any loss, damage, or liability incurred by another.” BLACK’S LAW DICTIONARY 772 (7th ed. 1999).

5. Lisa Brener Cusimano, *Contractual Indemnity Under Maritime and Louisiana Law*, 43 LA. L. REV. 189, 190 (1982).

6. PATRICK J. WIELINSKI ET AL., *CONTRACTUAL RISK TRANSFER: STRATEGIES FOR CONTRACT INDEMNITY AND INSURANCE PROVISIONS* § XI.B.1 (2003).

7. Samir B. Mehta, *Additional Insured Status in Construction Contracts and Moral Hazard*, 3 CONN. INS. L.J. 169, 178 (1996).

8. MALECKI ET AL., *supra* note 3, at 58.

9. *Id.*

10. *Id.*

under the policy,¹¹ although the subcontractor, when paying the general contractor, will nearly always rely on his insurance to fund the obligation.¹²

There are three types of indemnities: the limited form indemnity, the intermediate form indemnity, and the broad form indemnity.¹³ The limited form indemnity requires the indemnitor (the subcontractor) to save and hold harmless the indemnitee (the general contractor) only for the indemnitor's own negligence.¹⁴ The intermediate form indemnity requires the indemnitor to save and hold harmless the indemnitee for all liability excluding that which arises out of the indemnitee's sole negligence.¹⁵ The broad form indemnity obligates the indemnitor to save and hold harmless the indemnitee from all liabilities arising from the project, regardless of which party's negligence caused the liability.¹⁶

Courts will generally uphold the limited and intermediate forms of indemnity so long as they meet the requirements for a valid contract.¹⁷ The broad form indemnity, however, has been held unenforceable in construction contracts by many courts and state statutes on the ground that it violates public policy.¹⁸ The Supreme Court confirmed this in *United States v. M.O. Seckinger* stating that "[a] contractual provision should not be construed to

11. *Id.* at 2.

12. Mehta, *supra* note 7, at 174 n.29; Brief of Amicus Curiae American Subcontractors Association at 9, *Chrysler Corp. v. Merrell & Garaguso, Inc.*, 796 A.2d 648 (Del. 2002) (No. 38-2001). Ideally, these indemnity agreements should blend together with the additional insured obligation. However, in practice, the language of the indemnity agreement is rarely used in the additional insured endorsement. Lisa Oonk, *The Construction Industry: Coverage Issue Created by Claims Against Additional Insureds*, 28 THE BRIEF 8, 10 (1999). This leads to much litigation regarding the scope of coverage for the additional insured. In the ensuing cases to interpret the scope of the additional insured's coverage, most courts will not look to the language of the indemnity agreement and will look only to the language in the insurance contract. *Id.* But see *Bonner County v. Panhandle Rodeo Ass'n*, 620 P.2d 1102 (Idaho 1980).

13. Terry J. Galganski, *Owners and Contractors Protective Liability: An Insurance Tool in Construction*, 15 CONSTR. L. 8, 12 (1995) [hereinafter Galganski, *Owners and Contractors*]; Mehta, *supra* note 7, at 179.

14. Galganski, *Owners and Contractors*, *supra* note 13, at 12; Mehta, *supra* note 7, at 179.

15. Galganski, *Owners and Contractors*, *supra* note 13, at 12-13; Mehta, *supra* note 7, at 179.

16. Galganski, *Owners and Contractors*, *supra* note 13, at 13; Mehta, *supra* note 7, at 179.

17. Mehta, *supra* note 7, at 179.

18. *Id.* The Utah Supreme Court articulated the major public policy argument against broad form indemnities in *Jankele v. Texas Co.*, 54 P.2d 425 (Utah 1936), one of the earliest and most often cited cases establishing courts' unfavorable view of broad form indemnities:

Undoubtedly contracts exempting persons from liability for negligence induce a want of care, for the highest incentive to the exercise of due care rests in a consciousness that a failure in this respect will fix liability to make full compensation for any injury resulting from the cause. It has therefore been declared to be good doctrine that no person may contract against his own negligence.

Id. at 427.

permit an indemnitee to recover for his own negligence . . .”¹⁹ Justice Brennan noted that the courts have had a “traditional reluctance” to “cast the burden of negligent actions upon those that were not actually at fault . . . particularly [where] there is a vast disparity in bargaining power . . . between the parties.”²⁰

As of 2003, thirty-four states have passed laws invalidating broad form indemnity provisions in construction contracts as unenforceable as against public policy.²¹ Courts in states that have not passed such laws show their opposition to these agreements by applying the “clear and unequivocal” test.²² This test states that in order for a broad form indemnity to be enforceable, there must be clear and unequivocal terms in the contract articulating the parties’ intent to require such a broad obligation.²³ Statutes and strict tests invalidating broad form indemnities are the result of strong public policy arguments against allowing an indemnitor to save and hold harmless an indemnitee for the indemnitee’s own negligence in construction contracts.²⁴ An indemnitee, protected from consequences of his negligence, has little incentive to take measures to avoid causing injuries.²⁵ By preventing owners and contractors from contracting away their duties to the public and to workers, these

19. *United States v. M.O. Seckinger*, 397 U.S. 203, 211 (1970).

20. *Id.* at 211-12. The cases that the Court chose to cite in support of this proposition illustrate the long history that it has enjoyed: *Bisso v. Inland Waterways Corp.*, 349 U.S. 85, 90 (1955); *Otis Elevator Co. v. Maryland Cas. Co.*, 33 P.2d 974, 977 (Colo. 1934); *Sternaman v. Metro. Life Ins. Co.*, 62 N.E. 763, 766 (N.Y. 1902); *Johnson’s Adm’x v. Richmond & D.R. Co.*, 11 S.E. 829, 829-30 (Va. 1890).

21. American Subcontractors Association, Inc., *Subcontractor’s Chart of Anti-Indemnity Statutes*, at <http://www.asaonline.com/pdf/AntiIndemnityChart.pdf> (last updated May 2, 2003). Many of these statutes were enacted in the 1970s in response to inequitable and rarely negotiated form agreements that forced contractors to indemnify owners and architects from their own negligence. Brief of Amicus Curiae American Subcontractors Association at 27, *Barton-Marlow Co. v. Grunau Co.*, 835 So.2d 1164 (Fla. Dist. Ct. App. 2003) (No. 2D-01-3347).

22. Mehta, *supra* note 7, at 180. For cases applying this test see, e.g., *Craig Constr. Co. v. Hendrix*, 568 So.2d 752, 756 (Ala. 1990); *Washington Elem. Sch. Dist. No. 6 v. Baglino Corp.*, 817 P.2d 3, 6 (Ariz. 1991) (en banc); *Arkansas Kraft Corp. v. Boyed Sanders Constr. Co.*, 764 S.W.2d 452, 453 (Ark. 1989); *Goldman v. Ecco-Phoenix Elec. Corp.*, 396 P.2d 377, 379 (Cal. 1964) (en banc); *State v. Interstate Amiesite Corp.*, 297 A.2d 41, 44 (Del. 1972); *Rodrigue v. LeGros*, 563 So. 2d 248, 254 (La. 1990); *Parliament Constr. Co. v. Beer Precast Concrete Ltd.*, 319 N.W.2d 374, 378 (Mich. 1982); *Braegelmann v. Horizon Dev. Co.*, 371 N.W.2d 644, 646 (Minn. Ct. App. 1985); *Southwestern Bell Tel. Co. v. J.A. Tobin Constr. Co.*, 536 S.W.2d 881, 885 (Mo. Ct. App. 1976); *Port Auth. of New York & New Jersey v. Honeywell Protective Serv.*, 535 A.2d 974, 978 (N.J. Super. Ct. App. Div. 1987); *Perry v. Payne*, 66 A. 553, 555-56 (Pa. 1907); *Freund v. Utah Power & Light Co.*, 793 P.2d 362, 370 (Utah 1990).

23. Mehta, *supra* note 7, at 180-81.

24. *Id.* at 181.

25. *Id.* at 182; Brian Cabbage, *Indemnity & Insurance Requirements from the Sub’s Point of View*, CFMA: BUILDING PROFITS, May/June 2003 at 3, available at http://www.cfma.org/documents/Cabbage%20M_J%2003.pdf.

prohibitions on broad form indemnities serve to protect construction workers and the general public from suffering construction related injuries by encouraging accident prevention methods.²⁶

IV. ADDITIONAL INSURED STATUS AND HOW IT HAPPENS

When a construction contract is awarded, all general contractors and subcontractors working on the project will nearly always be required to carry a certain amount of liability insurance that will pay defense, settlement, and judgment costs should a claim arise for an injury or a construction defect. "Named insureds" are the persons or businesses to whom the liability policy is issued.²⁷ The named insured pays the premium and deductibles, has the power to cancel the policy, and is entitled to receive notice of cancellation from the insurer.²⁸

Because the possibility of death or injury readily exists with each construction project, it is very likely that someone's insurance will be called upon at some point to defend or pay a judgment. Realizing this risk, it is very common today for a property owner contractually to require his designer, program manager, construction manager, and general contractor to name him as an additional insured on their insurance policies.²⁹ In turn, these stronger parties push this insurance liability to the participant on the bottom: the subcontractor.³⁰ The additional insured (the general contractor) is thus given a direct contractual relationship with the named insured's (the subcontractor's) insurance carrier, but with no responsibilities to pay the policy premium.³¹ The additional insured receives the benefit of coverage under the named insured's policy, while it is the named insured that actually pays any additional premium.³²

26. *J.S. Alberici Constr. Co. v. Mid-west Conveyor Co.*, 750 A.2d 518, 521 (Del. 2000); *Bosio v. Branigar Org.*, 506 N.E.2d 996, 998 (Ill. App. Ct. 1987); *Guitard v. Gulf Oil Co.*, 670 P.2d 969, 972-73 (N.M. Ct. App. 1983).

27. *MALECKI ET AL.*, *supra* note 3, at 11.

28. *Id.* at 14; *WIELINSKI ET AL.*, *supra* note 6, at § XI.C.5.

29. Terry J. Galganski, *The Insurance Exceptions of the Missouri Anti-Indemnity Statute (Part I)*, 58 J. MO. B. 86, 88 (2002) [hereinafter Galganski, *Insurance Exceptions*].

30. *Id.*; Cabbage, *supra* note 25, at 2; *Walsh Constr. Co. v. Mut. of Enumclaw*, 76 P.3d 164, 169 (Or. Ct. App. 2003) (citing Audio Tape, House Committee on Commerce, Subcommittee on Commerce, SB 788, Tape 33, Slide A, (May 11, 1995) [statement of Representative Larry Wells]).

31. Galganski, *Insurance Exceptions*, *supra* note 29, at 88.

32. Douglas R. Richmond, *The Additional Problems of Additional Insureds*, 33 TORT & INS. L.J. 945, 948 (1998) [hereinafter Richmond, *Additional Problems*]. The additional insured, however, does not have the same rights as the named insured. For example, the additional insured has no right to be notified that the named insured's policy has been cancelled. Mehta, *supra* note 7, at 173.

Additional insured status does not happen automatically. The general contractor only becomes an additional insured after the subcontractor has added an endorsement (an amendment) to his policy.³³ These endorsements typically come in one of two categories: either the “standard” form, developed by the Insurance Services Office (ISO) for general use, or the “manuscript” form, drafted by the insurance company for a specific situation.³⁴ The most common ISO “standard forms” are the ISO Endorsement Form CG 20 09 and the ISO Endorsement Form CG 20 10.³⁵

V. WHY GENERAL CONTRACTORS INSIST ON ADDITIONAL INSURED STATUS

Historically, additional insured endorsements have been considered to be one of several valid techniques for the allocation of risks.³⁶ The possibility of bodily injury, property damage, and death readily exists with each construction project.³⁷ The construction industry accounted for 19.5% of workplace fatalities in 2000 and 20.8% in 2001, even though the industry employed less than 5.2% of the workforce in either year.³⁸ In addition, the workers’ compensation laws of most states allow injured workers to sue the general contractor for additional money, even if they have already collected from their employer’s (the subcontractor’s) workers’ compensation insurer.³⁹ Possible construction defect lawsuits elevate the risks even higher.⁴⁰ By hiring a subcontractor, a general contractor exposes himself to these liability risks,

33. MALECKI ET AL., *supra* note 3, at 57; Galganski, *Insurance Exceptions*, *supra* note 29, at 88.

34. David R. Hendrick, *Insurance Law: Understanding the Basics Regarding “Additional Insureds,”* 690 PRACTISING LAW INSTITUTE 591, 617 (2003).

35. Galganski, *Owners and Contractors*, *supra* note 13, at 14. The ISO CG 20 09 endorsement, also called the long form, adds additional insureds “but only with respect to liability arising out of [the named insured’s work] for the additional insured or acts or omissions of the additional insured in connection with their general supervision of [the named insured’s] work.” Oonk, *supra* note 12, at 11. The ISO CG 20 10 endorsement, also called the short form, adds additional insureds “but only with respect to liability arising out of” either “your work for that insured by or for you” (1985 version) or “your ongoing operations performed for that insured” (1993 version). *Id.* A third endorsement, the ISO CG 20 33, adds as an additional insured any entity the named insured is contractually required to provide coverage for by changing the classification of “Who is Insured” in the policy. Coverage is limited to the work, operations, or facilities of the named insured. *Id.*

36. MALECKI ET AL., *supra* note 3, at 58; Thomas, *supra* note 2.

37. Galganski, *Owners and Contractors*, *supra* note 13, at 8.

38. Cabbage, *supra* note 25, at 1.

39. *Id.*

40. *Id.* at 2. Construction defect claims can drag on for years and result in significantly large settlements. For example, a decade-long Florida case recently ended with a \$9 million verdict awarded to fewer than 200 plaintiffs after a brand new courthouse was evacuated due to complaints of mold growth. *Id.*

including vicarious liability for his subcontractor's negligence.⁴¹ Additional insured endorsements are one way to allocate these risks in a way that probably would not have occurred under common law in the absence of the contract.⁴² The original rationale for this contractual risk transfer was to make the party with the most control over the risk responsible for suffering the financial loss should it fail to prevent the loss from occurring.⁴³ Recently, recognizing the great potential these additional insured endorsements can have, general contractors have begun to insist on them for many more reasons.

A. *Protecting His Own Insurance Policy*

A general contractor does not want to deplete his own insurance to defend claims, and he would prefer to involve the carrier to whom he is not paying a premium when a claim arises.⁴⁴ Although it has not been litigated in all jurisdictions, courts have held that by tendering his defense to the subcontractor's insurer, the general contractor is assuring that his insurance company will not be brought into the suit.⁴⁵ This is known as a "targeted tender."⁴⁶ The general contractor, as the additional insured on the subcontractor's policy, has the right to choose which insurer will defend him in a lawsuit: his own or the subcontractor's.⁴⁷ If he chooses to tender his defense

41. John H. Mathias, Jr. & Timothy W. Burns, *General Contractors and Subcontractors' Insurers: The Additional Insured Provision*, 89 ILL. B.J. 526, 526 (Oct. 2001).

42. MALECKI ET AL., *supra* note 3, at 58. In absence of a contract, the customary method of allocating risk involved the court's distinguishing between active and passive fault of the parties. *Id.* at 44. Under common law, parties had to provide compensation only when their conduct violated rules of negligence. Mehta, *supra* note 7, at 171.

43. MALECKI ET AL., *supra* note 3, at 58. The thought of most general contractors is that since the subcontractors perform most of the daily work at the construction site, they rightly deserve all the blame for most workplace accidents and faulty construction claims. Cubbage, *supra* note 25, at 3. While many injuries and defects are the fault of the subcontractors, it is unreasonable of general contractors to evade responsibility for all claims. *See infra* notes 235-238 and accompanying text.

44. WIELINSKI ET AL., *supra* note 6, at § XI.C.11; Mathias & Burns, *supra* note 41, at 526; Gary D. Nelson, "Additional Insured" Endorsements: *Conflicting Expectations*, 24 THE BRIEF 29, 67 (1995). Additional insured coverage nearly always results in two or more policies covering the same incident. Many issues are raised when this occurs, and this note only discusses one of these. For discussion of these "other insurance" issues, *see* Douglas R. Richmond, *Issues and Problems in "Other Insurance," Multiple Insurance, and Self Insurance*, 22 PEPP. L. REV. 1373 (1995); Richmond, *Additional Problems*, *supra* note 32, at 984-99.

45. WIELINSKI ET AL., *supra* note 6, at § XI.C.21. As will be discussed later in this note, a majority of courts hold that the subcontractor's insurance company will still have an obligation to pay defense and judgment costs even if the defect or injury was caused by the general contractor's sole negligence, if the general contractor has been named as an additional insured on the subcontractor's policy.

46. *Id.*

47. *Am. Nat'l Fire Ins. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 796 N.E.2d 1133, 1139 (Ill. App. Ct. 2003); *John Burns Constr. Co. v. Indiana Ins. Co.*, 727 N.E.2d 211, 215 (Ill.

to the subcontractor's insurer and requests no defense or indemnification from his own insurer, the subcontractor's insurer is then precluded from suing the general contractor's insurer for reimbursement of any money paid out on the general contractor's behalf.⁴⁸ The general contractor will thus not be responsible for paying any deductible, nor will his premiums increase or his policy be cancelled, as his insurer will not be involved in paying any losses.

B. Preventing Subrogation

Additional insured status precludes the subcontractor's insurer from suing the general contractor directly if the general contractor caused the loss.⁴⁹ Normally, insurers have the right of subrogation, which is the legal right to pursue recovery from third parties who are legally to blame for the loss.⁵⁰ However, an insurer has no right of subrogation against its insured, which includes an entity that holds the status of an additional insured.⁵¹ While some jurisdictions limit the protection an additional insured has from subrogation, it seems well settled that an additional insured is immune from subrogation so long as the money paid out was within the defined scope of the additional insured coverage.⁵²

C. Reinforcing the Indemnity Agreement

Additional insured status achieves the same result as an indemnity agreement without relying on the indemnity clause and without the hassles that accompany indemnity agreements.⁵³ Additional insured status gives the general contractor direct rights to the subcontractor's insurance policy.⁵⁴ Unlike an indemnity clause where the general contractor must pay costs out of his own pocket and then wait for reimbursement, additional insured status provides immediate coverage for defense costs.⁵⁵ The situation can become

2000); *Inst. of London Underwriters v. Hartford Fire Ins. Co.*, 599 N.E.2d 1311, 1313 (Ill. App. Ct. 1992); MALECKI ET AL., *supra* note 3, at 131.

48. *See Inst. of London Underwriters*, 599 N.E.2d at 1313.

49. Mehta, *supra* note 7, at 175.

50. WIELINSKI ET AL., *supra* note 6, at § XI.B.4; Mehta, *supra* note 7, at 175.

51. *Frank Briscoe Co. v. Georgia Sprinkler Co.*, 713 F.2d 1500, 1502 (11th Cir. 1983); *Airlines Reporting Corp. v. United States Fid. & Guar. Co.*, 31 Cal. App. 4th 1458, 1464 (Cal. Ct. App. 1995); *Reeder v. Reeder*, 348 N.W.2d 832, 836 (Neb. 1984); *see Winkelmann v. Excelsior Ins. Co.*, 650 N.E.2d 841, 843 (N.Y. 1995); *First Nat'l Bank of Columbus v. Hansen*, 267 N.W.2d 367, 371 (Wis. 1978). *See also* MALECKI ET AL., *supra* note 3, at 79; Hendrick, *supra* note 34, at 614. Courts feel that allowing subrogation against its own insured places the insurer's own interest at variance with its insured since the insurer has less incentive to defend claims. *See* MALECKI ET AL., *supra* note 3, at 80.

52. WIELINSKI ET AL., *supra* note 6, at § XI.B.4.

53. MALECKI ET AL., *supra* note 3, at 58.

54. *Id.* at 75; Mehta, *supra* note 7, at 177.

55. *See* MALECKI ET AL., *supra* note 3, at 75; Mehta, *supra* note 7, at 176-77.

more problematic if the subcontractor refuses to pay the general contractor, as the general contractor must then expend more money to file a breach of contract claim against the subcontractor. Additional insured status prevents this. As soon as he learns of the case, the general contractor can tender the defense directly to the subcontractor's insurer, who must pay as the costs are incurred.⁵⁶ Additional insured status also results in the duty to defend beginning at the time the claim is made, as opposed to indemnity agreements in which the duty to defend may not arise until later in the proceeding, such as after a ruling that the indemnitor was at fault.⁵⁷

D. Circumventing the Indemnity Agreement

Additional insured status is a clever method to circumvent some states' prohibitions against broad form indemnities.⁵⁸ Even though most courts will not allow the subcontractor to indemnify the general contractor for his own negligence, courts do allow the subcontractor to provide both defense and judgment coverage for the general contractor's own negligence if there is an additional insured endorsement in place.⁵⁹ This situation arises most frequently when the agreement is a broad form indemnity (agreeing to indemnify for the general contractor's sole negligence) because most states have passed laws invalidating such agreements as against public policy.⁶⁰ However, a majority of courts have held that providing another party with insurance coverage is not the same as indemnifying that party, thus general contractors can be covered for their sole negligence.⁶¹ After the court holds

56. MALECKI ET AL., *supra* note 3, at 78; Mehta, *supra* note 7, at 177.

57. Mehta, *supra* note 7, at 178.

58. See MALECKI ET AL., *supra* note 3, at 62; WIELINSKI ET AL., *supra* note 6, at § XI.B.2; Mehta, *supra* note 7, at 178.

59. Mehta, *supra* note 7, at 181.

60. WIELINSKI ET AL., *supra* note 6, at § XI.B.2. See also *supra* note 21 and accompanying text. As of 2003, only 8 states have not passed any type of law regarding indemnity provisions. They are Alabama, Arkansas, Iowa, Kansas, Kentucky, Maine, Vermont, and Wyoming. American Subcontractors Association, Inc., Subcontractor's Chart of Anti-Indemnity Statutes, at <http://www.asaonline.com/pdf/AntiIndemnityChart.pdf> (last updated May 2, 2003).

61. WIELINSKI ET AL., *supra* note 6, at § XI.B.2. Such cases include *Shell Oil Co. v Nat'l Union Fire Ins. Co. of Pittsburgh, Pennsylvania*, 52 Cal. Rptr. 2d 580 (Cal. Ct. App. 1996) (state law invalidating broad form indemnities does not outlaw an agreement to procure insurance for another party's sole negligence); *Chevron U.S.A, Inc. v. Bragg Crane & Rigging Co.*, 225 Cal. Rptr. 742 (Cal. Ct. App. 1986) (there is no limit in obtaining insurance despite the fact that state law limits the amount of risk that can be transferred in an indemnity contract); *Heat & Power Corp. v. Air Prods. & Chemicals, Inc.*, 578 A.2d 1202 (Md. 1990) (although state law prohibited broad form indemnity agreements, a party insured under the indemnitor's liability policy can be insured against its sole fault); *Long Island Lighting Co. v. Am. Employers Ins. Co.*, 517 N.Y.S.2d 44 (N.Y. App. Div. 1987) (the additional insured was ordered to be protected by the named insured's policy even after the indemnity agreement between the parties was held void as against public policy).

the broad form indemnity agreement between the subcontractor and general contractor unenforceable, the general contractor can simply look for coverage directly under the subcontractor's insurance policy and achieve the same result.⁶²

VI. EVOLUTION OF THE COURTS' INTERPRETATION OF ADDITIONAL INSURED ENDORSEMENTS

It is not disputed that all the provisions of an insurance policy that apply to the named insured also apply to the additional insured.⁶³ However, whether the additional insured should be covered for his own acts of negligence, or covered only if the additional insured is held vicariously liable for acts of the named insured, is disputed. Additional insured endorsements began as a risk shifting tool to cover the general contractor's costs should he be found vicariously liable for an act of his subcontractor.⁶⁴ It was with this purpose in mind that the courts originally interpreted these provisions to allow coverage only when the additional insured was held vicariously liable for acts of the named insured.⁶⁵

A case illustrative of the courts' original interpretation of additional insured endorsements is *Harbor Insurance Co. v. Lewis*.⁶⁶ In this case, the City of Philadelphia attempted to obtain coverage for a three million dollar verdict that had been entered against both the city and the Reading Railroad. The verdict came after a trial in which the plaintiff, a young boy, alleged that he suffered severe injuries after being run over by a train operated by the Reading Railroad in an area located near a fence that had been negligently maintained by the City of Philadelphia. The city had been named an additional insured on Reading's insurance policy, issued by Harbor Insurance ("Harbor"). The additional insured endorsement stated that the City of Philadelphia was provided insurance as an additional insured on the policy issued to the railroad, but "only to the extent of liability resulting from occurrences arising out of negligence of Reading Company and/or its wholly owned subsidiaries."⁶⁷

The *Harbor* Court made several findings of fact before announcing its decision. The court found that additional insured provisions are "intended to

62. WIELINSKI ET AL., *supra* note 6, at § XI.B.2.

63. *Oakland Stadium v. Underwriters at Lloyds*, London, 313 P.2d 602 (Cal. Ct. App. 1957); *Hendrick*, *supra* note 34, at 624. The *Oakland* Court held that the additional insured endorsement incorporated all exclusions included in the main policy. Any other holding, the court stated, would put the additional insured in a better position than the named insured who paid the premium and would accordingly be "absurd." *Oakland Stadium*, 313 P.2d at 605.

64. *Hendrick*, *supra* note 34, at 624.

65. *Id.*

66. 562 F. Supp. 800 (E.D. Pa. 1983). All facts in this paragraph are taken from pages 801-02 of the court's opinion.

67. *Id.* at 801.

protect parties who are not named insureds from exposure to vicarious liability for acts of the named insured.⁶⁸ The court further found that Harbor did not charge any additional premium for the additional insured endorsement and that insurers typically will not increase or change the risks insured against without charging an additional premium.⁶⁹ The court went on to discuss the intent of the parties, finding that Harbor intended this endorsement to be a routine endorsement issued to cover additional insureds for vicarious liability that might result from acts of the named insured.⁷⁰ The court also pointed out that the City of Philadelphia stipulated that it did not look to or rely on the Harbor policy when making its own insurance decisions.⁷¹

Based on the language in the policy as well as the intent of the parties, the court found that Harbor agreed to the additional insured endorsement only because its coverage was restricted to the City of Philadelphia's vicarious liability for Reading Railroad's activities.⁷² The court concluded that the City of Philadelphia was not covered for liability resulting from its own negligence.⁷³

The court in *American Country Insurance Co. v. Cline*⁷⁴ made similar findings and limited the general contractor's coverage as an additional insured to vicarious liability. This court similarly recognized that the subcontractor received an unlimited number of additional insured endorsements for a single \$150 premium; thus, it made sense that the additional insured should only receive coverage for a narrow group of claims (i.e., those arising in strict liability).⁷⁵ The court went on to recognize that it would be inequitable to allow the additional insured to avoid its responsibility for its own conduct and to seek full coverage when the insurer has not been compensated accordingly.⁷⁶ The court noted that the general contractor carried his own general liability coverage to cover liability arising from his own work.⁷⁷ If the general contractor wanted the same level of coverage that he already received from his own insurer, then the subcontractor's insurer should have received a larger premium payment.⁷⁸

68. *Id.* at 803.

69. *Id.*

70. *Id.*

71. *Harbor Ins. Co.*, 542 F. Supp. at 804.

72. *Id.* at 805.

73. *Id.* at 805-06.

74. 722 N.E.2d 755 (Ill. App. Ct. 1999).

75. *Id.* at 761-62.

76. *Id.* at 762.

77. *Id.*

78. *Id.*

Although the court in *Granite Construction v. Bituminous Insurance Co.*⁷⁹ did not make any specific findings, it nevertheless limited coverage of the additional insured. In this case, Granite Construction (“Granite”) sought coverage for a lawsuit brought by an employee of Joe Brown Company (“Brown”), a subcontractor hired by Granite to haul asphalt materials from its construction site. By contract, Granite agreed to load the trucks that Brown was to use to haul the asphalt. Brown had obtained insurance and named Granite as an additional insured on the policy. The endorsement read, “The ‘Persons Insured’ provision is amended to include as an insured the person or organization named below [Granite] but only with respect to liability arising out of operations performed for such insured [Granite] by or on behalf of the named insured [Brown].”

A Brown employee was injured and filed a negligence action against Granite, claiming that Granite had negligently loaded its truck in such a manner that the truck had overturned and injured him.⁸⁰ Granite then asserted that it was entitled to coverage under the additional insured endorsement.⁸¹ The court, however, rejected that argument, stating that the endorsement restricted the carrier’s liability to those acts specifically performed by Brown and did not extend to operations performed by Granite itself.⁸² Because the complaint stated that Granite’s liability arose out of its own loading operations, it was not a claim “arising out of operations performed for [Granite] by or on behalf of [Brown].”⁸³ Therefore, the Texas appellate court held that Brown’s insurance carrier owed no obligation to defend Granite on those claims.⁸⁴

The court in *Valentine v. Aetna Insurance Co.* recognized that “it would be unreasonable to assume that a subcontractor would agree to procure liability insurance for all of the general contractor’s operations”⁸⁵ The court in *Anaconda Co. v. General Accident Fire and Life Assurance Corp.*⁸⁶ made a similar finding. In this case the owner, Anaconda, required his general contractor, McKee, to name him as an additional insured on his liability policy, insuring against risks of any kind relating to the construction at its smelter facilities.⁸⁷ Later, one of McKee’s subcontractor’s employees was injured when an Anaconda employee dropped a plank some thirty feet striking him.⁸⁸

79. 832 S.W.2d 427 (Tex. App. 1992). All facts in this paragraph are taken from page 428 of the court’s opinion.

80. *Id.* at 428.

81. *Id.*

82. *Id.* at 430.

83. *Id.*

84. *Granite Constr. Co.*, 832 S.W.2d at 430.

85. 564 F.2d 292, 295 (9th Cir. 1977).

86. 616 P.2d 363 (Mont. 1980).

87. *Id.* at 364.

88. *Id.*

He filed suit against Anaconda, alleging that the negligence of Anaconda's employee caused his injury.⁸⁹ Anaconda made a formal demand to McKee's insurer, General Accident, requesting a defense, and the insurance company denied coverage.⁹⁰ In the ensuing case, to determine whether General Accident owed a duty to defend Anaconda, the court acknowledged,

Were we to focus merely on the activities of the injured workman and not the activities of the named insureds [McKee], we would render application of [the contract] overly broad and make General Accident the insurer of all Anaconda activities at the Smelter that resulted in injuries to anyone working pursuant to the contract, regardless of control and benefit. This Court will place no such burden on anyone.⁹¹

These cases demonstrate the courts' concern for the inequality of placing the burdens of defense and indemnification on a party who has very little control in preventing that loss from occurring. They also demonstrate that the courts are willing to follow both the intent of the parties and the plain language of the endorsements. Courts are not straining to find coverage for the additional insured because they recognize that the general contractor carries his own insurance to cover his own operations.

VII. EMERGING INTERPRETATION

Developers and general contractors have become more sophisticated over the last decade.⁹² They now assert that additional insured coverage is intended to protect them from their own liability as well.⁹³ Unfortunately, courts have listened to them. The reason for this shift is not entirely clear. One commentator suggests that it is because the courts do not have an understanding of the parties' contractual relationship and have failed to appreciate the unique circumstances involved in an additional insured controversy.⁹⁴ Therefore, they are blindly treating disputes over additional

89. *Id.*

90. *Id.*

91. *Anaconda Co.*, 616 P.2d at 366.

92. Richard H. Glucksman & Glenn T. Barger, *Additional Insured Endorsements: Their Vital Importance in Construction Defect Litigation*, 21 WTR CONSTR. L. 30, 30 (2001).

93. *Id.* For years, parties paid little attention to additional insured policies until economic pressures in the construction industry in the 1990s changed the focus. Parties began to pursue aggressively claims for recovery of costs and contribution to claim settlements. Thomas, *supra* note 2.

94. Mark Pomerantz, *Recognizing the Unique Status of Additional Named Insureds*, 53 FORDHAM L. REV. 117, 120 (1984). Although Mr. Pomerantz's contentions apply to what he refers to as "additional named insureds," for purposes of this note his definition of "additional named insureds" is analogous to "additional insureds" discussed in this note. "This [an additional named insured] is an entity specifically designated as an insured subsequent to the issuance of the original policy. A party typically becomes an additional named insured pursuant to an agreement

insured coverage just as they would disputes over coverage for the named insured.⁹⁵ Whatever the reason, however, liberal interpretation of additional insured endorsements is quickly becoming the majority rule.⁹⁶

Courts now broadly construe any and all language contained in these endorsements, striving to find coverage for the additional insured general contractor. Because most endorsements contain some form of the language, “but only with respect to liability arising out of the named insured’s work,” this note will focus on the courts’ interpretation of these phrases.⁹⁷

A. “Arising Out Of”

One commentator recently noted that “‘arising out of’ has been construed to be so broad and general as to cover virtually anything having the least bit to do with the named insured’s work.”⁹⁸ Several cases illustrate this point. A California appellate court in *Acceptance Insurance Co. v. Syufy Enterprises* required only a minimal showing of causation to find the insurer had a duty to defend the additional insured.⁹⁹ The plaintiff, an employee of C&C, the general contractor, was injured while climbing through a hatch on the roof that had been negligently maintained by the building owner, Syufy Enterprises (“Syufy”).¹⁰⁰ He sued the owner for his injuries.¹⁰¹ The endorsement adding Syufy as an additional insured provided that Syufy was included as an insured under the policy, “but only with respect to liability arising out of ‘your work’ for that insured by or for you.”¹⁰² The policy stated that “you” and “your” referred to C&C, the named insured.¹⁰³ It defined “your work” as “[w]ork or operations performed by you or on your behalf.”¹⁰⁴ The owner tendered his defense to the contractor’s insurer, Acceptance Insurance Co. (“Acceptance”), even though the owner was himself fully insured.¹⁰⁵ Acceptance attempted to deny coverage by claiming that the plaintiff was injured while exiting the roof

obligating the named insured to add the additional named insured to the named insured’s pre-existing policy.” *Id.* at 119.

95. *Id.* at 120.

96. Richmond, *Additional Problems*, *supra* note 32, at 958; Douglas R. Richmond & Darren S. Black, *Expanding Liability Coverage: Insured Contracts and Additional Insureds*, 44 *DRAKE L. REV.* 781, 801 (1996); Cusack, *supra* note 2.

97. For an extensive compilation of courts’ interpretations of a variety of additional insured endorsements, see Nelson, *supra* note 44.

98. Lawrence A. Steckman & James J. Cleary Jr., *Construction Industry AIE’s: Problems of Contract Interpretation and Solutions*, 65 *DEF. COUNS. J.* 78, 90 (1998).

99. *Acceptance Ins. Co. v. Syufy Enters.*, 69 Cal. App. 4th 321 (Cal. Ct. App. 1999).

100. *Id.* at 323.

101. *Id.*

102. *Id.* at 324.

103. *Id.*

104. *Acceptance Ins. Co.*, 69 Cal. App. 4th at 324.

105. *Id.*

through the hatch and that his work was limited to the roof itself.¹⁰⁶ Therefore, Acceptance claimed that the injury did not “arise out of” the named insured’s work.¹⁰⁷ In addition, Acceptance argued that the endorsement should be limited to situations where the owner is held vicariously liable for acts of the contractor.¹⁰⁸

The court rejected Acceptance’s arguments noting that “arising out of” language “[d]oes not import any particular standard of causation or theory of liability into an insurance policy. Rather, it broadly links a factual situation with the event creating liability, and connotes only a minimal causal connection or incidental relationship.”¹⁰⁹ The court found that, because the plaintiff could not have done his work without passing through the hatch, the connection between the injury and the work was more than incidental; thus, the “arising out of” requirement was satisfied.¹¹⁰ The fact that the defect was solely caused by Syufy’s negligence was irrelevant.¹¹¹

Similarly, in *Shell Oil Co. v. AC & S, Inc.*, Shell Oil Co. (“Shell”) filed a declaratory judgment action against two subcontractors and their insurers claiming that it was entitled to defense and indemnity for a personal injury suit filed against Shell by one of the subcontractor’s employees.¹¹² Shell was the owner of the property and had hired Bechtel as the general contractor.¹¹³ Bechtel hired Sachs as a subcontractor, who in turn hired AC & S as his subcontractor.¹¹⁴ The plaintiff, Neels, was an employee of AC & S.¹¹⁵ The contract between Sachs and AC & S incorporated by reference the contract between Shell and Bechtel.¹¹⁶ Pursuant to those contracts, AC & S and Sachs each obtained general liability policies naming Shell as an additional insured.¹¹⁷

Neels was injured when he tripped over a pipe on Shell’s premises.¹¹⁸ Neither AC & S nor Sachs was alleged to be at fault. In fact, it was undisputed that neither of them was in any way responsible for the pipe.¹¹⁹ When Shell

106. *Id.* at 326.

107. *Id.*

108. *Id.* at 330-31.

109. *Acceptance Ins. Co.*, 69 Cal. App. 4th at 328.

110. *Id.*

111. *Id.* at 328-29.

112. *Shell Oil Co. v. AC & S, Inc.*, 649 N.E.2d 946, 948 (Ill. App. Ct. 1995).

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

117. *Shell Oil Co.*, 649 N.E.2d at 948.

118. *Id.*

119. *Id.* at 951-52.

tendered its defense to AC & S's and Sach's insurers, respectively National Union and Transamerica, both refused coverage.¹²⁰

Both endorsements naming Shell as an additional insured contained similar language and the phrase "arising out of."¹²¹ The court noted that the phrase "arising out of" is both broad and vague and therefore "must be liberally construed in favor of the insured; accordingly, 'but for' causation, not necessarily proximate causation, satisfies this language."¹²² National Union argued that the endorsement unambiguously limited coverage to work performed by the subcontractors and that the pipe over which Neels tripped had nothing to do with the work being performed by either subcontractor.¹²³ Additionally, it was Shell, the additional insured, that had drafted the "arising out of" language, giving National Union the added argument that if the phrase was ambiguous, it should be construed against Shell.¹²⁴ Nevertheless, the court held that Neels's injuries arose from the subcontractor's operations because Neels would not have been on Shell's premises "but for" the operations of the subcontractor, his employer.¹²⁵ The court ruled in favor of Shell, ordering it to be covered as an additional insured for both defense and indemnity purposes.¹²⁶

In summary, in the preceding two cases the named insured did absolutely nothing wrong. However, in both cases because of the expansive reading of the additional insured endorsement by the court, the faultless named insured was forced to pay anyway.

120. *Id.* at 948.

121. *Id.* at 950.

122. *Shell Oil Co.*, 649 N.E.2d at 951.

123. *Id.*

124. *Id.*

125. *Id.* at 952.

126. *Id.* The list goes on and on. Other cases supporting broad interpretation of "arising out of" language in additional insured endorsements include: *Merch. Ins. Co. of New Hampshire v. United States Fid. & Guar. Co.*, 143 F.3d 5 (1st Cir. 1998); *Am. States Ins. Co. v. Liberty Mut. Ins. Co.*, 683 N.E. 2d 510 (Ill. App. Ct. 1997); *Transamerica Ins. Group v. Turner Constr. Co.*, 601 N.E.2d 473 (Mass. App. Ct. 1992); *Lim v. Atlas-Gem Erectors Co.*, 225 A.2d 304 (N.Y. App. Div. 1996); *Township of Springfield v. Ersek*, 660 A.2d 672 (Pa. Commw. Ct. 1995). In addition, slight deviations from the "arising out of" language are of no benefit to insurers and subcontractors. *See, e.g., Maryland Cas. Co. v. Regis Ins. Co.*, No. Civ.A.96-CIV-1790, 1997 WL 164268 (E.D. Pa. Apr. 9, 1997) ("as a result of" language imposed no greater causation than "arising out of"); *Con't Heller Corp. v. St. Paul Fire & Marine Ins. Co.*, 54 Cal. Rptr. 2d 621 (Cal. Ct. App. 1996) ("resulting from" the named insured's work standard is met even when the injured named insured's employee was just fetching some tools); *Travelers Indem. Co. v. LLJV Dev. Corp.*, 643 N.Y.S.2d 520 (N.Y. App. Div. 1996) ("by or on behalf of" language included operations performed by additional insured employee's operations).

B. “Your Work”

In addition to broadly construing the phrase “arising out of,” courts also broadly construe the term “your work.” A commentator noted:

Absent an extremely clear and unambiguous restriction on an additional insured endorsement, it is clear that the courts will interpret such endorsements to provide full coverage for the additional insured not only for vicarious liability, but also for acts of its own negligence, as long as they are related to the work contemplated in the underlying agreement.¹²⁷

In *Pardee Construction Co. v. Insurance Co. of the West*, the appellate court held that the unambiguous language of the policies and endorsements provided the general contractor (the additional insured) with coverage for completed operations of the subcontractors (the named insureds).¹²⁸ In this case the general contractor, Pardee Construction Co. (“Pardee”), had been named as an additional insured on all of his subcontractors’ policies for a project in San Diego.¹²⁹ When the owners sued him a few years later for various construction defects, he tendered his defense to all of his subcontractors’ insurers, four of whom denied coverage claiming that additional insured coverage did not apply to completed operations.¹³⁰ The endorsements provided Pardee coverage for liability arising out of the subcontractor’s work for Pardee.¹³¹ The subcontract itself between Pardee and his subcontractors defined the phrase “your work” as “Your work will be deemed completed at the earliest of the following times: (1) when the work called for in your contract has been completed. . . or (2) when that part of the work to be done at the job site has been put to its intended use. . . .”¹³² However, the court refused to look beyond the language in the endorsement or in the insurance policies to consider the language of the subcontract. The court held that the unambiguous language of the policies and endorsements provided Pardee with coverage for completed operations of the named insured subcontractors.¹³³ The court noted that the policy provided coverage limited only by the phrase “liability arising out of your [the named insured’s] work for the [additional insured] by or for you.”¹³⁴ The court stated that “the insurers failed to expressly limit covered completed operations as to time or particular

127. Joel M. Simon, *Coverage for the Additional Insured*, N.Y. L. J., Jan 8, 1996, at 1.

128. 92 Cal. Rptr. 2d 443 (Cal. Ct. App. 2000).

129. *See id.* at 446-47.

130. *Id.* at 447-49.

131. *Id.* at 454.

132. *Id.* at 455 n.13.

133. *Pardee Constr. Co.*, 92 Cal. Rptr. 2d at 453-54.

134. *Id.* at 454.

project in their policy and endorsement language. [Such failure] implies a manifested intent not to do so.”¹³⁵

Courts have also held that if the subcontractor installs the work, it is “his work” for purposes of additional insured endorsement interpretation, regardless of whether or not the work deviates from the original subcontract. In *Travelers Indemnity Co. v Westfield Insurance Co.*, Hoar Construction (“Hoar”) was the general contractor for the renovation of a department store.¹³⁶ The installation of the floor coverings was subcontracted out to Turner Brook, Inc. (“Turner”), who was insured by the Westfield Insurance Co. (“Westfield”).¹³⁷ Under the subcontractor’s agreement, Turner was required to install flooring first and then paper to protect it.¹³⁸ However, when other aspects of the project outside Turner’s control fell behind, it became apparent that more heavy construction work would occur after the floor was laid than originally anticipated.¹³⁹ Hoar instructed Turner to use more durable Masonite panels instead of paper to protect the floor.¹⁴⁰

An employee of another subcontractor sustained injuries after allegedly tripping over a piece of Masonite and brought suit against the property owner and general contractor.¹⁴¹ Hoar had been named as an additional insured on Turner’s policy, “but only with respect to liability arising out of your [Turner’s] work.”¹⁴² The general contractor tendered his defense to Westfield, Turner’s insurer, who refused coverage.¹⁴³ Westfield argued that because the injured employee alleged that the Masonite panels had caused his injury, the panels did not “arise out of” but were merely incidental to Turner’s work.¹⁴⁴ The court, noting that broad and ambiguous language must be strictly construed against the insurer to maximize coverage, rejected this argument and ordered Westfield to defend Hoar in the underlying claim.¹⁴⁵ The court also concluded that no level of causation is required for determining when liability “arises out of” a subcontractor’s work.¹⁴⁶

135. *Id.* at 454, 456.

136. No. 97-2190, 1999 WL 98586, at *1 (6th Cir. Jan. 26, 1999).

137. *Id.*

138. *Id.*

139. *Id.*

140. *Id.*

141. *Travelers Indem. Co.*, 1999 WL 98586 at *1.

142. *Id.*

143. *Id.*

144. *Id.* at *3.

145. *Id.*

146. *Travelers Indem. Co.*, 1999 WL 98586 at *3.

C. *Broad Duty to Defend*

Courts continue to expand the liability of subcontractors and their insurance companies. Not only do they bend over backwards to construe the endorsement language against the insurer, but there is also a growing majority finding that the duty to defend means that the insurer selected to defend owes the additional insured a complete and prompt defense, even though other insurers may well be equally responsible to defend the claim.¹⁴⁷ This situation most commonly arises when the general contractor has been named an additional insured on several of his subcontractors' policies. If a case is tendered to him, the insurer must fully fund the defense and may not argue about which portions of the lawsuit are covered and which are not and/or which insurers are obligated to concurrently fund portions of the defense costs.¹⁴⁸ This was confirmed in the case of *Presley Homes, Inc. v. American States Insurance Co.*¹⁴⁹ In this case, various homeowners sued Presley Homes ("Presley"), a real estate development company, for defects in the construction of their homes.¹⁵⁰ Presley sought coverage for the suit pursuant to additional insured agreements it had procured with several of its subcontractors.¹⁵¹ Two of those subcontractors had policies with American States Insurance ("American States").¹⁵² American States agreed that it had a duty to defend Presley but claimed that its defense obligation was limited to the claims involving work performed by its named insured subcontractors, and thus it only offered to pay a percentage of Presley's defense costs.¹⁵³ When Presley and American States could not come to an agreement on a defense, Presley demanded a "full and complete defense" from American States.¹⁵⁴ The court agreed with Presley and held that American States carried not just an equitable portion of the defense, but it was also obligated to defend Presley, fully and completely, in the entire action.¹⁵⁵ American States was thereafter fully empowered to seek equitable contribution from all other potentially responsible carriers but could not rely on its endorsement to limit the defense obligation that it had to Presley, the additional insured.¹⁵⁶ Essentially, the holding of this case is that when the additional insured seeks a defense from a

147. WIELINSKI ET AL., *supra* note 6, at § XI.C.19.

148. *Id.*

149. *Presley Homes, Inc. v. American States Ins. Co.*, 108 Cal. Rptr. 2d 686 (Cal Ct. App. 2001). For one commentator's view on how this case has changed the duty to defend, see David Ezra, *How Presley Homes Has Changed the Duty to Defend*, 26 L.A. LAW. 17 (2003).

150. *Presley Homes, Inc.*, 108 Cal. Rptr. 2d at 688.

151. *Id.*

152. *Id.*

153. *Id.*

154. *Id.*

155. *Presley Homes, Inc.*, 108 Cal. Rptr. 2d at 690.

156. *See id.*

carrier that has named it as an additional insured, the additional insured is entitled to a full and complete defense, notwithstanding the fact that the named insured is not fully responsible for all damages arising out of the project.¹⁵⁷ The case further confirms that the duty to defend is a broad one and will implicate any carrier, regardless of how potentially small his indemnity obligation may be.¹⁵⁸

VIII. WHAT THE COURTS ARE NOT SEEING

When interpreting these additional insured endorsements, the courts' attitude seems to reflect the impression that this is only the insurance company's money, and that insurance exists for the protection of the insured. Courts do not seem to consider or even recognize the impact on the subcontractor when its policy is called upon to defend. Broad interpretation of these additional insured endorsements dramatically increases the number of times the subcontractor's insurer becomes involved in lawsuits and has several detrimental effects on the subcontractor.

A. *Policy Dilution*

Affording broad additional insured coverage dilutes the subcontractor's policy limits.¹⁵⁹ In a large construction dispute, there are surely other insureds permitted to make claims against the same policy, and thus the policy's limits can become depleted quickly.¹⁶⁰ With so many parties entitled to make claims against the named insured's policy, the probability exists that claims by these additional insureds may exhaust coverage in favor of additional insureds and leave the named insured without coverage, or worse, exposed to any unsatisfied additional insureds.¹⁶¹ Even if only one other party is making claims against the subcontractor's policy, every dollar paid out on his behalf reduces money available for the subcontractor.

B. *Increasing Premiums*

Allowing broad additional insured coverage that includes coverage for the negligent actions of others increases the potential for claims and losses. Because most subcontractors' policies are not purchased on a project-by-

157. *See id.*

158. It is this case that allows the general contractor and developer in our hypothetical to choose you, and only you, to defend them in the lawsuit. They are neither responsible nor required to find any other potential subcontractors who may be at fault and are entitled to a full and complete defense from your insurance carrier.

159. Steckman & Cleary, *supra* note 97, at 82.

160. MALECKI ET AL., *supra* note 3, at 71; Hendrick, *supra* note 34, at 632.

161. Hendrick, *supra* note 34, at 642. When the policy limits have been exhausted, the insurer is released from any further responsibility, whether it is to the additional insured or to the named insured. *Id.* at 635.

project basis,¹⁶² the insurer maintains an experience rating of these claims and losses.¹⁶³ The insurer then applies these claims and losses in the future when determining coverage and premiums for the subcontractor.¹⁶⁴ In many cases, this can mean outright non-renewal of the policy and the inability to get coverage at any cost.¹⁶⁵ If the carrier does agree to renew the policy, bad risk experience can only mean higher future premiums for the subcontractor.¹⁶⁶ This “hidden” cost is not fully passed on to the general contractor in the form of construction costs because it is not apparent at the time the subcontractor submits a price quote to the general contractor.¹⁶⁷ The minimal fee charged to the subcontractor for the actual endorsement is only a portion of the subcontractor’s cost.¹⁶⁸ Clearly it is the subcontractor alone who is bearing all of the future cost of the policy, not the general contractor who is only indirectly paying for a portion of the unaffected current risk.¹⁶⁹ Ironically, the small subcontractor, bearing all the future costs, is the party least able to absorb the insurance costs caused by the negligence of other parties.¹⁷⁰

C. *Deductibles*

Nearly all insurance policies have a deductible that must be satisfied before the policy will begin to pay for judgments, settlements, and, in some cases, defense costs.¹⁷¹ The named insured is liable for the deductible, which can range anywhere from a couple of thousand to a couple of million dollars.¹⁷² Paying this deductible is not so problematic if the subcontractor has a great deal of liability on his own, as he would be responsible for it anyway. However, this becomes very problematic if the subcontractor is found to be completely without fault or at fault for only a couple of thousand dollars. In such a situation, the subcontractor is being forced to pay the deductible out of his own pocket to satisfy the liabilities of another party. This can present a severe hardship on the subcontractor, as most subcontractors are small entities

162. Brief of Amicus Curiae American Subcontractors Association at 7, *Chrysler Corp. v. Merrell & Garaguso, Inc.*, 796 A.2d 648 (Del. 2002) (No. 38-2001).

163. Hendrick, *supra* note 34, at 643.

164. *Id.*

165. Cabbage, *supra* note 25, at 1.

166. MALECKI ET AL., *supra* note 3, at 71; Hendrick, *supra* note 34, at 643; Brief of Amicus Curiae at 10, *Chrysler Corp.* (No. 38-2001).

167. Hendrick, *supra* note 34, at 643.

168. Brief of Amicus Curiae at 7, *Chrysler Corp.* (No. 38-2001).

169. *Id.*; see Hendrick, *supra* note 34, at 643.

170. Brief of Amicus Curiae at 12, *Chrysler Corp.* (No. 38-2001).

171. See MALECKI ET AL., *supra* note 3, at 71; Hendrick, *supra* note 34, at 644; Cabbage, *supra* note 25, at 1. Some policies will pay defense costs immediately; the deductible must be paid only before the insurer will pay any settlement or judgment costs.

172. See MALECKI ET AL., *supra* note 3, at 63.

with limited resources.¹⁷³ Many subcontractors agree to large deductibles because large deductibles mean smaller premium payments; however, maxing out the deductible payment can devastate a small subcontractor.

There is no difference between dollars paid by the subcontractor before the deductible has been met and dollars paid by the insurance company after the deductible has been exceeded.¹⁷⁴ As mentioned previously, an insurer has no right of subrogation against its insured.¹⁷⁵ Therefore, the subcontractor has no cause of action against the general contractor for money he has paid out to satisfy his deductible, even if the money paid out was due to the sole fault of the general contractor.

D. No Accountability

Normally, an insurance company has complete control over the defense of its insureds, which entails the right to select the lawyer for its insured.¹⁷⁶ However, in the additional insured context, the subcontractors providing the insurance are normally not named in the initial lawsuit but are brought in much later only because the general contractor has tendered his defense to the subcontractor's insurer. The general contractor thus has already selected his lawyer, who has already expended time on his client's case.

Insurers have an enhanced duty of good faith, and failure to satisfy this enhanced obligation may expose the insurer to liability.¹⁷⁷ Thus, the insurer, not wanting to separate the general contractor from a lawyer who has already expended time on the lawsuit and potentially expose itself to bad faith damages, normally agrees to pay the lawyer the general contractor has already selected and waives its right to select counsel for the additional insured.¹⁷⁸ This puts the defense in the hands of lawyers who have little or no accountability as another insurer, and not their client, is paying the bills.¹⁷⁹ It is an open invitation to do unnecessary work at someone else's expense.¹⁸⁰

Even if the insurer does select counsel for the general contractor, it will, at the very least, have to select separate counsel for the general contractor and the

173. Berardi v. Getty Ref. & Mktg Co., 107 Misc. 2d 451, 463 (N.Y. Sup. Ct. 1980).

174. E-mail from Jack O'Neil, General Counsel, The Western Group, (Jan. 9, 2004) (on file with author).

175. See *supra* notes 49-52 and accompanying text.

176. Douglas R. Richmond, *Walking a Tightrope: The Tripartite Relationship Between Insurer, Insured, and Insurance Defense Counsel*, 73 NEB. L. REV. 265, 269 (1994) [hereinafter Richmond, *Walking a Tightrope*].

177. *Id.* at 276-77. For various bad faith issues that can arise specifically in the context of additional insured coverage, see Oonk, *supra* note 12, at 13-14.

178. E-mail from Jack O'Neil, General Counsel, The Western Group, (Aug. 26, 2003) (on file with author).

179. *Id.*

180. *Id.*

subcontractor as these parties will nearly always have adverse interests (i.e., the subcontractor will be claiming the general contractor caused the building defect or injury, while the general contractor will be arguing the same against the subcontractor). In such situations, the insurer has a duty to assign separate counsel for both parties.¹⁸¹ This leads to higher defense costs, which erode and reduce available coverage for the subcontractor.

IX. LEGAL ANALYSIS OF WHY THIS INTERPRETATION IS FLAWED

A. *Additional Insured Disputes Are Unique*

In construing these additional insured endorsements, courts are applying the well founded principle of insurance contract interpretation that all ambiguities in an insurance contract should be construed against the insurance company and in favor of coverage.¹⁸² However, this principle is not as suitable for determining coverage for the additional insured as it is for the named insured because the following two rationales for construing insurance contracts against the drafter are not applicable in the additional insured context.

The first justification for construing all insurance terms against the insurance company is that insurance policies are contracts of adhesion for which the insurer supplies the terms.¹⁸³ An adhesion contract is a form contract created by the stronger of the contracting parties and is offered on a “take it or leave it” basis.¹⁸⁴ The terms are imposed upon the weaker party who has no choice but to agree because the weaker party is usually unable to look elsewhere for a more favorable contract.¹⁸⁵ Therefore, all ambiguities

181. See Richmond, *Walking a Tightrope*, *supra* note 176, at 279.

182. In disputes over coverage for the additional insured, courts are applying this well founded principle of insurance law but offer only conclusory statements as to why this type of dispute should be treated in the same way that disputes over coverage for the named insured are. See, e.g., *Acceptance Ins. Co. v. Syufy Enter.*, 69 Cal. App. 4th 321, 328 (Cal. Ct. App. 1999) (“This language [“arising out of”] does not import any particular standard of causation or theory of liability into an *insurance policy*”) (emphasis added); *Maryland Cas. v. Nationwide Ins. Co.*, 65 Cal. App. 4th 21, 31 (Cal. Ct. App. 1998) (“Although *Gray* arose in the context of a defense duty owed to [a] named insured, its holding applies equally to an insured added by endorsement.”).

183. *Greenly v. Mariner Mgmt. Group, Inc.*, 192 F.3d 22, 26 (1st Cir. 1999); *Great Divide Ins. Co. v. Carpenter ex rel. Reed*, 79 P.3d 599, 606 (Alaska 2003); *Cont’l Ins. Co. v. Burr*, 706 A.2d 499, 500-01 (Del. 1998); *First Fin. Ins. Co. v. Am. Sandblasting Co.*, 477 S.E.2d 390, 392 (Ga. Ct. App. 1996); *Dairy Road Partners v. Island Ins. Co.*, 992 P.2d 93, 106-07 (Haw. 2000); *Clark v. Prudential Prop. & Cas. Ins. Co.*, 66 P.3d 242, 245 (Idaho 2003); *Masonic Temple Ass’n of Crawfordsville v. Indiana Farmers Mut. Ins. Co.*, 799 N.E.2d 21, 27-28 (Ind. Ct. App. 2002); *Burge v. Mid-Continent Cas. Co.*, 933 P.2d 210, 219 (N.M. 1996); *Symington v. Walle Mut. Ins. Co.*, 563 N.W.2d 400, 403 (N.D. 1997).

184. *Robin v. Blue Cross Hosp. Serv.*, 637 S.W.2d 695, 697 (Mo. 1982) (en banc).

185. *Id.*

should be construed against the drafter and in favor of coverage because the insured did not supply any of the terms.¹⁸⁶

None of these factors are present in the additional insured context. An additional insured is not forced to “take the policy or leave it,” but rather is asking to be added to a preexisting policy.¹⁸⁷ The contract is not offered by the stronger insurance company, but by the subcontractor. This lacks the oppressive features of an adhesion contract because it is the result of negotiation between two strong parties, the subcontractor and the general contractor. If anything, the subcontractor is the weaker party, not the additional insured general contractor. Additionally, the general contractor has many alternative places to turn. There are literally hundreds of subcontractors that general contractors could turn to should one refuse to include the language he desires in the additional insured endorsement. For these reasons, an additional insured endorsement is not a contract of adhesion.

The second rationale for construing all insurance terms in favor of coverage is that public policy warrants providing injured parties with an adequate source of compensation.¹⁸⁸ However, the additional insured general contractor nearly always has his own general liability insurance that will cover defense, judgment, and settlement costs.¹⁸⁹ In many cases, because the general contractor is a more economically powerful entity, his insurance actually will be superior to his subcontractor’s and thereby will be an even larger source of compensation for the injured victim. Therefore, in most cases, the rationale of ensuring that the injured party will be fully compensated does not apply in the additional insured context either.

B. *General Contractor Is Not a Party to the Contract*

When interpreting the scope of additional insured coverage, the same rights should not be afforded to additional insureds, who are not parties to the original insurance contract, as those given to named insureds, who are parties to the contract.¹⁹⁰ First, the general contractor (the additional insured) is not a party to the original contract between the subcontractor and his insurer and is therefore not in the position to demand, as one of the contracting parties could,

186. *Symington*, 563 N.W.2d at 403.

187. Pomerantz, *supra* note 93, at 128-29.

188. *Chrysler Corp. v. Merrell & Garaguso, Inc.*, 796 A.2d 648, 652 (Del. 2002); *Bosio v. Branigar Org.*, 506 N.E.2d 996, 998 (Ill. App. Ct. 1987); *Stickovich v. City of Cleveland*, 757 N.E.2d 50, 59 (Ohio Ct. App. 2001); Pomerantz, *supra* note 93, at 128.

189. *Am. Country Ins. v. Cline*, 722 N.E.2d 755, 762 (Ill. App. Ct. 1999); Nelson, *supra* note 44, at 67; Onk, *supra* note 12, at 12; Pomerantz, *supra* note 93, at 129; Richmond, *Additional Problems*, *supra* note 32, at 964.

190. Pomerantz, *supra* note 93, at 126-27.

that the contract be construed strictly against the other party.¹⁹¹ Second, the general contractor is urging a construction of the contract that is detrimental to both parties to the contract. It makes the insurance company liable for damages for which its named insured may not be fully liable and payment which could only result in higher insurance premiums for the named insured. Therefore, the general contractor, who is not a party to the contract, is not in a position to urge a construction of the contract which would be unfavorable to both parties to the contract.¹⁹²

C. Public Policy

The same public policy argument that is made for broad form indemnities can also be made for additional insured agreements.¹⁹³ A party who knows he will not be financially responsible for any damages has little incentive to take any preventative measures to ensure his negligence does not hurt a third party.¹⁹⁴ This lower degree of care, known as “moral hazard,” increases the likelihood of a loss or injury to a third party.¹⁹⁵ The possibility of moral hazard should also be, but has rarely been, construed by the courts to restrict additional insured endorsements.¹⁹⁶ Consequently, even when the broad form indemnity is declared unenforceable due to state law or otherwise, the subcontractor, in a majority of jurisdictions, may still be forced to save and hold harmless the general contractor if there is an additional insured endorsement in place.¹⁹⁷ For example, in *McAbee Construction Co. v. Georgia Kraft Co.*, the general contractor entered into a contract with the property owner which obligated the general contractor to save and hold harmless the

191. *Westfield Ins. Co. v. Galatis*, 797 N.E.2d 1256, 1262 (Ohio 2003); *Cook v. Kozell*, 199 N.E.2d 566, 569 (Ohio 1964).

192. *Cook*, 199 N.E.2d at 569.

193. Mehta, *supra* note 7, at 181.

194. *Id.* at 182. See also *supra* note 25 and accompanying text.

195. Mehta, *supra* note 7, at 182.

196. *Id.* at 183. The court in *Buckeye Union Ins. Co. v. Zavarella Bros. Constr. Co.*, 699 N.E.2d 127, 130 (Ohio Ct. App. 1997), did base its decision to void the additional insured agreement on public policy grounds, as did the court in *Amoco Prod. Co. v. Action Well Serv., Inc.*, 755 P.2d 52, 55 (N.M. 1988). Others have based their decisions on notions of common sense and fairness. Courts are mindful that they should interpret statutes to achieve common sense results and to avoid unreasonable or absurd results. *Snell v. Engineered Sys. & Designs, Inc.*, 669 A.2d 13, 20 (Del. 1995). To enforce an obligation to insure a party for its own negligence is inconsistent with a void indemnity obligation and is to do indirectly what cannot be done directly. See generally *Heat & Power Corp. v. Air Prods. & Chemicals, Inc.*, 578 A.2d 1202, 1209 (Md. 1990) (Eldridge, J., dissenting); *Walsh Constr. Co. v. Mut. of Enumclaw*, 76 P.3d 164 (Or. Ct. App. 2003); Brief of Amicus Curiae American Subcontractors Association at 10, *Chrysler Corp. v. Merrell & Garaguso, Inc.*, 796 A.2d 648 (Del. 2002) (No. 38-2001).

197. Mehta, *supra* note 7, at 183-84. See also *supra* note 61 and accompanying text.

owner from liability.¹⁹⁸ The court properly held that this indemnity provision, taken alone, would violate the Georgia law invalidating broad form indemnities.¹⁹⁹ The court went on to hold, however, that because the contractor also added the owner as an additional insured, the owner had effectively transferred the risk of loss, even that arising from his own negligence, to the contractor.²⁰⁰ In doing so, the court made an unexplained distinction between indemnification and additional insured status and did not speak to how this “shifting the risk of loss” evaded the public policy arguments that it had already agreed voided broad form indemnities.²⁰¹

198. *McAbee Construction Co. v. Georgia Kraft Co.*, 343 S.E.2d 513, 514 (Ga. Ct. App. 1986). The indemnity provision read:

The Contractor hereby assumes exclusive responsibility for all injury and/or damage to any and all persons whomsoever and to any property whatsoever, and loss of use, resulting from or arising out of the performance of the Work. The Contractor further agrees to indemnify, hold harmless and defend the Owner against all claims, suits, losses, damages and costs, including, but not limited to, court costs and reasonable attorney’s fees, on account of such injury or damage, except when caused by the sole negligence of the Owner. Provided, however, with respect to injury, including death, to any employees of the Contractor or any Subcontractor, the Contractor agrees to indemnify, hold harmless and defend the Owner from any claims, damages or suits filed against the Owner by any employees of the Contractor and/or any employees of any Subcontractor, even though such injury, including death, was caused by the sole negligence of the Owner.

Id.

199. *Id.* The Georgia statute invalidating broad form indemnities read:

A covenant, promise, agreement, or understanding in or in connection with or collateral to a contract or agreement relative to the construction, alteration, repair, or maintenance of a building structure, appurtenances, and appliances, including moving, demolition, and excavating connected therewith, purporting to indemnify or hold harmless the promisee against liability for damages arising out of bodily injury to persons or damage to property caused by or resulting from the sole negligence of the promisee, his agents or employees, or indemnitee is against public policy and is void and unenforceable, provided that this subsection shall not affect the validity of any insurance contract, workers’ compensation, or agreement issued by an admitted insurer.

Ga. Code Ann. § 13-8-2 (b) (1982).

200. *McAbee Constr. Co.*, 343 S.E.2d at 515.

201. Mehta, *supra* note 7, at 185. Many courts that have held similarly based their decisions on the insurance “savings clause” that many states have enacted along with their statutes invalidating broad form indemnities. A typical insurance savings clause in an anti-indemnity statute reads, “Nothing in this section shall affect the validity of any insurance contract.” The court reads the statute to disallow broad form indemnities but reads the savings clause to allow a party to procure insurance for another’s sole negligence. Courts also contend that the policy argument for allowing one to provide insurance for another’s sole negligence outweighs the policy arguments against it. *See, e.g.*, *Chrysler Corp. v. Merrell & Garaguso, Inc.*, 796 A.2d 648, 652 (Del. 2002) (“From the viewpoint of the injured worker, the greater the amount of insurance available to respond to his claim, the better the prospect for full compensation.”); *Bosio v. Branigar Org.*, 506 N.E.2d 996, 998 (Ill. App. Ct. 1987) (“An agreement in a construction contract requiring a contractor to provide insurance protecting the owner also protects the interest of the construction worker and the general public by preserving a potential source of

In the traditional liability insurance situation, moral hazard can be avoided because the named insured will be charged higher premiums if he engages in activities that bring about greater risk.²⁰² Additionally, to provide incentive for insureds to prevent loss, insurance companies may also reduce premiums if the named insured takes certain steps to reduce the risk of loss.²⁰³ However, the additional insured is shielded against these prospects because he is not responsible for premium payments to the insurer and is unaffected by the raising or lowering of premiums.²⁰⁴ Thus, an entity that is only paying a predetermined amount of the subcontractor's current insurance cost has no incentive to act more responsibly.²⁰⁵

D. *Why the Court's Solution Will Not Work*

1. No Bargaining Power

In most of these decisions, the courts suggest a solution: had the parties intended for coverage for the sole negligence of the additional insured to be excluded, language embodying that intent was available and should have been used in the endorsement.²⁰⁶ However, this is much easier said than done. In the negotiating process, subcontractors have little or no real bargaining power over the general contractor.²⁰⁷ Huge corporations exert disproportionate leverage over the contracting industry, and very few if any of these huge corporations are subcontractors.²⁰⁸ Many general contractors refuse to allow subcontractors to include limiting language in their additional insured endorsements, as they want the broadest coverage possible. The general contractor can easily turn to the numerous other subcontractors available

compensation for injured workers.”); *Stickovich v. City of Cleveland*, 757 N.E.2d 50, 59 (Ohio Ct. App. 2001) (“In the context of insurance, one is more apt to encounter public-policy arguments to require coverage or to override policy exclusions, rather than to invalidate coverage, because the predominate social purpose of liability insurance is to compensate injured persons.”); *Brzeczek v. Standard Oil Co.*, 447 N.E.2d 760, 764 (Ohio Ct. App. 1982) (“Courts do not, as a general matter, look unfavorably on agreements which, by requiring parties to carry insurance, afford protection to the public.”).

202. Mehta, *supra* note 7, at 185.

203. *Id.* at 186.

204. *Id.* at 187.

205. Brief of Amicus Curiae at 8, *Chrysler Corp.* (No. 38-2001).

206. *McIntosh v. Scottsdale Ins. Co.*, 992 F.2d 251, 255 (10th Cir. 1993); *Pardee Constr. Co. v. Ins. Co. of the West*, 92 Cal. Rptr. 2d 443, 454 (Cal. Ct. App. 2000); *Acceptance Ins. Co. v. Syufy Enter.*, 69 Cal. App. 4th 321, 331 (Cal. Ct. App. 1999); *National Union Fire Ins. Co. of Pittsburgh, Pennsylvania v. Glenview Park Dist.*, 632 N.E.2d 1039, 1042 (Ill. 1994); *Consol. Edison Co. v. Hartford Ins. Co.*, 610 N.Y.S.2d 219 (N.Y. App. Div. 1994).

207. *Walsh Constr. Co. v. Mut. of Enumclaw*, 76 P.3d 164, 169 (Or. Ct. App. 2003); *Steckman & Cleary*, *supra* note 97, at 83.

208. Brief of Amicus Curiae at 8, *Chrysler Corp.* (No. 38-2001).

should one refuse to include the language he desires in the additional insured endorsement. The reality is that in order to get scarce construction work, it may be necessary to agree to additional insured status, and the stronger general contractor usually is successful in obtaining the broad coverage he desires.²⁰⁹

2. Courts Will Find Coverage Illusory

Even if the subcontractor is successful in negotiating an additional insured endorsement limiting coverage to vicarious liability, some courts will still go out of their way to construe the language against the insurer. The words of Chief Justice Bilandic's dissent in *National Union Fire Insurance Co. of Pittsburgh, Pennsylvania v. Glenview Park District* represent the stance that some courts take towards additional insured agreements limiting coverage to vicarious liability; such coverage is illusory.²¹⁰ He stated:

NDS [the contractor] is an independent contractor and the Glenview Park District [the property owner] cannot be held vicariously liable for its acts except under a narrow exception. Even if it was to be held vicariously liable for the acts of NDS, the Glenview Park District would have an action for indemnity against NDS and, therefore, would have no need for vicarious liability coverage on the painting contract. The endorsement is illusory and provides no coverage at all. [T]he endorsement's exclusion violates public policy and should not be enforced.²¹¹

The majority in this case, while basing its decisions on other grounds, did indicate that it would be willing to hear the argument that these types of exclusions are illusory and thus always unenforceable.²¹²

209. See *Berardi v. Getty Ref. & Mktg. Co.*, 107 Misc. 2d 451, 463 (N.Y. Sup. Ct. 1980); *Walsh Constr. Co.*, 76 P.3d at 169 (citing Audio Tape, House Committee on Commerce, Subcommittee on Business, SB 788, Tape 33, Slide A, (May 11, 1995) [statement of Representative Larry Wells]).

210. This argument has been made in several cases by general contractors seeking a declaratory judgment that the subcontractor's insurance has the duty to defend and indemnify him for his own negligence, but as of yet has not been accepted by the courts. See, e.g., *Liberty Mut. Fire Ins. Co. v. Statewide Ins. Co.*, 352 F.3d 1098, 1101 (7th Cir. 2003); *Nat'l Union Fire Ins. Co. of Pittsburgh, Pennsylvania v. R. Olson Constr. Contractors, Inc.*, 769 N.E.2d 977, 985 (Ill. App. Ct. 2002); *Am. Country Ins. Co. v. Kraemer Bros., Inc.*, 699 N.E.2d 1056 (Ill. App. Ct. 1999); *Am. Country Ins. Co. v. Cline*, 722 N.E.2d 755, 762 (Ill. App. Ct. 1999). The *Liberty* court even noted "[The general contractor] has not convinced us there are indications the tide is turning in its favor." *Liberty Mut. Fire Ins. Co.*, 352 F.3d at 1101. It still remains, however, a potentially viable argument for the general contractor to make.

211. *Nat'l Union Fire Ins. Co. of Pittsburgh, Pennsylvania v. Glenview Park Dist.*, 632 N.E.2d 1039, 1046 (Ill. 1994) (Bilandic, C.J., dissenting).

212. *Id.* at 1043. This same concept is also discussed in Douglas Richmond's article, *The Additional Problems of Additional Insureds*. He states that public policy may actually strengthen an argument for liability coverage for the additional insured's sole negligence. See Richmond, *Additional Problems*, *supra* note 32, at 964. See also Hendrick, *supra* note 34, at 625.

3. Courts Will Ignore Exclusionary Language

In addition to holding additional insured endorsements limiting coverage to vicarious liability illusory, courts may simply ignore clear exclusionary language. Such was the case in *Bonner County v. Panhandle Rodeo Ass'n*.²¹³ The Idaho Supreme Court, although not relying on public policy, refused to uphold a clear exclusion in the additional insured endorsement.²¹⁴ In this case, Bonner County was covered under an additional insured endorsement that expressly and unambiguously excluded liability arising out of the County's sole negligence.²¹⁵ The endorsement excluded "liability of the [additional insured] arising out of [the additional insured's] sole negligence."²¹⁶ In addition to promising to procure insurance for the County, Panhandle Rodeo Association ("Panhandle") also agreed to hold the County harmless for any liability incurred as a result of the rodeo performance.²¹⁷ Despite the general rule that courts must enforce a clear and unambiguous policy provision, the *Bonner* Court went outside the policy and interpreted its terms together with the underlying agreement between the County and Panhandle.²¹⁸ Once it did so, the exclusion of liability caused by the additional insured's sole negligence and the agreement to hold harmless for any liability incurred were at odds. The court stated, "Accordingly, we find, under the facts before us, the ambiguous circumstance in which a policy has been issued purportedly providing coverage but with exclusionary provisions which, if applied, would narrow that coverage to 'defeat the very purpose or object of the insurance.'"²¹⁹ Consequently, the exclusion was not given effect, and Panhandle's insurer had a duty to defend the County on a claim indisputably arising out of the County's sole negligence.²²⁰

Another case similar to *Bonner* is *Maryland Casualty Co. v. Nationwide Insurance Co.*²²¹ Again, the unambiguous language of the endorsement at issue in this case clearly limited coverage of the additional insured to instances when the additional insured was held vicariously liable for acts of the named insured.²²² The court, notwithstanding the endorsement's clear exclusions, ruled that the subcontractor's insurer owed a duty to defend the general

213. *Bonner County v. Panhandle Rodeo Ass'n*, 620 P.2d 1102 (Idaho 1980).

214. *Id.* at 1106-07.

215. *Id.* at 1104.

216. *Id.* at 1104.

217. *Id.* at 1103.

218. *Bonner County*, 620 P.2d at 1106-07.

219. *Id.* at 1106.

220. *Id.* at 1106-07. In coming to this conclusion, the court disregarded the well established principle that courts should not strain to create ambiguities in an insurance policy where none exist. See *Richmond & Black*, *supra* note 95, at 807 n.236.

221. *Maryland Cas. Co. v. Nationwide Ins. Co.*, 65 Cal. App. 4th 21 (Cal. Ct. App. 1998).

222. *Id.* at 28.

contractor when the allegations of the complaint did not allege vicarious liability.²²³ In this case, Nielsen Construction Company (“Nielsen”) served as the general contractor of a construction project.²²⁴ Nielsen hired various subcontractors, including West Coast Sheet Metal (“West Coast”) and R.W. Strang Mechanical (“Strang”).²²⁵ The subcontractors’ agreements required the subcontractors to obtain general liability coverage and name to Nielsen as an additional insured.²²⁶ Nielsen was subsequently sued for various construction defects and tendered his defense to Nationwide, the company insuring both West Coast and Strang.²²⁷ The language of the endorsement read, “Who is an insured is amended to include as an insured [Nielsen] but . . . this insurance . . . applies only to the extent that [Nielsen] is held liable for [West Coast’s and Strang’s] acts or omissions”²²⁸

The court acknowledged that this language did limit the scope of the subcontractors’ indemnity obligations to situations where Nielsen would be held vicariously liable for either West Coast’s or Strang’s actions.²²⁹ It went on, however, to disregard all the limiting language in the endorsement and stated that because the duty to defend is broader than the duty to indemnify, Nationwide still owed a duty to defend Nielsen, even though Nielsen was fully covered by his own insurance policy.²³⁰

4. Courts Will Strictly Construe the Limitation

In addition to finding endorsement language attempting to limit additional insured coverage illusory or ignoring it completely, the court may strictly construe any limitation in the endorsement. For example, if the complaint alleges anything other than common law negligence, such as the violation of a statute, the court may strictly construe the limitation to exclude only common law negligence and to find any other cause of action covered. A case that illustrates this point is *National Union Fire Insurance Co. of Pittsburgh, Pennsylvania v. Glenview Park District*.²³¹ In this case, National Decorating Service (“NDS”) and Glenview Park District (“Glenview”) entered into a contract for NDS to paint portions of the Glenview Ice Center.²³² NDS named Glenview as an additional insured on its general liability policy issued by

223. *Id.* at 33-34.

224. *Id.* at 25.

225. *Maryland Cas. Co.*, 65 Cal. App. 4th at 25.

226. *Id.*

227. *Id.*

228. *Id.* at 28.

229. *See id.* at 31.

230. *Maryland Cas. Co.*, 65 Cal. App. 4th at 25, 31.

231. *Nat’l Union Fire Ins. Co. of Pittsburgh, Pennsylvania v. Glenview Park Dist.*, 632 N.E.2d 1039 (Ill. 1994).

232. *Id.* at 1040.

National Union Fire Insurance Company (“National Union”).²³³ The endorsement stated that it extended coverage to additional insureds “with respect to operations performed by” the named insured.²³⁴ However, the endorsement also contained a clause that excluded from coverage “damages arising out of the negligence” of the additional insured.²³⁵

During NDS’s performance of its contract with Glenview, one of NDS’s employees was injured after falling from a scaffold and filed suit against Glenview for his injuries.²³⁶ The complaint alleged that Glenview was liable under both the Structural Work Act and common law principles of negligence.²³⁷ Glenview tendered its defense to National Union, who refused coverage claiming the endorsement in NDS’s insurance policy excluded coverage for damages arising from Glenview’s “negligence,” which would include the claims for Structural Work Act violations and ordinary negligence.²³⁸ The court disagreed and ordered National Union to defend Glenview. The court stated:

[W]e find it significant that the explicit language of the endorsement refers solely to “damages arising out of the *negligence*” of the additional insured. In our view, this plain and unambiguous reference to “negligence” in the exclusionary provision of the present insurance policy is reasonably interpreted as a reference to the *common law* tort of negligence. If National Union intended the term “negligence” to include allegations that the additional insured had committed a *statutory* tort, such as a violation of the Structural Work Act, it could have easily modified its insurance policy to so provide.²³⁹

Having decided that National Union had a duty to defend Glenview on one count, the court then relied on existing Illinois law that an insurer, faced with a multi-count complaint only one count of which is covered, has an obligation to provide a full defense for all counts, even those which are not covered.²⁴⁰ The result in this case was that even after successfully negotiating contract terms excluding coverage for the negligence of the additional insured, the named insured’s carrier still had a duty to provide a full defense for claims resulting from the negligence of the additional insured.

233. *Id.*

234. *Id.*

235. *Id.* at 1040-41.

236. *Nat’l Union Fire Ins.*, 632 N.E. 2d at 1040.

237. *Id.*

238. *Id.*

239. *Id.* at 1042 (emphasis in original).

240. *Id.* at 1043.

X. SOLUTION

A. *The Courts*

Because of the courts' expansive interpretation of additional insured endorsements, the general contractor is essentially being handed coverage under the subcontractor's policy even for the consequences of his own negligence, after the subcontractor's work is finished and frequently completely outside the subcontractor's knowledge or power to control.²⁴¹ The preceding cases illustrate that the courts' own suggestion to include limiting language in the endorsements will not work in some cases. The courts have consistently demonstrated their belief that these endorsements should be construed as broadly as possible and will construe strictly or even ignore any limiting language to find such coverage. Thus, it seems that the best solution lies with the courts themselves.

The courts should follow the shrinking minority's interpretation of additional insured endorsements and allow coverage for vicarious liability only. The allegations in the complaint must be within the scope of coverage for imputed liability for the duties to defend or to indemnify to be triggered. Restricting coverage to vicarious liability is not illusory. An illusory contract is defined as an agreement in which one party gives as consideration a promise that is so insubstantial as to impose *no* obligation.²⁴² Such a limited endorsement does impose an obligation on the named insured's insurance carrier: it must defend and indemnify the additional insured should he be alleged or be found vicariously liable for an act or omission of the named insured. Simply because there are fewer vicarious liability claims than negligence claims does not make coverage illusory.²⁴³ The fact that the subcontractor was only charged a minimal amount to add the general contractor to his policy reflects the reality that only narrow exceptions should be covered.²⁴⁴ If the general contractor wishes to have the subcontractor procure coverage for all of his operations, he should pay more than a nominal endorsement fee.²⁴⁵

The purpose of imposing liability on a party is not only to punish it for its wrongdoing, but to force it to consider whether steps should be taken to prevent a reoccurrence of the accident.²⁴⁶ Subcontractors are not in a position

241. See Hendrick, *supra* note 34, at 642; Cabbage, *supra* note 25, at 3; Brief of Amicus Curiae American Subcontractors Association at 9, Chrysler Corp. v. Merrell & Garaguso, Inc., 796 A.2d 648 (Del. 2002) (No. 38-2001).

242. BLACK'S LAW DICTIONARY 322 (7th ed. 1999).

243. Am. Country Ins. v. Kraemer Bros., Inc., 699 N.E.2d 1056, 1062 (Ill. App. Ct. 1998).

244. See Nelson, *supra* note 44, at 29.

245. Am. Country Ins. Co. v. Cline, 722 N.E.2d 755, 762 (Ill. App. Ct. 1999).

246. Ira S. Bushey & Sons, Inc. v. United States, 398 F.2d 167, 170 (2d Cir. 1968).

to prevent all workplace defects and accidents and thus should not bear all the risk for them. They do not dictate the work sequence that creates the conditions allowing many accidents to happen.²⁴⁷ Subcontractors do not design buildings.²⁴⁸ They cannot always ensure that their work will appropriately fit with work done by subsequent subcontractors, much less that their work will not be damaged by a subsequent subcontractor in a rush.²⁴⁹ General contractors, on the other hand, are responsible for sequencing, inspecting, and coordinating projects and otherwise bringing the entire job together, so they cannot rationally evade all responsibility for worker injury and defect claims.²⁵⁰ The general contractor, the party with the most authority and power, is in the best position to prevent and to avoid mistakes.

Pushing all liability onto the subcontractor, which is precisely the result of these expansive additional insured endorsement interpretations, is forcing the least able party to bear the cost for another's negligence and is encouraging *no one* to take any steps to prevent future accidents. In the previously discussed cases of *Acceptance Insurance Co. v. Syufy Enterprises*²⁵¹ and *Shell Oil v. AC & S, Inc.*,²⁵² the additional insureds were undisputedly solely at fault, yet still had to pay nothing. By using their superior bargaining power to push insurance obligations down to weaker parties, the additional insureds have no incentive to take any precautionary measures to prevent such accidents again. For example, if the court in *Shell Oil Co.* would have read the Shell endorsement to cover only situations where the owner was alleged to be vicariously liable, the subcontractor's insurer would not have become involved in any way. Shell's own insurance provider would have paid for its defense and any judgments against it. This is a fair and logical result: Shell caused the injury, Shell's insurance pays, Shell's insurance premium goes up, and now Shell has incentive in the future to prevent such accidents. The subcontractor's insurance pays nothing, which is only reasonable as the subcontractor did nothing wrong.

B. *The Parties*

A simple solution to the additional insured situation seems to lie with the subcontractors simply assuming greater insurance costs in their bids to the general contractors. However, even if the subcontractor begins to assume greater insurance costs in formulating his bids as his premium increases, the

247. Cabbage, *supra* note 25, at 3.

248. *Id.*

249. *Id.*

250. *Id.*

251. *Acceptance Ins. Co. v. Syufy Enter.*, 69 Cal. App. 4th 321 (Cal. Ct. App. 1999). For a summary of the facts and holding of this case, see *supra* notes 98-110 and accompanying text.

252. *Shell Oil v. AC & S, Inc.*, 649 N.E.2d 946 (Ill. App. Ct. 1995). For a summary of the facts and holding of this case, see *supra* notes 111-125 and accompanying text.

general contractor is going to pass the subcontractor's cost to the property owner with a mark-up.²⁵³ If the general contractor can keep his own insurance costs down by insisting on additional insured status and passing his risk downstream, he will not care if the subcontractor has more cost because he simply passes the cost up to the owner.²⁵⁴ Consequently, this issue is going to resolve itself through negotiation only when enough subcontractors realize the sizeable risk they are assuming and start to say, "NO."²⁵⁵

In lieu of offering the general contractor additional insured status, a promising alternative is to offer him an Owner-Contractor Protective (OCP) policy.²⁵⁶ This policy has advantages for both the subcontractor and the general contractor.²⁵⁷ From the general contractor's perspective, it is beneficial because he is not sharing the limits of the subcontractor's policy with the subcontractor and every other additional insured, rather he is covered by a project-specific policy with separate limits.²⁵⁸ The subcontractor who purchases the insurance receives no coverage under this policy (he is still covered by his own general liability policy), so the general contractor has more coverage for himself.²⁵⁹ Additionally, the general contractor is a directly insured party, so the OCP carrier owes a duty to defend any claims immediately and to satisfy any imposed liabilities that fall within the scope of coverage.²⁶⁰

From the subcontractor's perspective, OCP is beneficial because it does not consume his own policy limits, and the loss experience is counted separately from his own liability policy's loss experience (i.e., his own policy premium will not increase or be cancelled).²⁶¹ Also, the negligence of the insureds is excluded from coverage because the policy is limited to claims for the named insured's vicarious liability or claims based on supervisory functions of the general contractor.²⁶²

Providing this OCP policy will force a subcontractor, before submitting a bid to the general contractor, to price separately and to contemplate both the risk it is agreeing to insure and what multiple of that risk should be included in his bid to the general contractor.²⁶³ This system, which holds each individual

253. E-mail from Jack O'Neil, General Counsel, The Western Group, (Jan. 15, 2004) (on file with author).

254. *Id.*

255. *Id.*

256. Hendrick, *supra* note 34, at 646.

257. *See id.*

258. Cabbage, *supra* note 25, at 4.

259. *Id.*

260. Hendrick, *supra* note 34, at 646.

261. *Id.*; Cabbage, *supra* note 25, at 4.

262. Hendrick, *supra* note 34, at 646; Cabbage, *supra* note 25, at 4.

263. Cabbage, *supra* note 25, at 4.

insured financially responsible for his own behavior, would bring a reasonable pricing model to the market for construction insurance and strengthen incentives for construction participants to keep prices down by safeguarding both workers and consumers.²⁶⁴

XI. CONCLUSION

The courts' broad interpretation of additional insured endorsements are conferring too much coverage on general contractors. The initial intent of these endorsements was to give immediate and direct coverage to general contractors in situations where the general contractor was held vicariously liable for acts of his subcontractor. The low price charged for these endorsements confirms this intent. However, courts have now begun to read broadly these endorsements and confer coverage not only for vicarious liability, but for the sole negligence of the general contractor as well. Courts do not understand the unique status additional insureds hold and are therefore interpreting these endorsements in the same manner they would in a dispute over coverage for the named insured. These expansive readings have a detrimental effect on subcontractors whose insurance is called on to defend. However, the courts do not see this because the parties in front of them are not normally the subcontractors, but two insurance companies litigating over who should bear the financial liability. The subcontractor's deductible is many times maxed out, his premiums may go up, and his policy may be cancelled. Additionally, no public policy argument can justify this broad interpretation. The general contractor often has his own liability insurance coverage to pay out any judgments, settlements, or defense costs he incurs. He is also, as an additional insured, not entering into a contract of adhesion, thereby negating the argument that any ambiguous terms should be interpreted in his favor. Lastly, pushing this burden of covering the general contractor for the general contractor's sole negligence is making the subcontractor, who has no control over the risk, responsible for suffering the financial loss. It is the subcontractor, the least able to pay for the cost of this risk, who is left paying for the negligent acts of others. Additional insured endorsements should be read with the original intent in mind: vicarious liability only.

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264. *Id.*

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