Residential

SHARING RISK

Indemnification can be a valuable tool for builders. BY MATTHEW J. SIEGEL

It's a familiar scenario – you are the general contractor on a large commercial project; the cast of characters working with you is huge, the relationships complex. As the general contractor, your primary responsibility is the coordination of the construction, including scheduling and logistics so the work of your subcontractors is carried out as efficiently and smoothly as possible. Although the subcontractors will likely do most of the work on the job, if something goes wrong, you are the target defendant, or as your opponent might call you, the deep pocket. It is therefore absolutely essential that you do not assume all of the risk yourself.

There are basically three ways you can spread the risk on such a project. First, prior to bidding, you should get your own comprehensive general liability policy, with umbrella and excess coverage in an amount sufficient to cover you in the event of a catastrophe. Second, when negotiating the particulars of your subcontracts, include all appropriate indemnification clauses. Third, confirm your inclusion as an additional insured under your subcontractors' general liability policies. It is easy to overlook or miss the nuances of these last two, especially as you are rushing to begin construction on schedule; don't make this potentially costly mistake.

Indemnification Agreements

Indemnification agreements are often considered standard, but there are several varieties of such agreements and you should not let the "form" nature of them deter you from making revisions to provide the protection you need. A typical indemnification provision will state that the subcontractor will indemnify you for all claims arising from, resulting from, or connected with, services performed under the subcontract by your subcontractor or the subcontractor's agents.

From that point, there are often three options to choose from. In a "no fault" agreement, your subcontractor will indemnify you regardless of which party actually causes the loss. Alternatively, the agreement may provide that the subcontractor only owes indemnity if the liability arises "in whole or in part" from the

subcontractor's negligence. A third option is where the subcontractor indemnifies you only where it is found solely liable. Some states place limitations on these agreements, and those that recognize the right of a party to seek indemnification for its own negligence stress that such an intention must be clearly expressed in the agreement.

When a lawsuit is filed, you will want protection immediately, in the form of a defense to the plaintiff's allegations. Although that defense may be provided by your general liability insurer in case of coverage problems, you also may want to ensure that your subcontractor is obligated to provide a defense. This defense obligation is not automatic. Many courts have held that the subcontractor is not obligated to defend simply because the complaint claims that the subcontractor was negligent; rather, they require that such negligence be proven before the obligation arises. However, in a recent decision in California, the court held that when the indemnity clause provides a duty to defend, rather than a mere promise to pay defense costs, that duty is triggered by any claim alleging subcontractor negligence. You should ask yourself: do you want to wait until the case is over before finding out whether your subcontractor should repay your defense costs, or do you want to be covered from the outset of the litigation?

The key to the indemnification clause is for you to decide at the beginning how much risk you are willing to assume – and how much your subcontractors will tolerate – and make sure the language accurately reflects your intentions.

Additional Insured

It is equally imperative to make sure you are listed as an additional insured under your subcontractor's general liability policy. A typical contract provides that the subcontractor will maintain general liability insurance protecting against liability from damages "arising from" the subcontractor's work on the project. The agreement will specify the limits, including the minimum amount that the subcontractor must obtain. This clause may be critical. In a recent federal case, the court found a contractor only entitled to $1 million in coverage as an additional insured, despite the fact that the policy limits were $1.75 million. This was because the policy endorsement limited coverage to the additional insured to the "lesser of" the policy limits – in other words, the minimum amount the subcontractor agreed to provide in the contract.

The agreement should also state that the subcontractor must provide proof of coverage in the form of a certificate of insurance before the work begins. However, you should be aware that a certificate of insurance, standing alone, is not always sufficient to confer additional insured status. So, make sure you have it in hand and that you review it carefully to ensure that it contains the correct names, limits, policy periods and coverage types. If possible, you may want to obtain a copy of the subcontractor's insurance policy to ensure that the appropriate endorsement is attached. Some policy forms automatically provide additional insured status to anyone with whom the named insured enters into a contract. Others require that the additional insured be separately listed on a schedule.

Assuming you are named as an additional insured, you now have a direct contractual relationship with the subcontractor's insurance company and your rights vis-à-vis the insurer are controlled by the policy. The standard forms generally provide that you are only an additional insured with respect to liability "arising out of" the named insured's work. Thus, if the subcontractor is found not liable, you may not be covered because your liability, at least arguably, would not arise from the subcontractor's work. Therefore, you must consider the possibility that, although you are named as an additional insured, you are not necessarily insured under that policy for any situation in which you are held liable – your liability must arise, at least in part, from the subcontractor's activities in its performance of the subcontract.

If you intend to be included as an additional insured, you should make absolutely certain that you obtain the required proof and that all relevant documents reflect that intention. In a recent case in California, the court found that certain contractors were not additional insureds under their subcontractors' general liability policies despite language in the agreement that suggested that all contractors should be covered and despite having received certificates of insurance from the subcontractor's broker. The problem was that the contractors who sought coverage were not listed in the insurance provision of the contract or on the additional insured endorsement to the policy.

Importantly, in what should be a cautionary tale to the readers of this article, the court noted that the contractors, as sophisticated business entities with experience in the construction industry, should have been aware that the certificates issued by the broker were insufficient to provide them coverage under the subcontractor's policies. The problem could have been solved had the contractors ensured themselves at the outset that their names were included in both the subcontract and the policy before work commenced on the project.

With that last thought in mind, you should recognize that courts will rightfully treat you as sophisticated business people. Unlike in your direct dealings with your insurers, where the courts will construe policy language strictly against the insurer, the language used in your subcontracts will often be construed against you as the party seeking to spread your risk. However, with the proper attention to detail, and with some consideration given at the outset of a project, you won't have to bear the entire financial burden in the event of a catastrophe on one of your projects. ◆

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