



Insurance Matters!

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of the Real Property Probate and Trust Law Section of The Florida Bar

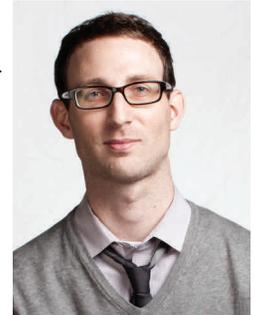
Risk Transfer Pitfalls for Additional Insured Endorsements*

By: Blake Croson, CPCU, ARM, CRIS, AIA, Assurance, Schaumburg, IL



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Additional insured endorsements are critical to contractual risk transfer systems. Currently, 44 states have anti-indemnity statutes that limit a company’s ability to contractually transfer risk to another party within a construction contract.¹ Conversely, only 10 states have statutes that limit the additional insured endorsement’s ability to transfer risk from one party to another.² Because of this, additional insured endorsements are typically more effective risk transfer mechanisms than indemnification agreements.



However, as these forms are rapidly changing, one particular additional insured endorsement pitfall is the direct contract requirement, which was the focus of *Westfield Insurance Company v. FCL Builders, Inc.*³ While this decision is more than six years old, its ramifications are still not widely understood. This article will discuss the case, explore its impact, and offer best practices to all parties on how to avoid associated risks.

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Analysis of *Sebo v. Am. Home Assurance Co.**

By: Arthur J. Menor, Esq., Shutts & Bowen, LLP, West Palm Beach, FL



In *Sebo v. Am. Home Assurance Co.*, 208 So.3d 694 (Fla. 2016), the major issue before the Court was the theory of recovery to be applied when more than one cause or “peril” resulted in the loss of a homeowner’s home and at least one of those causes was excluded from coverage by the homeowner’s insurance policy. The Court held in this case that the appropriate theory to apply in such multiple peril, first-party insurance policy situations was the concurrent cause doctrine (CCD).

In April 2005, Mr. Sebo purchased a home in Naples, Florida that was insured under an “all-risk” policy for \$8 million. By May, the home started to exhibit defects in its construction in the form of water leaks, and in August of that year the home incurred further damage when Hurricane Wilma struck the area. Mr. Sebo reported the damage to his insurance company, American Home Assurance Company (AHAC), in December 2005, but AHAC denied coverage for most of the damages in April 2006. AHAC tendered 50,000 dollars to Mr. Sebo for mold damage, which was covered under his policy, but maintained that “the balance of the damages ... [was] not covered.” Mr. Sebo renewed his claim and provided more information to AHAC in May 2008, but his claim was again denied by the insurance company. The home was eventually demolished as a result of the damages.

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Mr. Sebo initially filed suit against multiple parties in January 2007 regarding the home's construction defects, but amended his complaint in 2009 to include AHAC as a defendant. In his amended complaint, Mr. Sebo sought a declaration that the home's insurance policy provided coverage for the claim that had been denied by AHAC. At the trial court level, the jury found for Mr. Sebo and the court entered judgment against AHAC based on the CCD under *Wallach v. Rosenberg*, 527 So.2d 1386 (Fla. 3d DCA 1988). The Second District Court of Appeals reversed and remanded for a new trial, disagreeing with the trial court's application of the concurrent cause theory of recovery and instead relying on a number of California decisions to find the efficient proximate cause (EPC) theory to apply.

The Supreme Court of Florida quashed the decision of the Second District and remanded for further proceedings. In its discussion, the Court explained both the EPC theory and the CCD and why the CCD should apply in the situation at bar. The EPC theory, the Court stated (citing *Sabella v. Nat'l Union Fire Ins. Co.*, 377 P.2d 889, 892 (Cal. 1963) and *Fire Ass'n of Phila. v. Evansville Brewing Ass'n.*, 75 So. 196 (Fla. 1917)), "provides that where there is a concurrence of different perils, the efficient cause – the one that set the other in motion – is the cause to which the loss is attributable." The Court relied on *Evansville Brewing* in which it held that coverage exists for a peril covered by the insurance policy setting into motion an uncovered peril, but *not* for a peril not covered by the insurance policy which sets into motion a peril covered by such a policy. On the other hand, the Court explained, relying on both *Wallach* and *State Farm Mut. Auto. Ins. Co. v. Partridge*, 514 P.2d 123, 133 (Cal. 1973), "The CCD provides that coverage may exist where an insured risk constitutes a concurrent cause of the loss even when it is not the prime or efficient cause." *Wallach*, the court noted, was the first application of the CCD in Florida. In that case, the Third District Court of Appeals, citing *Safeco Ins. Co. v. Guyton*, 692 F.2d 551 (9th Cir. 1982), found coverage where "weather perils combine with human negligence to cause a loss ... even if one of the causes is excluded from coverage."

The Court noted that Mr. Sebo's policy provided an explicit exclusion of damages caused by "Faulty, Inadequate or Defective Planning," but that all parties had conceded to the fact that weather perils, combined with the home's defective construction, had caused the damage. Further, the Court explained, there was no way to distinguish the proximate cause of the property loss because the construction defects and weather had acted together to cause the damage. As such, the Court ultimately concluded that when independent causes of damage or "perils" come together such that no single cause can be distinguished as the proximate cause of the damage, the CCD should apply rather than the EPC.

The Court also examined whether AHAC explicitly excluded application of the CCD within the relevant portion of Mr. Sebo's policy. It found that the plain language of the policy did not preclude recovery in Mr. Sebo's case because AHAC had written other portions of the policy to explicitly avoid applying the CCD, but had not done so for the defective work exclusion. The Court held that where such insurance policies contain ambiguities, those ambiguities will be strictly construed against the insurer.

One commentator¹ has opined that this last point may be the most important takeaway from the *Sebo* case. The CCD has been the law in Florida when multiple causes of damage are independent since *Wallach* was decided nearly 30 years ago. Because of *Wallach* property insurers in Florida have routinely included "anti-concurrent cause" language in their policies and the courts have generally upheld these provisions when clearly written.² Following *Sebo* it is likely that insurers will rewrite their policies to add clear anti-concurrent cause language in defective work exclusions. Practitioners advising clients on coverage will need to be alert for these anti-concurrent provisions and attempt to negotiate them out although the cost to do so may be significant. IM

¹ Mickley, "Sebo v. American Home Assurance Company: The Florida Supreme Court Confirms Application of the Concurrent Cause Doctrine When a Loss is Caused by Multiple Independent Perils," ActionLine, Spring 2017.

² Paulucci v. Liberty Mut. Fire Ins. Co., 190 F. Supp 2d, 1312 (M.D. Fla. 2002).

* A substantial contribution to this article was made by Yugma Desai, a student at Stetson University College of Law and a summer law clerk in the West Palm Beach office of Shutts & Bowen, LLP.



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Background

FCL Builders, Inc. (FCL) was the general contractor (GC) on a project that required the fabrication and erection of structural steel. FCL subcontracted the steel fabrication and erection to Suburban Ironworks, Inc. (Suburban). Since Suburban was a steel fabricator and not an erector, it subcontracted the steel erection to JAK Iron Works, Inc. (JAK).

FCL issued a contract to Suburban outlining the insurance requirements that Suburban was mandated to provide, including to add FCL as an additional insured under its general liability policy. This contract also required that all lower-tiered subcontractors hired by Suburban had to follow the same insurance requirements. Suburban hired JAK and JAK responded accordingly by issuing a certificate of insurance referencing additional insured endorsement it was required to add in favor of FCL.

During the course of the project, an employee of JAK, Anwar Oshana, fell from an elevated steel beam and sustained a significant head injury. Alleging a breach of duty of care that the working conditions were not safe, Oshana filed a lawsuit against FCL and Suburban. FCL in turn submitted this lawsuit to the general liability policies of Suburban and JAK, having been previously added as an additional insured.

However, JAK's general liability insurer, Westfield Insurance, disagreed with the notion that FCL was a valid additional insured on JAK's policy and denied coverage and indemnification. A legal battle ensued, with declaratory and summary judgment actions being filed by Westfield and FCL. Illinois' appellate court ultimately sided with Westfield in the matter, denying additional insured coverage for FCL.

In ruling in favor of Westfield, the court pointed to and analyzed the language found in JAK's additional insured endorsement, which stated that coverage is afforded for "any 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."

Somewhat lost in plain English is the fact that this form requires a direct contract or written agreement between FCL and JAK to exist, in order for JAK's form to offer any protection to FCL – i.e. "you and such a person or organization."

In giving depositions, both representatives of JAK and Suburban acknowledged that they intended for JAK to add FCL as an additional insured to its policy. The contract between Suburban and JAK spelled this out explicitly as a requirement. FCL even had a certificate of insurance from JAK including the additional insured endorsement. Unfortunately for FCL, the intentions of those involved did not supersede the policy language put forth by Westfield.

Case Comparison

Let's compare this with language that has historically been more common on blanket CG2010 additional insured forms, which outlines who qualifies as an additional insured by stating "any person or organization who you have agreed in writing in a contract or agreement that such persons or organizations be added as an additional insured." This type of language had become so universal and commonplace that a single master contract between the owner and GC or GC and its subcontractor that outlined all the required additional insured connections was sufficient for triggering coverage, assuming these connections were adopted in downstream contracts as well.

It was a safety net that was not tested or broken until the Westfield case. The words "when you and such a person or organization" have forever changed how additional insured endorsements work. We can no longer assume the additional insured endorsement we're holding is worth the paper on which it's printed.

As more insurance companies switch from standardized Insurance Services Office (ISO) forms to carrier-specific manuscript forms, the problem worsens. The main content of a standard CG2010 or CG2037 endorsement is the same from one carrier to the next. The only place a carrier can amend these forms with limiting language would be in the "schedule" box at the top of the form. If the phrase "when you and such a person or organization" is in the schedule box, that is sufficient to determine the endorsement requires a

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direct contract. With manuscript forms (that are longer and more technical to begin with), however, this language can be buried anywhere, making it arduous to interpret them.

Impact to Parties

As a result of Westfield, owners and developers likely have non-functioning additional insured agreements with some of their contractors. Since owners and developers don't often have a direct contractual relationship with the vast majority of contractors onsite, this can significantly hamper their ability to tender claims to the appropriate party.

What's worse, in states that have been known to apply a horizontal exhaustion of limits principle, not preserving additional insured rights with every contractor onsite may force direct financial participation by the owner, developer or GC, or their insurers. New York, California and Illinois, with their major markets, have already adopted horizontal exhaustion. Florida, with the *United Educators Insurance v. Everest Indemnity Insurance* case, has also applied horizontal exhaustion.

GC's will generally have a direct contractual relationship with a majority of contractors onsite, so there are fewer opportunities for these issues to arise. However, GC's tend to soak up the vicarious liabilities of their subcontractors. This means that owners and developers have a more reliable contingency plan than a GC in cases where the owner or developer doesn't have direct access to the responsible contractor's general liability policy because of additional insured issues. GC's generally do not have this option when faced with a large claim and are unable to shift the risk to the responsible party. Subcontractors hiring lower-tiered subcontractors have almost no opportunity to be held vicariously liable for a subcontractor with which they don't have a direct contractual relationship. However, like Suburban in the case of Westfield, if the lower-tiered subcontractor can't be reached by upstream parties, then the blame can fall back onto the original subcontractor.

Suburban did not contribute to the claim in any way, and yet was still responsible for paying significant damages simply because FCL had access to Suburban's policy and not to JAK's. These middle-tier subcontractors have a hugely vested interest in making sure the policies of their subcontractors are accessible to all upstream parties. Failing to do so could result in catastrophic damages that affect insurability and ultimately the ability to compete in the marketplace.

Best Practices

Every party to a construction contract has a shared interest in creating a functional risk transfer system: Owners and developers want protection from GC's and the actions of their subcontractors; GC's want protection from their subcontractors; subcontractors want protection from lower-tier subcontractors; and so on. How then, do the different parties handle the ramifications of this issue?

Owners & Developers

Owners and developers should know what steps their GC's are taking to monitor the risk transfer program. Some basic questions to ask include:

1. Are GC's collecting all the certificates and actual endorsements from subcontractors?
2. What is the process for reviewing the endorsements to determine if they provide adequate coverage?
3. What is the process for tracking the expiration of subcontractors' policies and obtaining new certificates?
4. How do GC's handle lower-tier subcontractors?
5. What steps are GC's taking when subcontractors are not in compliance with the insurance requirements?
6. Where is all this information stored?

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The GC is on the front line of administering the risk transfer program; if it doesn't have detailed answers for each of these questions, then it probably is not doing enough to adequately manage the risk.

GC's

GC's can take several steps to address the risks created by the *Westfield* decision. First, GC's should use their contracts and agreements to address the handling of lower-tier subcontractors. Subcontractors are not to hire lower-tier subcontractors without first notifying the GC, and all lower-tier subcontractors should adhere to the same insurance and indemnity provisions in the original subcontract agreement. Lower-tier subcontractors should be doing the same for third and fourth-tier subcontractors (and so on).

Execute a written agreement with each of the lower-tier subcontractors that requires them to provide insurance and additional insured protections. This form should reference the second-tier subcontractor's contract with the subcontractor that hired it, as well as the GC's contract with that same subcontractor. This should adequately close the loop on any instances where a direct contract additional insured endorsement is used. GC's should also evaluate their process for tracking and reviewing subcontractor certificates and endorsements. With the continued emergence of manuscript endorsement forms and complex coverage language, internal staff may not have the time and/or expertise to effectively manage the risk transfer program. Consider hiring a certificate tracking vendor.

When looking for a certificate tracking vendor, be wary of its level of expertise relevant to cost, as a vendor offering this service for free may be lacking the necessary expertise or resources. If the vendor provides this service for free, confirm it has an attorney on staff to review endorsement forms and offer a legal opinion on the quality of coverage. Also, ask if its errors and omissions policy is broad enough to cover the legal opinions rendered by an attorney.

Subcontractors

Subcontractors that regularly hire lower-tier subcontractors should generally take many of the same steps as GC's. Consider using a third-party vendor for tracking subcontractor certificates. For the subcontractor that hires lower-tier subcontractors 50-100 times per year, the cost of a third-party service is nominal.

Having a third-party vendor will help eliminate the risk of ending up like Suburban – a subcontractor that was financially burdened with a claim with which it had nothing to do, all because it was accessible to the GC while the lower-tier subcontractor was not. By protecting the GC, the subcontractor protects itself and adheres to the contractual requirement of arranging to have its subcontractors add the GC as an additional insured.

Conclusion

"Ignorance is bliss" is definitely not an idiom that lends itself toward insurance matters. Armed with some background on this esoteric policy issue, applying some of this information to your own companies can help strengthen your risk transfer practices. 

¹ Wielinski, Patrick J., Woodward, W. Jeffrey, and Gibson, Jack P. IRMI's Contractual Risk Transfer. www.irmi.com/products/contractual-risk-transfer.

² *Ibid.*

³ *Westfield Insurance Company V. FCL Builders, Inc.* 2011 WL 855397 (Ill. App. 1st Dist. March 25, 2011).

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Committee Mission Statement

The purpose of the Insurance and Surety Committee is to educate the RPPTL Section of the Florida Bar on insurance, surety and risk management issues. The ultimate goal is to grow the Committee to the point it can seek Board Certification in Insurance and Risk Management. 

Leadership & Subcommittees

Interested in getting involved? Contact one of the persons below:

Chair & Newsletter - Scott P. Pence (spence@carltonfields.com)
 Co-Vice-Chair - Frederick R. ("Fred") Dudley (dudley@mylicenselaw.com)
 Co-Vice-Chair and CLE - Michael G. Meyer (mgmeyer83@gmail.com)
 Co-Editor of Newsletter - Mariela Malfeld (mmalfeld@watttieder.com)
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 Legislative Liaison - Louis E. "Trey" Goldman (treyg@floridarealtors.org)
 Secretary & Membership - Katherine "Katie" L. Heckert (kheckert@carltonfields.com)
 Website - Derrick M. Valkenburg (dvalkenburg@shutts.com)

Schedule of Upcoming Committee Meetings

- Do you know the difference between the various forms of additional insured endorsements?
- Do you understand your ethical obligations when representing sureties and their principals?
- Do you know what a "your work" exclusion is?
- Can you describe the difference between an additional insured and a loss payee?
- Do you understand the risks to your clients if they fail to obtain a waiver of subrogation?
- Do you know the difference between "claims made" and "occurrence" based insurance policies?

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 How: Dial-in number: **888-376-5050**
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The first part of each teleconference is devoted to Committee business, followed by an insurance/surety-related CLE presentation that lasts approximately 45-50 minutes.

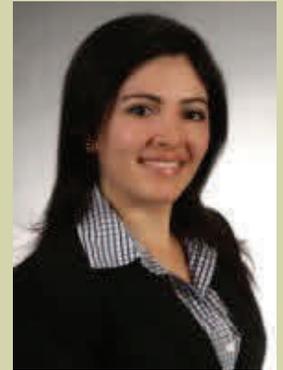
If you, or someone you know, might be interested in presenting at an upcoming meeting, please let us know.

Schedule of Upcoming RPPTL Section Meetings

October 11-15, 2017
 Out-of-State Executive
 Council Meeting
 Fairmont Copley Plaza
 Boston, MA

December 7-10, 2017
 Executive Council Meeting
 The Ritz-Carlton
 Naples, FL

February 22-25, 2018
 Executive Council Meeting &
 Convention
 Tradewinds Island Resort on
 St. Pete Beach
 St. Pete Beach, FL



Mariela Malfeld
Co-Editor

If you, or someone you know, would like to submit an article for possible inclusion in a future issue of *Insurance Matters!*, please contact Mariela Malfeld at mmalfeld@watttieder.com

We Need You!

We are in need of persons to assist in leading various subcommittees. Please contact us if you would like to become more involved.

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