Effective Use of Additional Insured Endorsements to Shift Risk

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I. OVERVIEW TO THE CONSTRUCTION CONTRACT PROCESS

A. IDENTIFYING THE PROBLEM

When contracting for construction, the owner, the architect, the engineer, the general contractor, and the subcontractors all face risk. The most common risks are bodily injury and damage to property. Damage to property can be divided into (a) damage by a contractor or subcontractor to the own work of that contractor or subcontractor and (b) damage by a contractor or subcontractor to work of another party. The parties to the construction contracts should understand the potential grounds for a claim arising from a project, and they should also be aware of risk shifting tools, including contractual provisions and insurance. As a general rule, owners and general contractors attempt to push risk "downstream" to the subcontractors. In contrast, the subcontractors must be aware of the risks accepted by contract and must make sure that, to the extent possible, such risks are covered by insurance.

When drafting and negotiating the contract, the attorney for any party in the construction process must consider each of these risks, the potential means of risk shifting and the insurance coverage available. Only by appreciating the exposure generated by each of these risks can the attorney select the proper indemnification, limitation of liability, and insurance provisions to protect the client.

Risk shifting needs to start from the beginning. The proper team must be assembled to identify the problem and they must work together towards that goal.

For a major construction or repair project, the team must include the owner's representative, the engineer, and counsel. The initial contract with the engineer must be specific as to the work to be done. When it comes to risk shifting, note that engineers and architects often will refuse to include indemnification or insurance clauses naming others as additional insureds. While they may identify their own coverage, it is common for them to refuse to add others to the policy.

Once that initial contract is in place, there should be a thorough discussion of the proposals among the owners, engineer, and counsel. At that point, all parties should be clear as to the next steps, including retention of contractors.

B. Preparation of Bid Documents

With a plan in place, the next task is preparation of bid documents. On larger projects, this is a time when things often go wrong.

Quality bid documents have two key parts. The first is the drawings and specifications prepared by the engineer. Those documents must be as specific as possible. They need to spell out, to the greatest degree possible, products to be used and quantities.

The second is part is a full copy of the contract. The bid document should include a full copy of the contract, including the contract, the general conditions, all riders or additional conditions, and the specifications. It must include detail as to the insurance to be provided, whether the insurance also applies to sub-contractors (if they are allowed at all), and the additional insured forms.

The document must be in such shape that the only changes would be adding the name of the contractor awarded the job, the agreed prices, and any relevant dates.

C. Review of Competing Bids

On large renovation projects, an often overlooked step is review of competing bids. The engineer must preliminarily review competing bids and rule out any clearly non-conforming bids.

The next step is a meeting among owner, engineer, counsel for the owner, and bidders. That meeting should be run by the engineer. The engineer needs to review each bid with each bidder invited to the meeting. The scope of work and plan for work must be discussed. The goal is for each bidder to present the plan as to how that contractor intends to complete the work. Owner and engineer should question the bidders in detail.

During this process, there are two important red flags. First, at times one bidder will submit a bid that lists one part of the project at a significantly higher price than competing bidders. There are two reasons for doing so. At times, the bid will simply be higher. That contractor will simply demand more for part of the project. However, there is a second option. At times, one contractor will notice a problem that others do not notice. For instance, that contractor may recognize that while cutting concrete, there may be hidden issues including electrical or plumbing lines running, which will need to re-located. As such, it is worthwhile for the engineer to ask the contractor about items that significantly out of line with other bids.

Conversely, low bids may also be either a warning that a contractor does not recognize an issue or it may be that the contractor is willing to do the job for less. Owners tend to want the low bidder and often will not ask those questions. The danger is that a low bid (or a bid that does not include a higher amount for certain work) may lead to a request for an add order on the basis that the contractor did not know of a hidden condition.

II. PRIOR TO THE LOSS: ADDITIONAL INSURED ISSUES AND THE CONTRACT REQUIRING COVERAGE

a. Introduction to the CGL Policy: The Basic Structure of the Policy

Commercial General Liability [CGL] policies have a similar structure, whether the policy is an Insurance Services Office Inc. [ISO] policy written by a major insurer or whether the policy is a "script" policy written by a smaller insurer.

The policies all start with the "Declarations." That section of the policy lists the named insured, the policy period, the policy limits, and lists the forms and endorsements.

The policy next has a "Commercial General Liability Coverage Form." That form starts with the "Insuring Agreement." The insuring agreement sets forth the basics for coverage. Typically, the Insuring Agreement will state that the insurer has the duty to both defend and indemnify an insured for a covered loss that takes place during the policy period.

The next relevant section of the CGL Coverage Form will be the list of exclusions. The exclusions that most often come up in construction litigation are exclusions for contractual liability, employer's liability, and damage to "your work." The "your work" exclusion bars coverage for damage by a contractor to the contractor's own work. The exclusion serves to make the policy an insurance policy rather than a performance bond. A CGL policy covers accidents that damage the property. It does not cover faulty performance that damages only the work done by the contractor.

The next important section is commonly referred to as "Section II, Who Is An Insured." That section identifies the insureds under the policy. Additional insured endorsements are separate documents added to the policy that serve to modify and expand that section of the policy.

Finally, the last relevant section of the Form is the "Other Insurance" section. Often, construction contracts will require that the contractor's (or subs', when the sub contracts with the general) policy be "primary and non-contributory for additional insureds." That section, along with the additional insured endorsement, must be consulted to determine if the policy provided complies with the contractual term. In many states, that provision is a key to effectively shifting loss. When a policy is "primary and non-contributory", that policy alone covers the loss. For example, where an owner is covered by both its own CGL and as an additional

insured under a contractor's policy that is primary and non-contributory, the contractor's policy provides the coverage and the owner's will not be touched.

Following the Coverage Form, the policy has various endorsements. Those endorsements serve to modify the coverage form. Among those endorsements are the Additional Insured endorsements. Note that insurers often charge an additional premium for additional insured endorsements. At times, courts have looked to the cost of the additional insured endorsement in determining the extent of coverage provided under the endorsement. *Liberty Mutual v. Statewide*, 352 F.3d 1098 (7th Cir. 2003).

b. <u>The Types of Additional Insured Forms:</u>
<u>ISO v. Script</u>
<u>Blanket v. Schedule</u>

The ISO was established in 1971. That office produces widely used insurance forms, including the most commonly used Commercial General Liability forms.

Each type of ISO form has a standard form number. For ongoing operations additional insured forms, that number is "20 10." Since the form is part of a commercial general liability policy, the policy form number starts with "CG." Finally, the last numbers are the month and year the form was approved. As such, "CG 20 10 11 85" would be a commercial general liability additional insured form approved in November 1985.

In contrast, "script" forms are forms prepared by a specific insurer and are limited to that insurer's policies. The numbering system on those policies is somewhat random.

Whether ISO or script, the policy's declarations section will include a list of all policy forms, listed by number. Insurers and producers are notorious for inadvertently sending an incomplete policy or inaccurate forms. As such, any person reviewing a policy should start with the declarations. The person should go down the list, identifying each form by number and confirming that the policy part or endorsement has been sent.

Additional insured forms – whether ISO or script – can be divided into "scheduled" endorsements and "blanket" endorsements. Scheduled endorsements provide additional insured coverage to a designated party. Some insurers will change "scheduled endorsements" to a "blanket" by scheduling "where required by written contract."

Blanket endorsements, in contrast, provide coverage to a range of entities that are not specifically listed. Typically, the blanket endorsement will identify additional insureds by description. They nearly always require a require a written contract. The biggest single mistake that owners and insured make on additional insured issues is to rely on a blanket endorsement without having a written contract.

c. The Language and Limitations of the Standard Forms

i. Introduction and a Warning about "Broad Form"

One of the terms we still see constantly in construction contracts is reference to "Broad Form" coverage. Unfortunately, it references policy language that is very difficult to obtain. The term refers to a very limited number of standard ISO additional insured forms. Those forms now are at least two generations out of date. Those forms are discussed below.

It would be very difficult for a contractor to comply with a requirement for "Broad Form" additional insured coverage. Any contractor faced with a contract requiring "Broad Form" coverage should contact their insurance producer to determine if it is possible to obtain such coverage. The worst-case scenario for a contractor is that the contractor signs a contract, invests in materials for the project, and then is kicked off the job for failure to comply with the insurance requirement. At times, owners will "build in breach" by requiring coverage that it knows the contractor cannot obtain. The owner will allow the contactor to start the job. However, if it becomes convenient for the owner to remove the contractor for convenience or otherwise, the owner will cite the failure to obtain proper coverage. Under most construction contracts, the owner would have that right.

The following are the most commonly used ISO forms. Owners and contractors should have a working understanding of each of these forms. From an owner's perspective, the construction contract should specify one of the following forms as a requirement. Contractors should review bid documents to determine which endorsement is required. Further, general contractors will also have to discuss the coverage requirements with any sub-contractors in order to make sure that the GC's bid includes subs able to obtain proper coverage.

ii. CG 20 10 11 85 (Ongoing operations) (Broad Form)

The first form that has continuing relevance is CG 20 10 11 85. It is the "broad form" coverage endorsement. Note that it dates back to November 1985.

As with all "scheduled" additional insured forms, the form was designed to include a schedule specifically naming the additional insureds.

The form provided:

> "Who is an insured (Section II) is amended to include the person or organization show in the Schedule, but only with respect to liability arising out of `your work' for that insured by or for you."

CG 20 10 11 85 included completed operations. As such, there was no separate form.

The "arising out of" language is very broad, and would include the additional insured's sole negligence. Courts take a very broad interpretation of that language. For instance, in a Texas case, a court found that "liability arising out of" work or operations is satisfied when the employee of the named insured was injured (1) while present at the worksite and (2) in connection with performing the named insured's business. *See Mid–Continent Cas. Co. v. Swift Energy Co.* (5th Cir.2000) 206 F.3d 487, 498–500; *McCarthy Bros. Co. v. Continental Lloyds* (Tex.App.1999) 7 S.W.3d 725, 730 [more than a mere presence existed because employee was carrying out a necessary part of his job for the named insured]; *Admiral Ins. Co. v. Trident NGL, Inc.* 988 S.W.2d 451, 454 (Tex.App.1999).

Similarly, a Wyoming court, in *Marathon Ashland Pipe Line v. Maryland Cas. Co.* 243 F.3d 1232 (10th Cir.2001) concluded: "`arising out of' language as used in insurance contracts carries a 'natural consequence' level of causation."

California had a slightly stricter standard. There, the analysis requires more than "but for" analysis. However, the same court found that the clause "broadly links a factual situation with the event creating liability, and connotes only a minimal causal connection or incidental relationship." *Fireman's Fund Ins. v. Atlantic Richfield Co.*, 115 Cal.Rptr. 2d 26 (2001).

That form was excellent for owners and upstream contractors as it provided additional insured coverage even where the named insured's fault was limited or non-existent.

iii. CG 20 10 10 93 (Broad Form)

In 1993, the standard form was amended to exclude completed operations. The form provided in relevant part:

> Who is an insured is amended to include "the person or organization shown in the Schedule, but only with respect to ***your ongoing operations*** performed for that insured." [emphasis added].

For that form, no standard completed operations additional insured endorsement was available.

iv. CG 20 10 10 01 (Broad Form)

The form continued to use the broad "arising out of" language. As with the other forms, it includes blank space for the name(s) of scheduled additional insureds. The operative language of the endorsement provides as follows:

> A. Section II - **Who is an insured** is amended to include as an insured the persons or organization shown in the schedule, but only with respect to liability arising out of your ongoing operations performed for that insured.
>
> Section B of that endorsement specifically excludes work:
>
> (1) Work after covered operations have been completed; and
>
> (2) Work after it has been put to its intended use other than by a contractor or subcontractor performing operations as part of the same project.

For completed operations, form **CG 20 37 10 01** was to be used. That form included blank boxes for the following:

> The Name of Person or Organization;
>
> Location and Description of Completed Operations;
>
> Additional premium.

Section II of that form amended the "Who is an insured" language as follows:

> "Who Is an Insured" is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of `your work' at the location designated and described in the schedule of this endorsement performed for that insured and included in `the products-completed operations hazard.'"

v. CG 20 10 07 04 (Intermediate Form)

Form CG 20 10 07 04 served to limit coverage. Rather than simply "arising out of" it added that the loss must have been caused by some act or omission of the named insured. In doing so, it excluded coverage for the additional insureds sole negligence.

Like the others, it included a schedule for name of additional insured(s) and the location(s) of the work. The key language to the form provided:

> Section II - Who Is An Insured is amended to include the scheduled entities "but only with respect to liability for `bodily injury', `property damage' or `personal and advertising injury' caused in whole or in part by: **1. Your acts or omissions; or 2. The acts or omissions of those acting on your behalf**; in the performance of your ongoing operations for the additional insured(s) at the locations designated above."

The form excluded completed operations. The related completed operations form was CG 20 37 07 04 which provided in relevant part:

> "Who is an insured is amended to include as an additional insured the persons or organization(s) shown in the Schedule, but only with respect to liability for `bodily injury', or `property damage' caused, in whole or in part by `your work' at the location designated and described in the schedule of this endorsement performed for that additional insured and included in the `products-completed operations hazard.'

vi. CG 20 10 04 13 (Narrow Form)

In 2013, ISO again limited coverage. This time, the changes were intended to make sure that the additional insured endorsement did not provide coverage broader than required by contract. The following language was added to CG 20 10 07 04:

> "The insurance afforded to such additional insured only applies to the extent permitted by law."
>
> "If coverage provided to the additional insured is required by a contract or agreement, the insurance afforded to such additional insured will not be broader than that which you [the insured] are required by the contract or agreement to provide for such additional insured."

> If coverage to the additional insured is required by a contract or agreement, the most [insurer] will pay on behalf of the additional insured is the amount of insurance 1. required by contract or agreement; or 2. available under the applicable Limits of Insurance shown in the Declarations, whichever is less.

For Completed Operations, the relevant form is CG 20 37 04 13. That form contains the same restrictions as CG 20 10 04 13.

In addition, in 2013, the ISO added form CG 20 01 04 13. That form revised the "other insurance" clause to state that the coverage to additional insureds is primary and non-contributory. Construction contracts typically require such coverage. Construction contractors would be well advised to require that form in the "Insurance" provision of the contract.

d. Blanket Additional Insured Forms

As with ISO scheduled AI forms, ISO also has blanket forms. The first is CG 20 33. That form provides additional insured coverage where required by contract. Importantly, the contract must be between the named insured and the additional insured. It does not cover "upstream" contractors. For instance, an electrical sub-contractor which is a named insured on a CG 20 33 will provide coverage to the general contractor, but will not provide coverage to the owner.

The most recent example, CG 20 33 04 13, provides coverage substantially similar to the coverage provided under CG 20 10 04 13.

In contrast, CG 20 38 provides coverage for "upstream" contractors. Rather than requiring a direct contract, it provides coverage for "any other person or organization you are required to add as an additional insured under the contract or agreement." As with 20 33, it tracks the 20 10 form.

Blanket forms nearly always require a written contract. The problem that most often arises is when the contract simply says "shall be named as additional insureds." Courts will often find that sort of clause vague and unenforceable. The clause must be specific as to the policies and coverage limits. Where there is no written contract at all, a court is likely to find that that policy does not provide coverage. *See Westfield Ins. Co. v. FCL Builders,* 407 Ill. App. 3d 730 (IL App. 1st 2011) (but see below regarding establishing the existence of a contract through other documents).

In a Tennessee case, a court found that although the original contract with the parties did not require an additional insured endorsement, an oral modification did require such coverage. *Lancaster v. Ferrell Paving, Inc.*, 397 S.W.3d 606 (2011).

Another problem that comes up far too often is poorly drafted insurance sections in contracts. In *West Bend Mutual Ins. Co. v. Athens Construction*, 2015 IL App (1st) 140006, the Illinois Appellate Court was faced with a contract clause that provided that the sub-contractor would be required to have certain policies of insurance. The contract then provided: "Following clause should be provided on the Subcontractor's Certificate of Insurance: Athens Construction Co., Inc. Additional Insured, on a primary and non-contributory basis." The Court found that the adding a party on a meaningless certificate was not the same as adding the party as an additional insured under the policy. As such, the policy did not provide coverage.

e. Non-Standard Forms: Potential Traps for the Owner or General

There are three basic types of script (i.e. non-standard/non-ISO) forms. First, some larger insurers which use script forms that relatively closely track standard forms.

Second, some smaller companies have used script forms with broader coverage as a marketing tool for insureds.

Finally, certain insurers that focus on high risk markets provide additional insured endorsements with extremely limited coverage.

An example of a strict form that provided broader coverage is an AI form provided by Old Republic insurance. That form provided coverage for losses "arising for the operations and uses performed by or on behalf of the Named Insured." Old Republic also offered a similar endorsement that simply tied the policy to a contract. That form provided AI coverage where:

"a. Which are covered by this Insurance; and
b. Which you have agreed to provide in such contract."

In contrast, many high-risk carriers provide additional insured endorsements that only cover conduct of the Named Insured Imputed to the Additional Insured (vicarious liability). An example is the late Statewide Insurance Company. That company had an endorsement that provided:

> The coverage Afforded to the Additional insured under this endorsement is solely limited to liability specifically resulting from the

> conduct of the Named Insured which may be imputed to the Additional Insured by virtue of the conduct of the Named Insured.

In *Liberty Mutual v. Statewide*, 352 F.3d 1098 (7th Cir. 2003), the endorsement was found to be enforceable. In that case, Liberty Mutual argued that the policy would apply only to strict liability claims. In Illinois, according to the Court, there are only two types of strict liability claims. The first is for dangerous products. The second is for ultrahazardous activities, including blasting. Based on the named insured's application for the policy, Statewide knew that the named insured engaged in neither of those activities. According to Liberty Mutual, that meant that the endorsement would never provide coverage and was illusory. The Seventh Circuit rejected the claim that the policy was illusory. Few claims is not the same as no claims. The Court also pointed to freedom of contract. The parties to the underlying contract had notice to review the endorsement, and they did not object. Finally, the Court looked to the cost of the endorsement. For the $35.00 price of the endorsement, the parties could expect limited coverage.

However, a Pekin policy provided:

> Who is an Insured (Section II) is amended to include as an insured any person or organization for whom you are performing operations when you and such person or organization have agreed in writing in a contract or agreement that such person or organization be added as an additional insured on your policy. ***Such person or organization is an additional insured only with respect to liability incurred solely as a result of some act or omission of the named insured and not for its own independent negligence or statutory violation***. * * * It is further understood that the designation of an entity as an additional insured does not increase or alter the scope of coverage of this policy."

In *Pekin Ins. Co. v. Pulte Home Corp.*, 404 Ill. App. 3d 336, 338 (Ill. App. Ct. 1st Dist. 2010), Pekin denied coverage on the basis that the endorsement does not provide coverage the additional insured's own acts or omissions. The underlying complaint did not allege that the named insured was solely liable. On appeal, the court found that it could not rule out that the named insured was solely liable. As such, the insurer was obligated to defend (although the court did not rule on any duty to indemnify).

Similarly, in a Nevada case, the following was found to be enforceable and was also found to be ambiguous such that it would provide coverage for losses beyond those solely caused by the named insured: "[O]nly with respect to liability arising out of [the named insured's] ongoing operations performed for [the

additional insured]." *Federal Ins. Co. v. American Hardware Mutual*, 124 Nev. 319 (2008).

For similar results, see also *See Also: American Country v. Kraemer Brothers*, 699 N.E.2d 1056 (Ill. App. 1998), *American Country v. Cline*, 722 N.E.2d 755 (IL App. 1999).

f. Separation of Insureds

A standard "Separation of Insureds" clause provides:

> Except with respect to the Limits of Insurance, and any rights or duties specifically assigned in this Coverage Part to the first Named Insured, this insurance applies:
>
> a. As if each Named Insured were the only Named Insured; and
>
> b. Separately to each insured against whom a claim is made or "suit" is brought.

The clause most commonly arises with regard to the professional liability exclusion. For instance, in one Northern District of Illinois case a court concluded:

> In sum, I conclude that the Policy's Separation of Insureds provision must be interpreted as requiring that the coverage of each insured or additional insured be determined separately from other insureds. Under this interpretation, the fact that the professional services exclusion deprives Eckland of coverage under the Policy does not mean that Shorenstein, too, is without coverage. Rather, the professional services exclusion must be applied vis a vis Shorenstein's own conduct. When it is thus applied, Shorenstein remains covered because it did not perform professional services in connection with the project. *United States Fid. & Guar. Co. v. Shorenstein Realty Servs., L.P.*, 700 F. Supp. 2d 1003, 1014-1015 (N.D. Ill. 2010).

A similar result was reached in *Patrick Eng'g Inc. v. Old Republic Gen. Ins. Co.*, 2012 IL App (2d) 111111, P28, 973 N.E.2d 1036, 1044, (Ill. App. Ct. 2d Dist. 2012). There again the court found that although a policy exclusion might exclude coverage for the named insured, it did not exclude coverage for the additional insured.

g. Certificates of Insurance? Are They Worth the Paper They Are Written on?

A standard insurance certificate is known as an ACORD certificate. Too often, certificates are mistaken for policy endorsements. They are not part of the policy. Each certificate includes the following disclaimer stating that it is for information only and will not modify the policy:

> THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AFFIRMATIVELY OR NEGATIVELY AMEND, EXTEND, OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW. THE CERTIFICATE OF INSURANCE DOES NOT CONSTITUTE A CONTRACT BETWEEN THE ISSUING INSURER(S), AUTHORIZED REPRESENTATIVE OR PRODUCER, AND THE CERTIFICATE HOLDER.

There are at least two lines of cases regarding certificates, and at times, states include both to some extent.

The most common rule is that the certificate does not modify the policy, and that a party cannot rely upon a certificate but instead must review the policy. *See Prudential Property and Cas. Ins. Co. v. Anderson*, 922 A. 2d 236 (Conn. 2007). Similarly, in Bradley Real Estate Trust v. Plummer & Row Ins. *Agency*, 609 A.2d 1233 (N.H. 1992), a New Hampshire referred to the certificate as a "worthless document." In *Ferguson v. Plummer's Towing & Recovery*, 753 So.2d 398 (La. App. 1st Cir. 2000), the Louisiana court found that the certificate was for information only and did not modify the policy. Where the information on the certificate differed from the policy, the court would not modify the policy based on the certificate.

However, there may be some relevance to cases where there is a blanket additional insured endorsement but no formal contract. A court may find that that the endorsement, combined with other documents, together form the written contract necessary to trigger the blanket endorsement. For instance, in an Illinois case, the parties to a contract has a long series of dealing with each other. The court ruled:

> Construed together, the Agreement, the work order and the certificate of insurance satisfied the policy requirement that there be a written contract requiring Cobra to name Valenti as an additional insured. Contrary to Mt. Hawley's position and the circuit court's determination, the policy's written contract provision did not require

> that Valenti's name appear in the Agreement. We conclude that Mt. Hawley was required to provide insurance coverage for Valenti as an additional insured. *Mt. Hawley Ins. Co. v. Robinette Demolition, Inc.*, 2013 IL App (1st) 112847, P54, (Ill. App. Ct. 1st Dist. 2013)

As a practical matter, contracts will often require that the parties to the contract produce a certificate of insurance. However, a far better policy is to require that the contractor produce both a certificate and a copy of the relevant additional insured endorsement. Only when a copy of that endorsement is produced can a party be relatively certain (although not fool proof – fraud does happen) that the proper additional insured endorsement has been made part of the policy.

Similarly, contractors would be well served to provide a copy of the contractor's additional insured endorsement along with bid documents. Doing so creates a written record as coverage and creates a likelihood that the owner will either address the issue before granting the contact or may be barred from raising the issue after the contract is signed.

Finally, there is one more notation on the certificate that at times will cause confusion. Certificates at times reference "certificate holder." However, a "certificate holder" is not necessarily an additional insured. The certificate should reference "additional insured" and as noted above, the parties should require that the endorsement also be produced.

h. Indemnification Clauses, Anti-Indemnification Laws, and the Impact on Coverage

When it comes to risk shifting, a contract should have two clauses. The first is the insurance clause referenced above. The second is an indemnification clause. That clause creates an obligation of one party to pay for a loss incurred by another party. Generally, an agreement seeking indemnification for one's own negligence must be expressed in unequivocal terms. *See Roundtree v. New Orleans Aviation Board*, 844 So. 2d 1091 (La. 4th Cir. 2003). The language must show a clear intent for indemnification arising out of the party's own negligence.

Illinois, like many other states disfavors indemnity provisions. Under Illinois law the indemnification clause must be absolutely clear. *See Westinghouse Electric v. La Salle Bldg. Corporation,* 395 IL 429 (1947).

A few states, such as Texas, have more lenient provisions. Under Texas law, there are two requirements. First, the intent must be expressed in specific terms. Second, the language must be conspicuous. *Douglas Cablevision IV, L.P. v.*

Southwestern Electric Power Company, 992 S.W.2d 503 (Tex. App. – Texarkana 1999).

When it comes to construction contracts, many states simply ban indemnification for a party's own negligence. For instance:

Arizona: Ariz. Rev. Stat. 32-1159

Delaware: 6 Del. Code Section 2704(a)

Michigan: MCLA 691.991 ("sole negligence")

Missouri: VAMS Section 434.100. No bar to contracts to procure insurance.

Indiana: In Stat 26-2-5-1

Illinois: 740 ILCS 35/1. (However, in *Liccardi v. Stolt Terminals*, 283 Ill. App. 3d 141 (1st Dist. 1996), the Illinois court found that the provision would allow an action in contribution, rather than indemnification, to go forward).

Despite those anti-indemnification laws, many states including Illinois expressly state that contractual requirements to provide insurance do not violate the anti-indemnification act. 740 ILCS 35/3.

Given the new provisions of the 2013 ISO forms which limit coverage to the extent permitted by law, contractors are well advised to review state law on the topic to determine if the insurance clause is enforceable. Note also that ISO has state-specific "savings clause" endorsements that may serve to provide coverage even when an indemnification agreement would violate state law.

III. THE LOSS: WHAT TO DO WHEN IT GOES WRONG

a. Notice: Who is to Give Notice, of What, and When?

i. Notice of Loss, Notice of Suit and Tender of Defense

After a loss, a party facing a potential claim needs to properly report the loss to the insurer. A standard CGL policy will provided two notice requirements. The first is for notice of the incident in which a person or property is injured. The second concerns notice of a lawsuit or claim. At times, courts evaluate those provisions differently.

The first question is whether an actual tender of defense is required. Must a purported insured go to the insurer and specifically ask that the insurer cover the loss?

As a general rule, most states require that the purported insured contact the insurer to request defense and indemnity. For instance, under Washington law, the notice must come directly from the insured requesting defense and indemnity. *See Unigard v. Leven*, 97 Wn. App. 417 (Washington App. 1999).

However, in other states, including Illinois, no formal tender is required. In *Cincinnati v. West American Insurance Co.,* 183 Ill.2d 317 (1998), the Illinois Supreme Court ruled that notice to the insurer is tender, no matter the source of the notice. That notice triggers the duty to defend. Such notice can, and sometimes does, come from plaintiffs' attorneys who will provide notice to the insuer in order to trigger the indemnity clause of the defendant's policy.

In *Dearborn Insurance v. International Surplus Lines Insurance Co.*, 308 Ill. App. 3d 368 (1st Dist. 1999) the court confirmed that no formal tender by the insured is required to trigger coverage.

That Illinois rules creates a heavy burden for insurers, particularly where there is a blanket endorsement. The insurer should contact all defendants who may be insureds to determine if the purported insured may seek coverage.

However, when it comes to notice of the loss (rather than suit), the rule is somewhat different. In *Am. Nat'l Ins. Co. v. Nat'l Fire Union Ins. Co.*, the Illinois Appellate Court was faced with a question of late notice. Initially, the Court ruled that only the named insured was obligated to provide notice of the accident. However, both the named insured and any additional insured was obligated to provide notice of a suit. In that case, the additional insured was in possession of a Certificate of Insurance listing the policies. The Court ruled:

> Camosy was provided with a certificate of insurance which set forth the coverage which National was extending to Zalk-Josephs and to it as an additional insured. With this information, Camosy could have easily notified National of its request for a defense together with the specifics of the Gonzales claim. Camosy failed to do so and its actions clearly violated the notice provision in section 2(c)(1). *Am. Nat'l Fire Ins. Co. v. Nat'l Union Fire Ins. Co.*, 343 Ill. App. 3d 93, 104, (Ill. App. Ct. 1st Dist. 2003)

ii. Notice to Producers and Issues of Apparent Agency

One of the issues that comes up repeatedly is the question of whether notice to an agent or producer is the equivalent of notice to the insurer. Typically, faced with a loss, the producer will be notified and the insured will rely on the producer to guide the insured through the process. That often works. At times, however, the producer will drop the ball. At times, the producer will claim there is no coverage and as such, not tender the matter or at times producers have simply forgotten.

Standard policy language requires notice to the insurer. However, some cases have found that the producer is either the agent or apparent agent of the insurer and as such, the insurer is bound by the actions of the producer. In Illinois, that line of cases starts with *State Security v. Burgos*, 145 Ill. 2d 423 (1991). In that case, the insurance producer was found to be the apparent agent of insurer. Courts will look to contacts among insured, insurer and producer. The more reliant the insurer is on the producer, the more likely to be found to be an apparent agent.

More recently, in *First Chicago v. Molda*, 408 Ill. App. 3d 839 (Ill. App. 1st 2011) the court again looked at the course of dealings among insured, producer, and insurer. In that case, the insured claimed that it never had any direct contact with the insurer. All contact was through the producer. The court found that a question of fact existed as to apparent agency.

The lessons from the cases are as follows:

1. As an insured, make sure to give notice as soon as possible to somebody, and document it.

2. If notice is to the producer, follow up to obtain confirmation that the loss was sent to the insurer.

3. If possible, review the policy and the certificate to identify insurers and to identify procedures for notice. Admittedly, this may be a challenge for additional insureds.

4. Insurers, in contrast, should review their dealings with producers. Relying on producers is a wonderful way to shift the work to the producer. However, doing so may make the producer the apparent agent of the insurer. The insurer needs to decide if that makes it worthwhile.

iii. How Late is Too Late? Is Prejudice Required?

The next question for notice is "when must notice be given"? A standard policy will require notice "as soon as practicable." When it comes to additional insureds, there are a few issues. First, how late it too late? Second, must the notice be provided by the named insured or can it come from the additional insured?

For additional insured, there are added complications. The additional insured may not be aware of a loss. For instance, an owner may not be aware that somebody fell while working on a construction project. Second, the additional insured may not have access to all of the policies of insurance.

When it comes to late notice, the primary division among states is that certain states will require an insurer to establish that it was prejudiced by late notice, while others will simply look at the amount of time passed.

In Illinois, generally an insurer need not prove prejudice to establish a late notice denial. In *Country Mutual Insurance Co v. Livorsi Marine*, 222 Ill. 2d 303 (2006), the Illinois Supreme Court found that prejudice was not required.

In contrast, Washington has taken the opposite path, and requires insurers to establish "substantial prejudice." *Unigard Ins. Co. v. Leven*, 97 Wn. App. 417, 983 P.2d 1155, 1161 (Wash. Ct. App. 2000).

When it comes to the source of the notice, as noted above, Illinois courts have ruled that notice can come from any party. In contrast, in Ohio, that notice must come from the insured. One Ohio court has ruled:

> Here, the policy states that before a claim is covered TDC must receive at its offices a "written communication" from a Protected Party about a potential claim before the policy expires. The policy imposes a duty on the party to notify TDC about the potential claim "in writing" and to forward to TDC any document that it received relating to the claim. In addition, the party has a duty to provide "written details" about the claim. The policy requires that notice be made by the Protected Party itself or by someone "on behalf of " the party, like an agent or representative. Neither WSP nor Dr. Lacey satisfied any of these requirements. *Wright State Physicians, Inc. v. Doctors Co.*, 2016 Ohio 8367 (Ohio Ct. App. Montgomery County Dec. 23. 2016).

b. <u>The Reservation of Rights Letter and Conflict Issues/Choice of Defense</u>

Often insurers will reserve rights in cases involving additional insureds. One mistake made by some insurers is to pick up a defense and then send out a

reservation of rights letter. Nearly all states will find that doing so constitutes a waiver of any coverage defense. The ROR ***MUST*** go out before the defense is sent to counsel. A court will be extremely likely to find that any coverage defenses that existed at the time suit was sent to counsel and not referenced in a ROR have been waived.

The reservation of rights letter must be specific. If there is a potential conflict, it must be disclosed. The letter must adequately inform the insured so that the insured can intelligently choose between retaining its own counsel and relying on counsel provided by the insurer. As one court ruled:

> "A reservation of rights letter must make specific reference to the policy defense to be asserted by the insurer and to the potential conflict of interest.. . . A proper reservation allows the insured to decide intelligently whether to hire independent counsel in order to avoid the conflict or not*. Utica Mutual Ins. v. David Agency Ins., Inc.*, 327 F. Supp. 2d 922 (N.D. IL 2004), *See Royal Insurance Co. v. Process Design Associates, Inc.*, 221 Ill. App. 3d 966 (IL App 1991).

c. Conflicts, Control of the Defense and Representation of Multiple Parties

CGL policies include a duty to defend. However, where an insurer issues a reservation of rights, who controls the defense? The general rule is that when control of the defense can lead to defense counsel negatively impacting coverage, the insured must be offered control of the defense. In Illinois, that is known as a "*Peppers* conflict" under *Maryland v. Peppers*, 64 Ill. 2d 187 (1976). In that case the Court ruled that where there is a conflict between insurer and insured, the insured must be allowed to control it defense. Typically, that means that the insured may choose its own counsel, to defend the insured at the expense of the insurer.

Some examples of conflicts entitling the insured to choice of counsel:

- Whether damages were known to exist before the inception of the policy period. *American Family Mutual v. W.H. McNaughton.*

- Whether a driver had the insured's permission at the time of the accident. *Murphy v. Urso*, 88 Ill. 2d 444 (IL 1981).

- Claiming seeking both punitive and compensatory damages. *Illinois Municipal League Risk Management Assoc. v. Seibbert*, 223 Ill. App 3d 864 (4th Dist. 1992).

- Whether multiple negligent acts were related and therefore subject to the limits of a single policy period. *Doe v. Illinois State Medical Inter-Insurance Exchange*, 234 Ill.App.3d 129 (1st Dist. 1993).

d. Does Counsel Have an Obligation to Try to Shift the Loss?

Some have questioned whether an attorney retained by an insurer can attempt to shift loss. The Illinois State Bar Association (admittedly not a government body) has issued an advisory opinion stating [a] law firm may, with consent, represent an insurance company in a declaratory judgment action seeking to have other insurers provide coverage for the insurance company's insured where the insurance company will not contest coverage." ISBA Opinion 87-6

A few others rules seem clear. When retained by an insurer, counsel must consult with and obtain consent of insured to shift the risk. If counsel is retained by an insurer, the insured must consent to any tender. It is often in the insured's best interest to tender the defense. However, the retention letter should spell out that obligation and any coverage decisions by defense counsel must be approved by the insured.

CONCLUSION

Risk shifting is one of the biggest challenges of any complex contract. Counsel for the parties must be aware of the contractual issues involved with risk shifting as well as the complications when it comes to litigation. Only with that knowledge can the party effectively reduce risk.