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POLICYHOLDER INSURANCE COVERAGE E-UPDATE

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

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There are already too many inherent risks in a contractor's work for one to suffer the further indignity of being "hammered" by exclusions in your insurance coverage. In the hardened insurance market in the New York construction industry, one tactic we have seen utilized by certain carriers is the insertion of "hammer clauses" or exclusions that remove a substantial portion of a contractor's everyday activities from its insurance coverage. While you may be offered some relief from the growing premiums, in fact, you are likely being sold an "empty" policy that literally will not cover some of the most basic occurrences on construction projects. It is imperative that you or your professional consultants read your policies carefully so you know exactly what you are getting for your increasingly costly insurance premiums.

One "hammer clause" we are seeing too often now is the insertion of "Third Party Over" exclusions in CGL policies. This exclusion is directed to the third party action, which is a lawsuit that is commenced by an owner and/or general contractor against a lower tier contractor when the employee of that lower tier contractor sues for injuries suffered on a job. Because of the workers' compensation laws, 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 benefits. However, unlike many other states, New York allows the injured employee to sue the other parties on the project (i.e., the owner, general contractor, construction manager and all other subcontractors) for their comparative fault in causing his/her injuries. Again unlike many other states, New York law allows the owner, general contractor, et al. to start a third party action (which is just a separate lawsuit that is part of the underlying personal injury lawsuit) against the employer of the injured worker based upon the written indemnification clauses that are part of essentially every construction contract. This is the "Third Party Over" action.

The typical general liability policy provides coverage for such written indemnification claims under an exception to the contractual liability exclusion in today's CGL policies. The CGL policy excludes coverage for contract claims, except if the contract claims meet the definition of an "insured contract," which most indemnification clauses do. Thus, the coverage of written indemnification clauses arises as an exception to an exclusion in the CGL policy. However, some insurers are now inserting endorsements into their policies to eliminate this exception to the contractual liability exclusion. These additional exclusions are named, rather euphemistically, "Action-Over" endorsement(s).

A typical example of this "endorsement" would read that it deletes and replaces in its entirety the exclusion for contractual liability (or employer's liability) that exists in the body of the insurance policy (i.e., insuring agreement) with language that is then quoted in full in the body of the endorsement. Be careful because while, at first, this endorsement sounds good because it is deleting an exclusion from coverage (which is usually a good thing), 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 the vast part of the obligations the contractor has assumed in the indemnification clause of its construction contract.

Consequently, when the contractor tenders the owner/general contractor's claim/suit for contractual indemnification to its general liability insurer (who is both the direct insurer of the contractor as named insured under the CGL and the insurer for the owner or general contractor per the additional insured endorsement on that policy), the tender is rejected with a disclaimer letter that states that, under the "Action-Over" endorsement, no coverage exists. As a result of this rejection, the contractor must be prepared to retain counsel to defend the owner and general contractor in the lawsuit, and to pay for any settlement reached or for any judgment rendered, all funded out of that contactor's own pocket and with no insurance recourse.

In this day of insanely high Labor Law personal injury judgments, it would not take more than one or two of these situations to face a contractor with financial ruin, leaving that contractor having to fund the defense and indemnification of several bodily injury lawsuits, resulting in potential payments totaling multiple millions of dollars.

Ironically, the owner or general contractor know that most contractors could not fund the legal defense out of their own pocket and, therefore, they have almost as much at stake as the contractor in ensuring that the contractor's general liability policies do not contain any "Action-Over" exclusions/endorsements.

G&C Commentary:

As we have stated many times in the past, contractors must be vigilant in reviewing their policies with their professional advisors. This "hammer clause" exclusion situation is just a further reason why it is imperative to do so. Unfortunately, it is not only the "Action-Over" exclusion that you have to look out for. We have also seen other "hammer clause" exclusions, such as the "cross-liability exclusion" or "bodily injury to independent contractors exclusion" or "designated work exclusion" or "residential construction exclusion", etc. 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 party of the contractor's daily activities.

Remember, the main part of your general liability policy is the "insuring agreement," which 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 all of the exclusions in the main body of the policy, as well as all the endorsements that follow it. Some of these endorsements expand the coverage and some eliminate the coverage as initially explained in the policy.

Your vigilance is required and is not optional. You must carefully review with your insurance professionals all of the terms of your various insurance policies to make sure you understand exactly what coverage is being offered (as opposed to what coverage you might have asked for). Remember, to avoid these "hammer clauses," you must protect your insurance protection.