Basic Principles of Construction Insurance:

Insureds and Additional Insureds, Subrogation, Notice and Other Requirements

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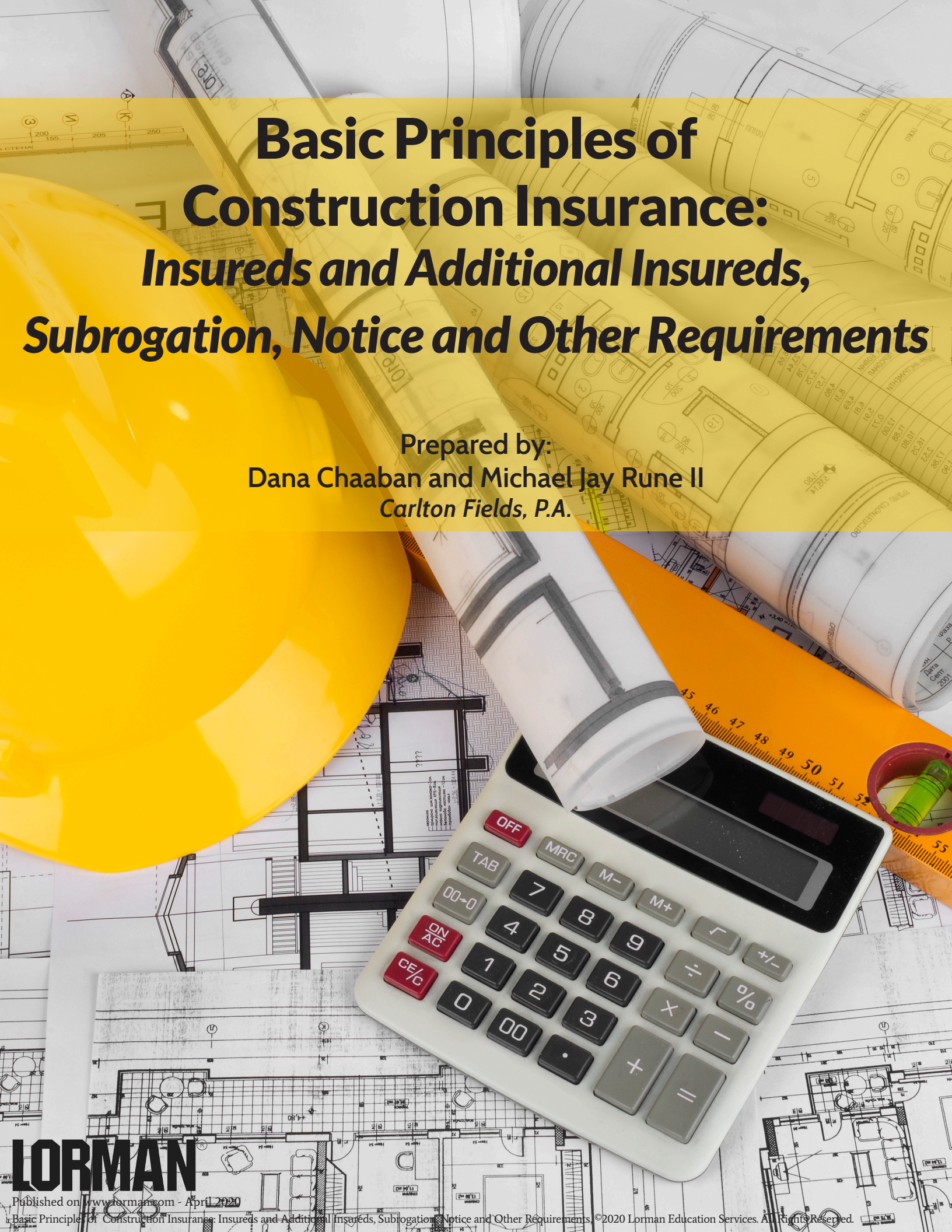

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BASICS PRINCIPLES OF CONSTRUCTION INSURANCE

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A. Insureds and Additional Insureds:

An insured is the named beneficiary under an insurance policy. However, other parties may be added to the policy as an additional insured. Whether an additional insured has coverage in a policy is controlled by the policy language.[1]

There are no hard and fast rules to determine whether an additional insured has coverage pursuant to an endorsement because of the variations in policy language and the individual facts of the case. Typically, the coverage provided by an additional insured coverage is limited to the time frame of the ongoing operations.[2]

A frequent problem in the construction context is the furnishing of proof of insurance. Often, the subcontractor or contractor will have an obligation to name a general contractor or the owner as an additional insured. However, what typically happens is that the Certificate of Insurance is often issued naming a general contractor and/or owner as a certificate holder as opposed to an additional insured. Being a certificate holder does not reasonably render one an additional insured, as most certificates are furnished for the purposes of information only and refer one to the policy for coverage.[3]

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[1] *Tidewater Equipment, Inc. v. Reliance Ins. Co.*, 650 F. 2d 503 (4th Cir. 1981); *In re Deepwater Horizon*, 470 S.W.3d 452, 459 (Tex. 2015), *reh'g withdrawn* (May 29, 2015).

[2] *Mountain Fuel Supply v. Reliance Ins. Co.*, 933 F. 2d 882, 887 (10th Cir. 1991); *Pennsylvania DOT v. American State Ins. Co.*, 588 A.2d 1320 (Pa. Commw. Ct. 1990).

[3] *TIC Ins. Co. v. Sedgwick James of Washington,* 276 F. 3d 754, 758 (5th Cir. 2002); *Sumitours Marine & Fire Ins. Co. v. Southern Guar. Ins. Co.*, 337 F. Supp. 2d 1339 (N.D. Ga. 2004); *Mid-Am Builders, Inc. v. Federated Mut. Ins. Co.*, 194 F. Supp. 2d 822 (C.D. Ill. 2002).

A common legal issue arising out of the additional insured language is that often the additional insured under a policy is only entitled to coverage "arising out of" the named insured's work.[4] The majority of jurisdictions construe this limitation to mean only there must be some causal connection between the occurrence and the work.[5] In addition, an additional insured endorsement may often contain some of the same exclusions contained in the CGL policy itself.

Only an insured or an additional insured is entitled to a direct action against an insurer.[6] What this means is that if one is not named as an additional insured under the policy, there is no right to sue the insured directly until there is a settlement with or a verdict against the insured. AI issues have become a focus in many recent construction defect litigations as carriers try to shift or spread the costs of defense and potentially liability to other carriers.

B. <u>Subrogation:</u>

An insurer which pays a claim for its insured is surrogate to an insured's rights against a person or persons who may also be responsible for causing a claim which was satisfied.[7] Subrogation may arise through contract, statute or at common law.[8]

In the construction context; however, due to common requirements that one of the contracting parties maintain the other parties as additional insurers has ramifications for an insurer's subrogation claim. In addition, most standard form agreements concerning construction contain waivers of subrogation clauses.

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[4] *Container Corp. of America v. Maryland Cas. Co.*, 707 So. 2d 733, 736 (Fla. 1998); *FP&L v. Penn America Ins. Co.*, 654 So. 2d 276, 278 (Fla. 4th DCA 1995) *citing, Cas. Ins. Co. v. Northbrook Property & Cas. Ins. Co.*, 501 N.E.2d 812 (Ill. App. 1986); *McIntosh v. Scottsdale Ins. Co.*, 992 F. 2d 251 (10th Cir. 1993); *Philadelphia Elec. Co. v. Nationwide Mut. Ins. Co.*, 721 F. Supp 740 (E.D.Pa. 1989).

[5] *FP & L*, at 279.

[6] Fla. Stat. §627.413; *see also Structural Group, Inc. v. FCCI Commercial Ins. Co.*, 11-CV-81339 (S.D. Fla. 2012).

[7] *Underwriters of Lloyd v. City of Lauderdale Lakes*, 382 So. 2d 702, 704 (Fla. 1980).

[8] *Dade Co. School Bd. v. Radio Station WQBA*, 731 So. 2d 638, 646 (Fla. 1999); *Wolters v. Am. Republic Ins. Co.*, 149 N.H. 599, 601, 827 A.2d 197, 199 (2003).

The law is well established that a subrogation insurer stands in the shoes of its insured and has no greater rights than the insured had.[9] The law is equally well established i that an insurance company typically cannot maintain a subrogation action against its own insured.[10] In the context of construction contract, the courts have consistently held that subrogated insurers are not entitled to recover against parties to a construction contract where one party is obligated to obtain insurance covering the risk or requires to name the other parties and the named insured under the policies.[11]

The prohibition against subrogated insurers applies even if the contracting party did not carry out its contractual duty to name other parties as an additional insured under the insurance contract. As the court in *Norland Industries*[12] summarizing the holding in *Smith v. Ryan* explained:

> In Smith an owner and contractor entered into a contract which provided the owner would carry fire insurance on the premises and that the contract or would be a named insured in all policies. The owner did obtain fire insurance but failed to have the contractor named as an insured on the policy. The contract further provided that if either party should suffer damage in any manner because of the wrongful act or negligence of the other party, the damaged party would be reimbursed by the other party. After a fire damaged the property, the insurance company paid the owner for losses and then brought suit against the contractor alleging negligence. The court affirmed the trial court's summary judgment in favor of the contractor, declaring that the contract clearly required the owner to name the contractor's insured in the fire insurance policy and the insurer could not maintain a subrogation suit against its own insured.[13]

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[9] See, *e.g., Cas. Index., Exchange v. Penrod Brothers, Inc.,* 632 So. 2d 1046, 1047 (Fla. 3d DCA 1994); *Great Am. Ins. Companies v. Gordon Trucking, Inc.*, 81 Cal. Rptr. 3d 65, 70 (Ct. App. 2008).

[10] See, *Travelers Ins. Co. v. Warner,* 679 So. 2d 324, 330 (Fla. 1996) ("The fundamental principal of insurance law"); *Continental Ins. Co. v. Kennerson,* 661 So. 2d 325, 327 (Fla. 1st DCA 1995); *Ray v. Earl,* 277 So. 2d 73, 76 (Fla. 2d DCA 1973) ("Basic rule of law"); *State Farm Gen. Ins. Co. v. Wells Fargo Bank, N.A.,* 49 Cal. Rptr. 3d 785, 790 (Ct. App. 2006).

[11] *Dyson and Co. v. Flood Engineering,* 523 So. 2d 756, 758 (Fla. 1st DCA 1988); *IN v. EL Nezlek, Inc.*, 480 So. 2d 1333, 1335 (Fla. 4th DCA 1986); *Housing I and V, Corp. v. Carris,* 389 So. 2d 689,690 (Fla. 5th DCA 1980); *Smith v. Ryan,* 142 So. 2d 139, 141 (Fla. 2d DCA 1962).

[12] *U.S. Fire Ins. Co. v. Norland Industries, Inc.,* 428 So. 2d 325, 326 (Fla. 1st DCA 1983).

[13] *Id.*

C. Notice and Other Requirements:

An insured is responsible for complying with the notice requirements in the insuring agreement. The failure of the insured to timely give notice to the insurer raises the presumption of prejudice and may discharge the insurer from liability.[14] Courts have typically treated notice provisions in insurance contracts as conditions precedent to recovery under insurance policies held to be an important part of the bargain for a contract.[15]

Florida, unlike the majority of jurisdictions, has refused to shift the burden to the insured to show substantial prejudice resulting from a lack of notice in order to avoid coverage. The Supreme Court explained in *Bankers Insurance:*

> Mafias urges us to abandon the *Tiedtke* presumption of prejudice rule as out-of-step with the modern trend requiring the insured to show substantial prejudice resulting from the lack of notice. *See* 32 A.L.R. 4th 141 (1984). We declined to do so, a notice of an accident in most insurance policies is a condition precedent to a claim and it was so designated in the policy in this case. Such a condition can be avoided by a party alleging and showing that the insurance carrier was not prejudiced by the non-compliance with the condition. The burden should be on the parties seeking an avoidance of a condition precedent.[16]

However, the courts have construed notice to be a coverage defense.[17] Under the Florida Insurance Code, an insurer must comply with the provisions of Florida Statute §627.426(2). Failure of the insured to timely comply with the statute may result in a waiver of that defense.[18] In addition, the

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[14] *Bankers Ins. Co. v. Macias,* 475 So. 2d 1216 (Fla. 1985); *National Gypsum Co. v. Travelers Indemnity Co.,* 417 So. 2d 254 (Fla. 1982); *Tiedtke v. Fidelity & Cas. Co.,* 222 So. 2d 206 (Fla. 1969); *Friedland v. Travelers Indem. Co.,* 105 P.3d 639, 641 (Colo. 2005).

[15] *Id.*

[16] 475 So. 2d at 1218.

[17] *Nationwide Mut. Fire Ins. Co. v. Beville,* 825 So. 2d 999 (Fla. 4th DCA 2002).

[18] *Nationwide Mut. Fire Ins. Co. v. Beville, supra; American Empire v. Gold Coast Elevator,* 701 So. 2d 904 (Fla. 4th DCA 1997); *Auto Owners Ins. Co. v. Salvia,* 472 So. 2d 486 (Fla. 5th DCA 1985).

courts have generally construed that issues of notice and prejudice are factual and should be resolved by a jury[19].

There is an important distinction in Florida law between policies which require the cooperation of the insured and policies which merely require notice.[20] Where a policy requires the cooperation of the insured, the burden is shifted to the insurer to demonstrate that the insured's failure to cooperate prejudiced the insurer.[21]

Generally, CGL policies contain a timely notice provision but not a cooperation provision.

[19] *Perez v. Public Service Mutual Ins. Co.,* 755 So. 2d 168 (Fla. 3d DCA 2000).

[20] *Allocation of Losses in Complex Ins. Coverage Claims § 16:3,* Seaman, Scott J.; and Schulze, Jason R. (Westlaw 2015); *Bankers Ins. Co. v. Macias,* 475 So. 2d 1216, 1218 (Fla. 1985).

[21] *Id.*