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# SPECIFIER

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## Litigation-Proof Specifications

The limitations general conditions often create for developers in litigation can result in financial horrors. Developers have little choice but to search for parties to share the risk. Unfortunately, too often it is the design professionals who are dragged in, if only to provide a financial pocket to assist in settling the case. The following scenario is typical.

A developer decides to build condominiums. The developer retains an architect who, in turn, retains a design team. Perhaps AIA Document A201 is adopted along with some customized

general supplemental conditions. The project is eventually completed and occupied.

Three years later, the home owners' association for the project initiates a lawsuit against the developer and the general contractor for negligence, strict liability, and other miscellaneous causes of action arising from minor water intrusion around windows, sound

transmission between party walls, and, more seriously, defective shear walls.

The developer tenders the suit to its insurance carrier as well as to the general contractor, requesting that they defend the developer in the lawsuit pursuant to the indemnity provision of the prime contract. The general contractor refuses the tender and the developer's insurance carrier defends under a reservation of rights.

The developer, in reviewing its contract documents and job files, realizes that the general conditions required the subcontractors and the general contractor to add the developer as an additional insured to their general liability insurance policies. The conditions also required that these parties provide the developer with certificates of insurance proving that it was added as an additional insured.

The developer tenders the defense of the lawsuit to all of the general contractor's and subcontractors' insurance carriers. None of the carriers defend the developer; indeed, all of them claim that there is no evidence that the developer is an additional insured on their policies.

Undeterred, the developer's attorney turns to the indemnity language in the prime contract. Again, the developer demands that the general contractor defend and indemnify it from the lawsuit. The general contractor refuses, claiming that there is neither a duty to defend nor a duty to indemnify.

The general contractor and subcontractors claim that the conditions are design related. Simultaneously, the developer's insurance carrier asserts that it will not indemnify the developer for any of the framing repair costs or the conditions causing sound transmission because they are not damages covered under the developer's insurance policy. It will, however, pay to "tune-up" the windows so they stop leaking.

Desperate for parties to contribute to the framing repair cost, the developer sues the architect and the structural engineer, alleging that they failed to properly design and inspect the framing and window installation during construction.

Eventually, after the parties spend a collective fortune in attorneys and experts' fees, the case is settled. The developer's insurance carrier pays approximately one-quarter to one-third of the total settlement. The design professionals who had errors and omissions insurance spend their deductible on defense costs and pay a significant portion of their policies in an indemnity contribution. The design professionals who had no errors and omissions insurance give personal notes to settle the case, rather than file for bankruptcy protection or spend in excess of the notes defending the suit.

Was the developer victimized by insurance carriers and a general contractor who took unreasonable or unsupported positions regarding the developer's tenders? No. In fact, under the circumstances, the positions taken by the carriers and the general contractor were correct.

### What Went Wrong?

Two of the developer's three problems could have been avoided with strong general and supplemental conditions. The third problem, a poorly built project, is often the result of economics and exceeds the scope of this article.

Intelligently written  
general conditions can  
reduce costly financial  
exposure in litigation.

By Peter V. Dessau

First, the general conditions required that the developer be made an additional insured on the general contractor's and subcontractors' general liability policies, and that a certificate of insurance be sent to the developer prior to construction. This is not enough.

A certificate of insurance is not, in many cases, binding on the insurance company. It is simply a document (usually generated by the contractor's insurance broker) that the contractor is contractually obligated to provide. If the certificate is never sent to the carrier or if the carrier never modified the contractor's policy with an endorsement identifying the developer as an additional insured, the developer will not be an additional insured. The general contractor's failure to secure the developer additional insured status is a simple breach of contract that, in light of the context in which it arises, is the least of the contractor's problems.

If the developer is, in fact, an additional insured on the general contractor's and subcontractors' insurance policies, this will significantly affect the litigation and increase the developer's leverage in settlement. As an additional insured, the developer's defense costs should be shared among the developer's and the contractors' insurance carriers. Though insurance carriers often will not acknowledge their duty to defend initially, the threat of a "bad faith" and breach of contract action to secure these costs will often increase their final contribution toward settlement.

If a general contractor's or subcontractor's insurance carrier assumes the developer's defense (which is rare), it will, due to increased defense costs, be motivated to settle the case. Finally, depending on the language adding the developer as an additional insured, it may successfully argue that exclusions that apply to the contractor who purchased the policy do

not apply to the developer. Ironically, as an additional insured on a contractor's insurance policy, the developer may have broader coverage than under its own general liability insurance policy.

Second, the indemnity language in AIA Document A201 3.18.1 is excellent with regard to personal injuries at the job site and other forms of ordinarily insured damage. However, because it tracks language in insurance policies, it fails to require the general contractor to defend and indemnify the developer for economic losses—i.e., diminution in value arising from defects in the general contractor's scope of work. Further, it does not require the general contractor to defend and indemnify the developer for tangible property damage to any part of the general contractor's scope of work.

### **Insurance Clauses**

When drafting insurance clauses in general conditions, ensure that the developer is added as an additional insured on the general contractor's and subcontractors' general liability policies by requiring that it be given not just a certificate of insurance, but an endorsement from the contractor's insurance carrier that specifically identifies the owner as an additional insured. If the project is large or complicated, the specifier may require the carrier to write a manuscript endorsement, i.e., a custom endorsement.

The developer should understand that additional insured status can create problems. For example, there may be conflicts between the developer's own insurance policy and the contractor's policies. However, the disadvantages affiliated with conflicting policies are far outweighed by the advantages of the additional insured status.

On jobs with a high risk of litigation, explore the economics of requiring the contractor's insurance carriers to keep the developer as an additional insured

for a period following project completion in case the event that triggers the insurance coverage occurs after the contractor has completed its work.

Depending on the job's size, consider whether the developer should be added as an additional insured on the contractor's excess and umbrella general liability insurance policies. Generally speaking, excess insurance adds to the primary policy's liability limits. Umbrella insurance may increase the insurance limit, but it will often add different terms of coverage to the additional policy limits. In some cases, if the developer is an additional insured on the primary policy, it will automatically be an additional insured on the umbrella or excess policies, though not always. Furthermore, in some instances, the policies may require extra premiums for additional insured status.

More importantly, the AIA A201 insurance clauses will limit the developer's coverage to the amount specified for each contractor. Since the developer may need more protection from the general contractor and from certain high litigation risk trades, customizing insurance clauses should be considered.

### **Indemnity Clauses**

Indemnity clauses are not as subject to generalizations as insurance policies. They are complicated clauses that ordinarily are strictly construed by courts since they may shift significant risks between parties. Because different states have different laws construing indemnity clauses, it can be dangerous to rely on "canned" clauses. In some states, if the indemnity clause is unenforceable, the parties will not have equitable indemnity rights; that is, they will have no legal means to shift losses based on comparative negligence.

Because indemnity is a key clause in a prime contract during litigation, the

specifier should draft it carefully and have it reviewed by an attorney if used in an unfamiliar legal jurisdiction.

Indemnity clauses have significant effects on litigation. In many jurisdictions, a party that is only 1 percent responsible

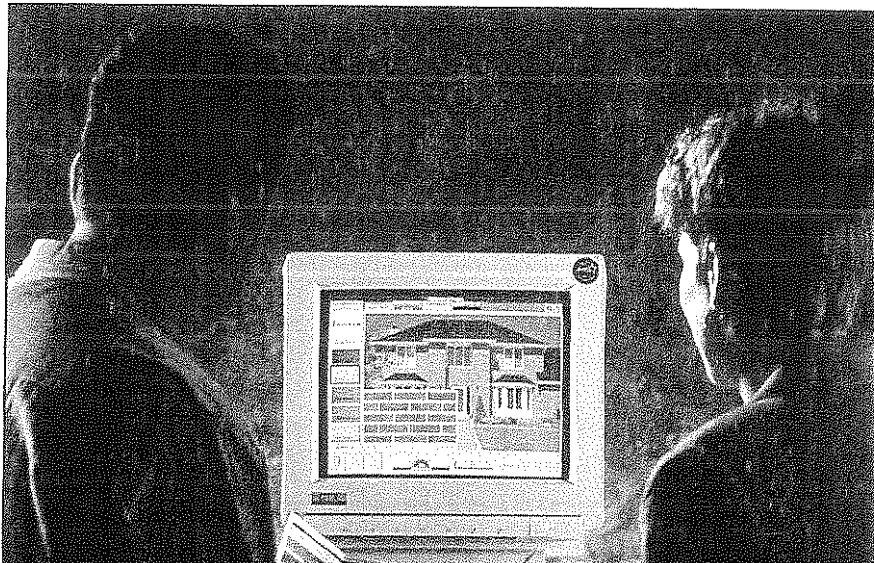
for damages can be made to pay for all damages as well as pay to defend the party that is 99 percent responsible. To ensure that the developer, and in many instances, the general contractor, achieve this type of favorable result, look for the

following characteristics in indemnity clauses:

- The clause should indemnify the developer for losses caused by any source of conduct, including the contractor's own, active negligence.
- The clause should indemnify the developer for losses caused by its own passive negligence, or for losses caused in part by its active negligence.
- Clauses attempting to indemnify the developer for losses caused by design defects are arguably void in some states, most notably California, and should be reviewed carefully.
- Clauses attempting to indemnify the developer for losses caused by any source of conduct, including the developer's sole negligence or willful misconduct, may be void in some states.
- The clause should indemnify the developer for damages arising from any of the contractor's site operations, including any operations arising out of the contractor's scope of work.
- Require that the prime contract's indemnity clause be expressly included in the subcontracts. Incorporating an indemnity clause may not be enforceable in some states. Also, simply incorporating the clause may create problems of interpretation, because there may be subtle differences in the prime contract's indemnity clause and the subcontractor's indemnity clause.

Too often, design professionals are dragged into litigation simply because the developer lacks the tools to litigate effectively without their "deep pockets." It is therefore in the specifier's interest to ensure that developers are armed with insurance and indemnity clauses that are effective in a post-construction, litigious environment. ♦

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