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The Critical Path

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Show Me the Contract: The Nonsensical Need for Contractual Privity on a Construction Site to Obtain Additional Insured Status

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Construction industry custom requires subcontractors and second tier subcontractors to procure insurance for the general contractors. For some courts, however, such standard contract provisions are not adequate to trigger a second tier subcontractor's insurance for the benefit of a general contractor. These rulings flatly defeat the expressed expectations of construction contractors. This article describes the conflicting rulings on this question and provides practical solutions to the problem.

Here is the situation: You represent a general contractor that hires a subcontractor to perform work on a construction project. Your client's contract with the subcontractor requires the subcontractor and any second tier subcontractors your client's subcontractor hires to obtain insurance naming your client as an additional insured. Your client's subcontractor contracts with a second tier subcontractor and their contract incorporates the terms of your client's contract with its subcontractor by reference, including the obligation that your client's subcontractor and its second tier subcontractors obtain insurance naming your client as an additional insured. The subcontractor-second tier subcontractor agreement expressly states that the second tier subcontractor must obtain insurance naming the general contractor as an additional insured. Before work begins, your client's subcontractor provides your client with the second tier subcontractor's certificate of insurance naming your client as an additional insured. Work begins and one of the second tier subcontractor's employees is injured. He files a negligence claim against your client. But not to worry, your client is covered under the plaintiff's employer's policy naming the general contractor as an additional insured, right? Think again.

Under cases decided in New York, Illinois, and the Eastern District of Louisiana, your client would not be an additional insured under the second tier subcontractor's policy and the second tier subcontractor's insurer may not be required to provide your client with coverage. How can this be? Your client negotiated a contract requiring that it be named as an additional insured and coverage was obtained. All parties agreed to provide the general contractor with coverage in the event of an accident like this. According to the courts in *Brooklyn Hosp. Ctr. v. One Beacon Ins.*, 799 N.Y.S.2d 158 (Sup. Ct. 2004), *Westfield Ins. Co. v. FCL Builders, Inc.*, 407 Ill.App.3d 730 (1st Dist. 2011), and *Venable v. Hilcorp Energy Co.*, 2010 WL1817757 (E.D. La. Apr. 29, 2010), your client has not done enough. The general contractor needed to have entered into a direct written contract with the second tier subcontractor requiring the second tier subcontractor to name the general contractor as an additional insured.

The courts' decisions are based on a narrow interpretation of an additional insured endorsement commonly found in insurance policies purchased by contractors. The endorsement defines an additional insured as:

> [A]ny person or organization for whom you are performing operations when you and such a person or organization have agreed in writing in a contract or agreement that such person or organization be added as an additional insured.

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If the *Brooklyn Hospital*, *Westfield*, and *Venable* holdings were applied to our example above and your client's second tier subcontractor's policy included this endorsement, your client, the general contractor, would not qualify as an additional insured under the second-tier subcontractor's policy as your client has not agreed in a written contract with the second tier subcontractor to name your client as an additional insured. Remember, your client's contract is with its subcontractor, not with its subcontractor's subcontractor.

Construction industry custom has been to transfer risk to a downstream party by incorporating the terms of an upstream party's contract into contracts with downstream parties by reference. The courts' strict construction of this common additional insured endorsement may mean upper-tier contractors and even property owners can no longer trust that, so long as coverage is obtained, they will be covered. These parties may need to rethink the way that they negotiate contracts and verify insurance coverage.

***Brooklyn Hospital*, *Westfield*, and *Venable*: No Privity, No Coverage**

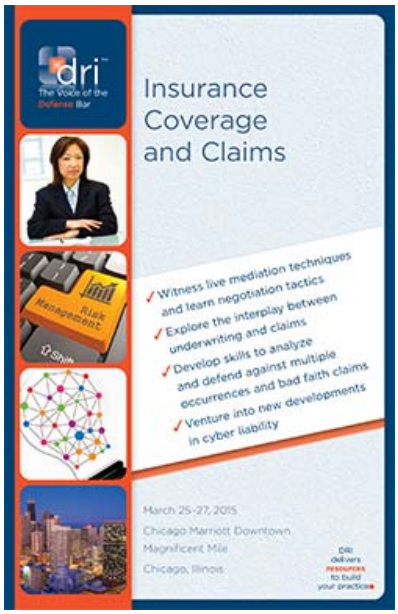
The facts of the cases that have given rise to this issue are oddly similar: Most involved a general contractor hiring a steel fabricator to fabricate and erect steel on a project and the fabricator subcontracting the steel erection work to a steel erector. The general contractors, of course, did not have written contracts with the erectors, but the fabricators' contracts with the erectors required the erectors to obtain insurance naming the general contractors as additional insureds and incorporated the terms of the general contractor-fabricator contracts by reference. The erectors' employees were then either injured or killed.

Again, the endorsement at issue defines an additional insured as "any person or organization for whom [the erector is] performing operations when [the erector] 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 [the erector's] policy." The Illinois trial court in *Westfield* determined that the plain meaning of the term "such person or organization" referred back to the same "person or organization" for whom [the erector] was "performing operations," which was mentioned earlier in the same provision, and it did not include any other entity, such as the general contractor. The court noted that the provision did not refer to "any" person or organization. By continually using the word "such" rather than "any," the provision required that, in order to qualify as an additional insured, an entity (the general contractor) must have had a written contract with the erector naming that entity (the general contractor) as an additional insured. No such written contract existed and the court held that the general contractor was not an additional insured under the erector's policy.

On appeal, the general contractor argued that it met the requirements of the erector's policy as the fabricator-erector contract incorporated the terms of the general contractor-fabricator contract by reference, including the term requiring the general contractor to be named as an additional insured. The general contractor also cited the fabricator and erector's deposition testimony that both intended that the erector name the general contractor as an additional insured. The appellate court was not persuaded and affirmed the trial court's decision requiring privity between the general contractor and erector in order for the general contractor to qualify as an additional insured. The *Brooklyn Hospital* and *Venable* courts interpreted the additional insured endorsement in the same way, requiring contractual privity.

***Millis Development*, *ProCon*, and *First Mercury*: Privity Not Required**

Yet, not all is lost. Recognizing that decisions like *Westfield*, *Brooklyn Hospital*, and *Venable* represent a departure from the industry custom of incorporating terms in construction contracts by reference, federal courts sitting in Texas, Maine, and Connecticut have pushed back, finding that the additional insured endorsement at issue does not require a direct written contract between upstream and downstream parties. The court in *Millis Dev. & Const., Inc. v. Am. First Lloyd's Ins. Co.*, 809 F.Supp.2d 616 (S.D. Tex. 2011), determined that contractual privity was not required where "the actual wording of the additional insured provision does not include the words 'direct' or 'between' in reference to the written contract. Nor are the words 'have agreed' followed by the words 'with each other' or 'together.'" The court in *Pro Con, Inc. v. Interstate Fire & Cas. Co.*, 794 F.Supp.2d 242 (D. Me. 2011), arrived at the same conclusion, finding that an ordinarily intelligent insured without specialized training in law or insurance would not read the endorsement to require contractual privity.



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In *First Mercury Ins. Co. v. Shawmut Woodworking & Supply, Inc.*, 2014 WL4726245 (D. Conn. Sept. 23, 2014), the court agreed with the general contractor and fabricator that the general contractor-fabricator contract and fabricator-erector contract, when read together, satisfied the requirement that the general contractor and erector agreed in a written contract (although not the same one) that the general contractor be named as an additional insured under the erector's policy. The general contractor and fabricator argued that the endorsement only required that each "have agreed in writing in a contract" for the general contractor to be an additional insured. They fulfilled this requirement because the erector specifically agreed in the fabricator-erector contract to name the general contractor as an additional insured and the fabricator-erector contract incorporated the general contractor-fabricator contract by reference, including its additional insured requirement.

Safeguarding Additional Insured Status

The decisions in *Brooklyn Hospital*, *Westfield*, and *Venable* make little sense and present obvious problems for upper-tier contractors, property owners, and even unwary insurance brokers. An upstream party may need a written contract with every downstream party on a construction site, including those that may only be on site for a short time, like a painter or a lessor of a small backhoe. Industry custom would have the general contractor's subcontractor(s) require that the painter or lessor name the general contractor as an additional insured by incorporating the terms of the general contractor-subcontractor contract by reference. Not safely anymore.

To ensure additional insured status (and avoid having to sue downstream parties for breach of contract), upstream parties should obtain copies of all downstream parties' insurance policies and review the policies to verify that they are actually an additional insured under the policies. An upper-tier contractor or owner seeking to be named as an additional insured should also confirm the necessary coverage by requiring an endorsement specifically naming the upper-tier contractor or owner as an additional insured. Ultimately, it is vital for parties to work with their insurance agents and attorneys to confirm that they have the necessary coverage on each project and protect themselves from liability exposure.

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