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Our Legal Reality

Important Insurance Developments by Kent J. Pagel

The legal profession wants to form a symbiotic relationship with your business. You provide the exposed flesh. They'll provide the butchers (Builder Magazine, Sept. 2001).

Builders and their insurance companies will tell you that this statement is right on point as they go about defending the large numbers of construction defect and mold related lawsuits that are being filed by homeowners.

Thus far, the primary tool used by builders to combat lawsuits from homeowners has been to demand broad-form indemnity clauses and additional insured endorsements from their subcontractors and suppliers. In other words, builders try to pass as much risk and liability as possible to their sometimes unsuspecting, and most of the time powerless, subcontractors and suppliers. Component manufacturers must work to resist this transfer of risk and loss as otherwise more companies insuring them will either reject doing business or will charge exorbitant premiums for what they view as far greater exposure to future loss.

While builders work to transfer or assign the risk and cost of the litigation they face to their subcontractors and suppliers, at the same time the insurance industry is embarking on across-the-board insurance premium increases. Before the tragedies of September 11, those targeted by the insurance industry for the largest premium increases in terms of a percentage

A WORD ABOUT ENDORSEMENT FORMS

The differences in the endorsement forms may not appear significant, but DO NOT be fooled. Builders have had success at requiring suppliers' insurance companies who issue forms 20-10-11-85 and 20-26-11-85 to defend the builder in Construction Defect cases filed years after the trusses are delivered and installed. Conversely, form 20-10-03-97 which utilizes the language "ongoing operations" has been generally limited to claims that truly arise out of the truss manufacturer's scope of work, (e.g. the design, manufacturing and delivery of the trusses to the customer jobsite).

ISO No. 20-10-11-85: "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 for that insured by or for you."

ISO No. 20-26-11-85: "WHO IS AN INSURED is amended to include as an insured the person or organization shown in the Schedule as an insured, but only with respect to liability arising out of your operations or premises owned by or rented to you."

ISO No. 20-10-03-97: "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 ongoing operations performed for that insured."

The following language from a production builder master form customer contract that I have reviewed recently, is typical of what you may find:

"All policies of insurance that Supplier is to maintain under this Agreement…shall name Contractor and its affiliated companies as

were those companies with annual revenues of less than $10 million. Such increases have been viewed as necessary by the insurance industry due to prior years of decreased profitability caused by many factors, including years of extreme competition for business and a corresponding decline in premiums, as well as lower or even negative returns realized by the industry from their investments in the equities markets. Of course September 11 changed the landscape in a large way for the insurance industry and the outcome will most likely be negative for all companies buying insurance.

> additional insured, using Insurance Services Offices Form B (version CG 20 10 11 85). The additional insured shall be provided the same coverage as provided Supplier…In addition, Commercial General Liability Insurance Coverage, including additional insured coverage for Contractor, shall be maintained in force until expiration of the applicable statute of limitations for claims related to latent defects and construction improvements for real estate."

Unfortunately, today's component manufacturers must buy insurance from companies that, to survive, believe that they must increase their revenues (i.e. premiums). And at the same time, component manufacturers must sell to a homebuilding and contracting industry in which they are being asked to bear greater legal responsibility, while their acquiescence will result in greater costs. It goes without saying that insurance companies will view component manufacturers not only by the risk that they themselves undertake, but also by the frequency that they are required to agree to broad-form indemnity provisions and unlimited additional insured endorsements.

REAL-LIFE EXAMPLES

- In January 2002, a Texas insurance broker advised a large component manufacturer that, in his opinion, there are "serious problems" in the insurance industry. He advised that, "There is very limited availability of coverage in the market for many types of subcontractors... Plumbers, drywall contractors, mechanical contractors, and roofing contractors are having difficulty in finding coverage at any price. Material suppliers will find themselves in the same situation if they allow the builders to force [broad indemnity provisions and additional insured] requirements on them."
- A component manufacturer in the Southwest experienced one relatively modest truss collapse claim. As a result its insurance company refused to renew the policy for the upcoming year at any price. Quotes for new coverage for one year ran from no less than two times the previous year's premium to as high as five times the previous year's premium. Most companies refused even to provide a quote.
- An Arizona component manufacturer experienced its first liability claim in the company's history. As a result its insurance company refused to renew its policy. New coverage was obtained for one year at more than two times the previous year's premium.
- A component manufacturer in the Southeast was told that its current insurance company was "dropping" coverage because of construction defect litigation and directly implied that the truss industry is projected as having a problem in this area.
- A memorandum written January 2002, from a knowledgeable broker to his component manufacturer client stated, "Insurance Markets are going 'High-Wire'—Anticipate Approx. 25% to 50% Insurance Rate Increases by Coverage Lines."

ADD "INSULT TO INJURY"

Last year a California Court of Appeals was asked to review the responsibilities of an insurance company issuing an unlimited additional insured endorsement to a builder. While this case only stands as good authority in California, the outcome will be significant for the entire U.S., even if the precedent from the case is not followed by other states.

In this case a builder was sued by a homeowner for construction defects. American States insured two of the subcontractors who performed work for the builder. The subcontract agreements required the subcontractors to name the builder as an additional insured, utilizing the Form No. 20-10-11-85, or some similar endorsement (the additional insured endorsement was broad in scope). The court held that, even though the homeowner's complaints centered on a great number of problems that went far beyond the scope of work of the two subcontractors, American States was obligated to defend the entire case (e.g. contract and tort claims alike that applied to a great number of subcontractors and perhaps suppliers as well). In other words, the builder was entitled to a complete defense from the one insurance company.

The court in turn placed the burden on American States to seek contribution (reimbursement) from the insurance companies of the other subcontractors and suppliers. The scope of work of the subcontractor was considered irrelevant in terms of the duty to defend.

What can we expect as a result of this case?

- Builders can be expected to continue to request additional insured endorsements from their subcontractors and suppliers.
- The premiums for those subcontractors and suppliers agreeing to such an endorsement will substantially increase.
- During litigation insurance companies called on to defend may be faced with the economic decision of settling for substantial amounts in order to “stop the bleeding.”
- Builders may, for whatever reason, choose to single out a subcontractor or supplier for payment of their defense costs. Such insurance carrier would be forced to seek contribution from other insurers and wade through the pitfalls and quagmires of today's insurance landscape (which includes the bankruptcies and receiverships of those insurance companies from whom it would be seeking contribution).
- Experts seem to agree this case will have a profound effect on how construction defect and mold litigation is handled and how risk is evaluated by insurers and insureds.

STEPS TO BE TAKEN

Unfortunately, little can be done to resist the industry trend to increase premiums due to lowered profitability reasons, especially if your company generates $10 million or less annually. Of course, WTCA's relationship with Lockton may help. Do not, however, overlook the following steps:

- Implement recommended risk management and liability avoidance techniques within your company immediately. Be able to demonstrate compliance.
- Prepare for your insurance negotiations as you would for a meeting with a bank for a loan request or renewal. Be proactive when dealing with your insurance broker and with

prospective insurers.

- Consider WTCA QC Version 3.0 (more information on this program may be found at www.woodtruss.com) or a good quality control procedure. Quality control assists component manufacturers by providing a process and records in response to any criticisms that may be asserted. It also reduces the risk that there will be lawsuits in the same way that properly defining a component manufacturer's scope of work in the customer contract and providing an adequate jobsite delivery package that truly warns and instructs the installers of structural building components will decrease the number of lawsuits (SBC Magazine, November 2001).
- SAY NO to the broad-form indemnity provision and the unlimited additional insured endorsement requirements such as forms 20-10-11-85 and 20-26-11-85. Use proven risk management techniques to modify broad indemnity provisions to make them more acceptable. Consider adopting a more limited additional insured endorsement. (See below & side bar.)
- Should you find yourself in construction defect or mold litigation cases, get counsel an attorney familiar with our industry and these types of cases.

Understanding Indemnity Provisions & Additional Insured Endorsements

No one can disagree that component manufacturers should be responsible for their own negligent conduct. However, by agreeing to a customer's unlimited indemnity provision, the other-wise nonnegligent component manufacturing company could find itself paying the defense costs, settlement or judgment for the negligent conduct of its customer. By agreeing to a broad-form indemnity provision, the component manufacturer, and quite likely its insurance company, may become responsible for 100 percent of a loss, even though the component manufacturer's negligent conduct contributed to, for example, ten percent of the damages sustained, with the customer's negligent conduct contributing to the remaining 90 percent of the damages.

By naming a customer as an additional insured, the customer essentially becomes an insured under the component manufacturer's insurance policy. Just as any other insured, an additional insured is entitled to the benefits and coverages afforded by the insurance policy subject to whatever terms exist in the policy endorsement that establishes the additional insured status. As I have written in past issues, different types of additional insured endorsements exist. Builders and their risk managers generally require broad endorsements from their subcontractors and sometimes their suppliers. On the other hand, the component manufacturer is recommended to narrow or limit the additional insured endorsement that it provides. Suggested language follows. The component manufacturing company should consult with its insurance agent to find what is suitable.

> [Builder] named as additional insured with respect to the delivery and unloading of trusses at the job site.
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> [Builder] named as additional insured with respect to the negligent acts or omissions of the Truss Manufacturer's employees in the delivery of products and materials to the customer's jobsite.

If a component manufacturer is sued for something covered by its insurance policy, its insurance company will normally provide the legal defense and pay settlements or judgments as stated under the terms of the policy. This occurs regardless of whether the component manufacturer was in fact negligent. The same is true when the component manufacturer's customer is sued for any matter relating to the component manufacturer's scope of work if broadly indemnified or made an additional insured without limitation. The customer simply turns the suit over to the component manufacturer's insurance company for handling. Since the customer is entitled to the benefits and coverages afforded by the indemnity provision and the component manufacturer's insurance policy, the customer expects the component manufacturer's insurance company to provide its legal defense and pay any settlements and judgments in connection with the suit.

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SBC HOME PAGE

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