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CONSTRUCTION LAW E-UPDATE

DON'T GET HIT BY THE ACTION-OVER "HAMMER" CLAUSE

By Henry L. Goldberg, Managing Partner, Goldberg & Connolly

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There are already too many inherent risks in a contractor's work. Contractors need not suffer the further indignity of being "hammered" by policy endorsements that contain exclusions that gut their insurance coverage. In the current insurance market in New York, one tactic we have seen utilized by certain carriers is the insertion of so-called "hammer" clauses. Basically, these are exclusions that remove a substantial portion of a contractor's normal activities from its insurance coverage. While this may offer some initially appealing relief from today's runaway premiums, you are likely being sold an "empty" policy that will not cover some of the most basic occurrences on construction projects. It is imperative that you know exactly what you are receiving for your increasingly costly insurance dollars.

One type of "hammer" clause is the insertion of "third party over" exclusions in Commercial General Liability (CGL) policies. This exclusion is directed at third party actions, lawsuits that are commenced by an owner and/or general contractor against a lower tier subcontractor when the employee of that subcontractor sues for injuries suffered on a job. Because of the Workers Compensation Law, a contractor's employee cannot sue his/her employer for personal injuries suffered on the job and is limited to recovery under the Workers Compensation Law. However, unlike many other states, New York allows the injured employee to sue other parties on the project (i.e., the owner, general contractor, construction manager, other subcontractors, suppliers, etc.) for their comparative fault in causing the alleged injuries. These parties, in turn, start a third-party lawsuit, the "third party over" action, against the employer of the injured worker. These third party claims are typically based upon the indemnification clause in the contractor's contract with the owner or GC. The CGL policy provides insurance coverage for such written indemnification clauses under an exception to the contractual liability exclusion. These CGL policies generally exclude coverage for any contract claims, except for these indemnification clauses found in construction contracts. However, some insurers are now inserting problematic endorsements into their policies to eliminate this exception. These additional exclusions are named, rather deceptively, "action-over" endorsements.

A typical example of this endorsement would read that it deletes and replaces in its entirety the exclusion for contractual liability that exists in the body of the insurance policy with language that is then quoted in full in the body of an endorsement. At first, this endorsement sounds good because it is deleting an exclusion from coverage. However, the language that is inserted as a replacement is even worse than the original exclusion. The "action-over" endorsement typically restates the original exclusion and then includes additional language stating that this exclusion applies: (1) whether the insured may be liable as an employer or in any other capacity; and (2) to any obligation to share damages with or repay someone else who must pay damages because of the injury (e.g., contractual indemnity). Thus, this language eliminates coverage for most, if not all, of the obligations the contractor has assumed in the indemnification clause of its construction contract. In the context of New York Labor Law Section 240's "strict liability" standard for fall-related accidents, this lack of basic coverage presents considerable risk.

Consequently, when the contractor tenders the owner/general contractor's claim/suit for contractual indemnification to its CGL carrier, the tender will be rejected under the "hammer" clause ("action-over" endorsement), since no coverage exists. The contractor will have to privately retain counsel to fully defend itself and the owner and general contractor, in the accident-related lawsuit, and fully pay for any settlement reached or for any judgment rendered. This will all be funded out of the contractor's own pocket, with no insurance company participation. This is an insurance coverage disaster that, with a modicum of risk management, could be readily avoided.

G&C Commentary:

Contractors must be vigilant in reviewing their policies with their professional advisors. Unfortunately, this "action-over" exclusion is not the only one that you have to look out for. We have also seen other "hammer" clause-type exclusions, such as the "cross-liability exclusion" or "bodily injury to independent contractors exclusion" or "designated work exclusion" or "residential construction exclusion." Each of these exclusions is designed to save an insurer from having to provide coverage for an injury that arises out of a typical and significant part of the contractor's daily activities.

Remember, the main part of your CGL policy states the losses that are covered. However, this is only the initial representation of what coverage exists and it is almost always significantly altered by exclusions in the main body of the policy, as well as all the endorsements that are attached to the main body of the policy. Some of these endorsements expand the coverage and, significantly, some eliminate the coverage initially provided for in the body of the policy, and for which the contractor believed it was "covered."

One last point should be kept in mind. Certificates of Insurance received from your broker or carrier (e.g., ACORD form) provide you with no coverage. They merely indicate the type of policy you are purchasing and the coverage dollar limits. They in no way indicate what language or exclusions or "hammer" clauses may be contained in your actual policy that have eliminated effectiveness, leaving you with an empty shell.

Mr. Goldberg may be reached by email at hlgoldberg@goldbergconnolly.com or by telephone at (516) 764-2800.