Liability Insurance and Wrap-Up claims: A New Set of Challenges For Insurers

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I. INTRODUCTION

Construction insurance is an expensive, complicated business. For the Owner of the project, or the Developer (“Owner”) the project presents all sorts of potential risks that can render the project uneconomic, or worse, catastrophic. Many different insurance products have been designed and implemented to fill the needs, including General Liability insurance, Pollution Liability Insurance, Design Errors and Omissions, and Builders Risk insurance, to name a few. In addition, each contractor requires Workers Compensation and Liability insurance minimally, and may require other coverages depending on their scope of work.

Traditionally, the Owner and/or General Contractor\(^1\) contractually requires each contractor to obtain both General Liability and Workers Compensation coverage. Through the cost of the subcontracts, the Owner ultimately pays the cost of insurance for each party, including safety and loss control costs that were included as part of the premiums for each contractor. In some cases, the cost is prohibitive, or worse, not available because of the risks associated with the work. One solution: have the Owner buy the coverage, and insure all the contractors on the project.

Wrap-Up Insurance Programs, also known as Controlled Insurance Programs or CIP’s, have been used for decades for large infrastructure projects, but they burst on the scene in the mid to late 1990s as a viable alternative to traditional insurance for many smaller and less sophisticated construction projects. The most common CCIP’s are the OCIP (Owner Controlled Insurance Program – where the Owner or Developer arranges for all the project insurance) and CCIP (Contractor Controlled Insurance Program—where the general contractor assumes that responsibility). Whereas previously, underwriters thought that, in order to be feasible, project-specific insurance needed to written only for the largest projects and include the premiums from Workers Compensation, now, Wrap-Ups are offered with many different combinations of

\(^1\) The General Contractor is the prime contractor ultimately responsible for delivering the project and executing the design for the project, who must supervise the actual means and methods of the specialty subcontractors.
coverage, including Wrap-Ups for just workers compensation, builders risk, General Liability or Professional Liability coverages.

Why the change? Commentators and risk management professionals have written volumes on the emergence of the Wrap-Up product for all kinds of construction risks. From the claims trenches it seemed that the combination of a 10-year statute of limitations for construction defect claims, with the difficult market for contractors’ insurance, meant that Owners often faced uninsured or uncollectible indemnity claims against responsible subcontractors. Furthermore, monitoring and maintaining insurance for each of the contractors on the site was expensive for the duration of the completed operations tail. Inefficiencies and insurance gaps led inevitably to increased insurance costs for the overall project whether a direct cost (in the form of payment of insurance premiums due to a decreased ability to transfer risk to subcontractors), or an indirect cost (included in the cost of a subtracted work and extra administration).

Additionally, the opportunity was presented because Owners recognized the inefficiency of having several insurance companies representing different parties on the same construction project, and insurers were willing to simplify the administration by providing a single, integrated insurance program; the premiums for providing all the insurance for a single project were also attractive to underwriters. Surplus lines carriers entered the marketplace, willing to participate in the newly evolving product, becoming niche players in the growing construction insurance market in the hot national construction market of 2000 to 2008.

Thus, the modern, more flexible Wrap-Up was born, where more and different projects could be considered. As compared to traditional insurance, an Owner’s choice to utilize a Wrap-Up for liability insurance provided two distinct benefits over the traditional insurance product. First, it assured adequate coverage for all of the parties on the job site, including both ongoing operations and completed operations losses for the duration for the statute of limitations. Secondly, at least for residential products, most Wrap-Up liability policies used a “close of escrow” composite rate, meaning that the policy in effect at the time the particular house or building is completed and sold will apply to all completed operations claims (also known as Construction Defect claims) that might occur in the future relating to that building. The developer knew the cost of insurance and the coverage available for each house, which in turn allowed for better management of the risk associated with future claims and lawsuits. Simply the ability to isolate the insurance that would apply to a particular project means that the insurance being bought today can match the future exposures that are created by today’s building.

In contrast, with traditional insurance, General Liability policies are purchased yearly, and are written on an “occurrence” basis. Occurrence policies are triggered, i.e., they respond to a claim, if there is covered damage that occurs during the policy period.
Most operations losses have a certain date of loss. However, for defect claims, the defect occurs during construction, but the damage occurs over several years until it is discovered; thus, for construction defect claims in most states, all policies insuring the contractors from the date of construction to the service of complaint are triggered and share in the responsibility, unless the policies are modified by endorsement. Therefore, traditional General Liability insurance purchased today by the builder covers losses occurring during building this year, plus some share of the completed operations exposure for past projects. Wrap-Ups allow the risk manager and CFO to more accurately gauge the entire insurance cost for today’s work.

Others have written about Wrap-Up programs, including program design, the marketing, costs and benefits of Wrap-Ups for contractors and Owners. The purpose of this paper is to survey some of the unique legal and claims issues that are presented by the General Liability insurance Wrap-Up product, including:

1) Insurance coverage limitations for construction claims applied to Wrap-Up programs,

2) The effect of contractual indemnity rights between the parties on the project on the coverage under the Wrap-Up policy,

3) Professional liability and ethical exposures of insurance agent, Wrap-Up administrator and lawyers retained relative to defense of suits against the Wrap-Up enrolled contractors, and

4) Claim handling and bad faith concerns for Wrap-Up insurers that arise because of the nature of the Wrap-Up program and relationships between the carrier, the Sponsor (Owner) and the contractors on the project.

II. TYPICAL COVERAGE ISSUES IN CONSTRUCTION GENERAL LIABILITY CLAIMS APPLIED TO WRAP UP PROGRAMS

A. Policy language unique to General Liability Wrap-Ups

Simplistically, a Wrap-Up provides General Liability insurance to all (or most) of the contractors on a job site. The policies themselves are General Liability type forms

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2 In California, for example, all General Liability policies are triggered for a defense from the date of construction to the date that liability is established, absent an endorsement providing otherwise. Montrose Chemical Corp v. Admiral Insurance Co. 10 Cal.4th 845; for indemnity a “qualified time on the risk” is the preferred method of allocation absent unique circumstances or policy language. City of Palos Verdes Estates v. Stonewall Ins. Co. 46 Cal.4th 1610.

3 By design, or because of unique risks or the cost of insurance, in some cases certain subcontractors are excluded from the Wrap Up program.
that are modified for Wrap-Up application. Modifications to the standard form must include, for example, who the Named Insureds will be, and modifications relating to the period of time that Completed Operations claims are covered. For example only, some carriers extend the policy period for purposes of the Completed Operations claims, but others treat them as a Claims Made type policy – that the work must be done during the policy period, but the claim must be made within the extended reporting period.

There are two means of creating a Wrap-Up product from a General Liability policy. The first uses industry standard ISO\textsuperscript{4} General Liability policy forms, and then uses manuscripted endorsements to modify the standard coverage. The second method uses a specially drafted Wrap Up policy form created from scratch; these ground up forms are known in the industry, and will be referred to in this paper, as manuscript forms. Whether the carrier uses a special endorsement, or a manuscript form, there are no standard Wrap-Up policies, and coverage limitations are unique to each carrier. It is critical, however, that because there are no standards, and limited resources for actuarial data, each carrier, it seems, has unique coverage “twists” that need to be recognized as soon as the claim comes in.

One way to tell whether their policy is a manuscript form or a modified ISO policy is to look at the General Liability policy form. If it uses the ISO coverage form (e.g. CG 0001) or if it says that the form is copyrighted by the Insurance Services Office, then the Wrap-Up policy is likely based on the ISO forms. In that case, the focus of attention of an experienced insurance professional is the specific endorsements to the policy to make sure the modifications correctly insure the Wrap Up risk. Alternatively, if the General Liability form does not contain the reference to ISO, or states that only certain portions of the form are copyrighted, or it uses an unfamiliar form number, it is likely a carrier-specific manuscript policy form. Most of the critical coverage terms will be in the main policy form.

Whether the carrier uses modified ISO forms, or a manuscript form, Wrap Up policies have certain characteristics that create unique challenges to Wrap Up claims professionals and insurance coverage lawyers:

1. Each contractor and subcontractor performing work on the project is usually a “Named Insured” on the policy;

2. The policy contains a “Separation of Insureds” condition so that each individual “Named Insured” must be treated as if it is “the only” “Named Insured” if a claim or “suit” is made, but there is a single policy limit applicable to all Named Insureds;

\textsuperscript{4} Insurance Services Office.
3. Each contractor retains its own responsibilities to other project participants for Workers Compensation and liability under the construction contracts;

4. The policy will likely have an endorsement (or the policy form will define) the Products – Completed Operations Hazard as including claims for damages that occur from completion of the project through the expiration of the applicable statute of limitations (or it might contain a fixed period of time);

5. The policy is likely to have specific exclusions applicable to damage to the project under construction, to avoid duplicating builders risk insurance;

6. Carriers have used their own experiences and developed “other” characteristics that set them apart from their competition, and create challenges for claim professionals and outside coverage counsel, for example:

   - Exclusion for claims by one Named Insured against another Named Insured;

   - Eliminating completed operations for any Named Insured until the entire project is completed, even if a subcontractor’s work is done at the beginning of the project, such as foundations, and causes damage to other portions of the project;

   - Eliminating coverage for subcontractors’ indemnity obligation to the General Contractor entirely, or for damage to the project.

   - Exclusion for damage that is pre-existing, when the Wrap-Up program is to finish construction of an incomplete project, or a condominium conversion to apartments, or the project is in Phases;

   - Complete elimination of the exclusion for damage to “your work”

B. Covered damages under a Liability Insurance Wrap Up program

1. Who qualifies as an “Insured” under the Wrap-Up Program--Is there a present duty to defend or indemnify?

   Generally speaking, courts use the same principals of insurance law to deal with Wrap-Up programs as they do typical insurance policies. Thus, all of the typical construction coverage concerns are present in Wrap-Ups. The difference, however, is that the carrier must consider coverage for each “Named Insured” under the program.

   Once a claim is presented against the contractor, and the matter is tendered to the Wrap-Up carrier, the first issue is whether the parties against whom the liability claim is presented, or could be presented, qualify as an “Insured” or “Named Insured”
under the policy. The Wrap-Up carrier has a unique vantage point at the onset of the claim. First, the carrier may actually have notice of the claim well before the project’s contractors, where the Sponsor of the program is the Owner making the claim. Second, upon obtaining notice, the carrier insures all of the contractors, and it must make strategic decisions knowing little about how the claim might evolve and whether any subcontractor in the Wrap Up might ultimately be responsible for the loss. It must decide early whether a “resolution” approach to the claim should be taken or whether the best strategy is to avoid commitments and continue to investigate. In many cases, a non-Wrap-Up party may be the ultimately responsible party, or, none of the enrolled contractors is responsible and the responsibility lies with the Owner, the design professionals, or some other non-Wrap-Up enrolled party.

a. Enrollment and “Insured” Status

An insurer has no obligation to defend or indemnify any party that does not qualify as its “insured.” Further, the insurer may sue a “non-insured” for contribution or subrogation to recover amounts paid under the policy on behalf of an insured. In the context of a Wrap-Up program, there are three principal issues that affect the “insured” status of the party, and the obligations of the carrier. The first is enrollment. In the typical Wrap-Up program, if a Wrap-Up program is in place the contractor will be required to sign certain paperwork in order to enroll in the Wrap-Up. Enrollment can be done in a variety of means and methods, but for purposes here, the key is this: the Wrap-Up program will undoubtedly require that each contractor affirmatively enroll in the program in order to be covered under the policy. Thus, “enrollment” determines “insured” status and creates a potential point of conflict with the insurer.

If the enrollment procedures are clear and, for example, the contractor is not covered until the application is submitted and proof of enrollment is supplied to that party, failure to complete those steps will result in no coverage for the contractor, even if the party works on the project and deletes coverage at the project from his regular liability insurance. The contractor is either enrolled, and therefore an “Insured”, or it is not enrolled. Contractors must follow the written procedures to enroll; the absence of enrollment forms is evidence that a party is not enrolled, and therefore is not an “Insured”. Other carriers’ policies provide automatic coverage in the Insured endorsement, sometimes called “blanket” coverage, which extends Insured status if certain conditions are met, such as executing a written agreement with the Wrap-Up sponsor, plus enrolling in the insurance program, and performing operations at the

5 The anti subrogation rule is discussed in Part V, claims handling.


project site. Significantly, therefore, without being listed in the policy by endorsement, these contractors are “enrolled”, and therefore “Insureds” under the policy.

The mechanics of the enrollment issue create a potential professional liability exposure to the insurance broker and/or the wrap administrator. Specifically, was the enrolling entity acting for the insurer to document who the insureds were to be, or was the enrolling entity acting for the Owner of the project who may be responsible for procuring insurance? In one case, dealing with an unenrolled contractor, where a General Contractor failed to include a subcontractor as an OCIP enrollee, the Owner was responsible for a large deductible under an OCIP to settle a tort claim by an employee of a subcontractor. In that case, the Owner was deemed to have no claim against the General Contractor for indemnity since, under the construction agreement, the Owner was obligated to obtain an OCIP policy and the General Contractor had no insurance procurement obligation. In other words there was a disconnect between the obligation to enroll the subcontractors and the consequences of failing to do so; the Owner was contractually responsible to obtain insurance for the contractors, but the General Contractor was supposed to do the enrollment.

b. The Separation of Insureds Condition

A closely related coverage issue related to enrollment and insured status is the “Separation of Insureds” condition on the policy. This condition is found within Section IV of ISO’s General Liability coverage forms, and states that each “Named Insured” under the policy will be treated as if it is the only “Named Insured” under the policy, and that each “insured” has separate rights as an Insured under the policy. This is a key provision to claims professionals and lawyers involved in a Wrap-Up program. Typically, each enrolled contractor will qualify as a Named Insured on the General Liability policy. This provision requires the insurer to analyze coverage separately from the perspective of each enrolled contractor.

Since each contractor is a Named Insured, it requires a claims professional or lawyer involved with Wrap-Up programs to recognize potential future moves by a claimant against other enrolled contractors that will result if the carrier chooses not to resolve the claim directly with the claimant. For example, a carrier’s position of non-coverage as to one party could result in that party presenting a covered indemnity claim against another enrolled subcontractor. For any given claim, there may be liability but no coverage for one participant, but coverage and liability for another and therefore an exposure to the Wrap Up policy. The carrier’s potential exposure is measured by the entire liability unless a non-Wrap-Up participant is responsible or there is no coverage for any responsible contractor.

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9 Knutson Construction Services Mid-West, Inc. v. Board of Regents, 767 N.W.2d 420 (Iowa App. 2009).
10 This is typical, but sometimes enrolled contractors are Insureds, which still provides that the policy applies separately to each Insured.
c. The Policy Versus Other Job Contracts

A Wrap-Up program normally consists of several related contracts designed to work together, one of which is the General Liability policy. Those program contracts will include other lines of insurance (e.g. Builders' Risk, Professional Liability, Workers' Compensation) and documents concerning administration of the program (program manual or similar document). In the context of this article, the General Liability policy is one piece of the Wrap-Up program. The General Liability carrier's duty to defend or indemnify is measured by the policy alone unless it incorporates other documents by its terms.\(^\text{11}\) The General Liability policy is typically negotiated by the broker and delivered to the Sponsor. The Wrap Up administrator or insurance broker must make sure it is correct. The policy, not the other program documents between the Sponsor and the enrolled contractors, governs when the insurer is obligated to defend and indemnify, what claims are covered, and when coverage expires.

In more sophisticated programs, the Sponsor or the Wrap-Up designer may create a distinction between insurance coverage for the Wrap Up participants, and the overall insurance the insurance program for the Sponsor. Lower premiums can be realized if the Sponsor of the Wrap-Up assumes a retained limit. On large projects, the sophisticated Sponsor of the program may have one appetite for risk but the individual contractors are not willing to assume such a large risk. Thus, for example, the Sponsor of the program could agree to have an insurance program with a $500,000.00 Self Insured Retention for each “occurrence” or cause of loss, but simultaneously contracts with individual contractors to be responsible for only a $25,000.00 retention.

Another example of a disconnect between the insurance program and the insurance policies actually obtained is where the program calls for primary and excess General Liability Insurance for each enrolled contractor. However, rather than have an Umbrella or Excess Liability policy that schedules the primary one, and applies in excess if it is exhausted by payment, the umbrella insurer instead issues a policy to apply in excess of an SIR that applies to indemnity only, but the primary policy contains a feature whereby defense costs erode the limit. For purposes here, a gap is created between the expectations of the enrolled contractors and the policies that are actually obtained for them by the insurance broker or Wrap-Up administrator.\(^\text{12}\)

What happens if there is a claim, but the Sponsor is not able or willing to fund the full retention? The “Named Insured” enrolled contractors expect coverage to be provided per the Wrap-Up program documents, but the insurer may have no obligation. While the contractor may qualify as an “insured,” the contractors have no carrier to turn to for defense or indemnity of an otherwise covered claim. This disconnect between the Wrap-Up documents and the actual policies can create a significant uninsured exposure.

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\(^{11}\) C.F. La Jolla Beach & Tennis Club, Inc. v. Industrial Indemnity Co, 9 Cal. 4th 27, 37 (Cal. 1994), the language of the policy contract alone governs its interpretation, if it is clear.

\(^{12}\) C.F. the complaint in Chartis Specialty Ins. Co etc. v. Gemstone LVS USDC D.Nev Case number 2:11-cv-01669 MMD-CWH
for the contractors, and difficult claim choices for the carrier if the loss is likely to exceed the retention. Specifically, a carrier is sometimes faced with difficult choices, if it hopes to realize the benefits of the retention it bargained for when it sold the policy—the Sponsor or another carrier would be absorbing losses within that retention amount and act to control the claims and the Insureds before the loss impacts the carrier. Should the carrier assume control over the loss, and potentially the total exposure of the case, or should it insist that it has no obligation to participate until the enrolled contractors satisfy the retention? Should the carrier agree to incur costs today, to hopefully reduce the total payout, or should it refuse to participate today, and hope that the contractors control the total cost of the claim?

Retentions can be a second pressure point between the enrolled contractors, the insurer and the professionals that are designing and administering the Wrap-Up program. In the circumstance where there is no insurance coverage upon payment of the agreed upon retention, does an enrolled contractor have a claim against the insurance agent or Wrap-Up administrator for failure to insure? Likely that claim would occur in limited circumstances. The wrap administrator or insurance broker would face exposure if it represented that insurance coverage would be available in excess of the lower retained limit, but it would be safe from liability if it represented only that the contractor would be responsible only for a smaller deductible or retention.  


d. Unique Problems if Premiums Not Paid

A third “insured” question arises in the context of the Sponsor not paying the full premium under the Wrap-Up policy. Even if a subcontractor enrolls and completes all of their work under the contract, if the Sponsor does not continue coverage, the contractors will be left without any coverage under the Wrap-Up program for construction defect or completed operations claims. As in any other policy, the payment of premiums determines the length of time that coverage is in place. Unlike a typical program, however, that provides typically one year of coverage under each policy through the date of cancellation, the Wrap-Up program is normally a multi year policy, with a policy period that covers the period of construction. The premium paid during the construction phase includes an extended coverage period for construction defect claims. Failure to complete payment of the premium during the operations phase, however, may eliminate all completed operations coverage for all contractors. Or stated differently: there is no coverage for a construction defect claim against the original contractors. A failure to insure claim against the Owner who couldn’t pay the premiums likely provides little protection.

13 See, for example: Fitzpatrick v. Hayes, 57 Cal. App. 4th 916, 927 (1997), dealing with the basis of liability against an insurance agent, and Hollywood Turf Club v. Montgomery Elevator Co., 58 Cal. App. 3d 580 (1976), dealing with the measure of damages as the uninsured loss. [it would be helpful to state briefly the holdings]
2. **Typical coverage issues for construction claims**

   a. Is there a covered “Occurrence” causing “Property Damage” or merely defective work?

   Construction claims present a host of “pure” coverage issues under a General Liability policy. The first is whether there is an “occurrence.” An “occurrence” is an “accident" and requires that the actions of the Insured leading to the damage are not deliberate or intentional. Determining if there is an “occurrence” causing “property damage” will necessarily be a determined from the standpoint of each enrolled contractor under the program given the Separation of Insureds condition. Thus, while the General Contractor may be performing exactly as called for in the plans (arguably no "occurrence"), subcontractors could negligently perform the work that would cause “Property Damage,” because they were surprised by the conditions, or negligently performed the work.

   In the context of Wrap-Up programs on Public Works and infrastructure projects, one of the challenges that will arise comes from businesses that are affected by the ongoing project. Normal disruption caused by street improvements, for example, can lead to business interruption and inverse condemnation claims. Some carriers have inserted “inverse condemnation” into their policies, to complement the “occurrence” requirement under the policy. The logic from the carrier’s perspective is straightforward: if the basic plan of construction was to shut down a street, block a driveway, or divert vehicle or pedestrian traffic away from a business, when that occurs, the damages are hardly an accident, “unforeseen” or fortuitous, which is the essence of insurance. By analogy, there is no “Occurrence” under a public entity indemnity contract that required damage be the result of an “Occurrence” where a business was shut down by the application of an ordinance passed after deliberation by the City Council.

   A difficult coverage issue in the context of a Wrap-Up involves workmanship issues at the project. In several states, workmanship issues alone do not constitute an “Occurrence” under a General Liability policy and therefore are not covered.

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14 An “occurrence” is defined as an accident, including continuous or repeated exposure to the same harmful conditions; “Property Damage” is defined as “physical injury to tangible property, including loss of use thereof.”


16 E.g. Cal Ins. Code §§ 22, 250

17 The intended and expected result of City’s passage of the anti-noise ordinance was economic damage to Sherlin’s business. It is clear that City’s activities fall outside the policy definition of occurrence, and, therefore, the scope of coverage. City of South El Monte v. Southern Cal. Joint Powers Ins. Authority, 38 Cal. App. 4th 1629, 1646 (Cal. App. 2d Dist. 1995)

Reaching a similar conclusion but by different means, other courts have found that a mere defect in construction that does not damage other property is not a claim for “Property Damage” as defined by the policy, because there is no liability for damage to “other property.” Additionally, General Liability policies contain business risk exclusions, excluding coverage for damage to “that particular part” of property being worked on by the Named Insured during operations, and for damage to “your work” for claims within the Products-Completed Operations Hazard.

General Liability policies “are not designed to provide contractors and developers with coverage against claims their work is inferior or defective. The risk of replacing and repairing defective materials or poor workmanship has generally been considered a commercial risk which is not passed on to the liability insurer. Rather liability coverage comes into play when the insured's defective materials or work cause injury to property other than the insured's own work or products.” These limitations become critical to investigate and difficult to enforce by carriers in the context of a Wrap-Up policy.

Often times, what is a “mere defect” to one Named Insured contractor may be damage to “other property” when viewed from the perspective of another; the Wrap-Up carrier will have coverage if there is any insured contractor that is both liable for the damage (directly or because it must indemnify the General Contractor) and for which the claim is not excluded. For example there could be cracked exterior stucco caused by shrinkage of green lumber to which it was attached; it may be defective work as to the stucco subcontractor and resulting damage to other property to the framer.

These same principles apply to Wrap-Ups and affect the ultimate Wrap-Up exposure. In one New York case, a portion of masonry on the façade of a building being built under a Wrap-Up program dislodged and had to be re-worked; the Court found that there was no “Occurrence” and the faulty workmanship was not covered under the General Liability Wrap-Up policy. The claim was presented, however, from the perspective of the General Contractor, and analyzed from that perspective alone. The opinion did not discuss whether, had the subcontractor been sued, the policy would have responded. Would the result have varied, for example, if, upon receiving a denial of coverage from the carrier, the General Contractor had simply sued the subcontractor for indemnity?

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20 “Your work” is the work by each Named Insured and materials supplied in connection with that work

21 F & H Construction v. ITT Hartford Ins. Co., supra at pg. 372-373

Even if there is a “mere defect” in construction by a contractor, some states allow coverage for access and repair costs that damage other property, so-called “Rip and Tear” or “Contractor Re-Work” coverage. Thus, for example, there could be a claim against one of the enrolled contractors that does not involve “Property Damage” or would not qualify as an “Occurrence;” in some states, if it was necessary to rip out undamaged work to repair the defective work, that “ripping” and “tearing” may constitute covered damages. Only by analyzing coverage from each enrolled contractor’s perspective, not just the one that originally tendered it or that appeared to be the target, can the carrier make a decision that withstands ultimate scrutiny, both from a business and legal perspective.

At least one insurer addresses the workmanship complexity by providing full coverage without exclusion for damage to "your work" in the completed operations phase for construction defect claims. In this way, after completion, and assuming that there is some damage and not merely non-conforming work, it is covered. It is elegant in its simplicity for claim handling, and likely, given the nature of the Wrap Up product, does not significantly increase the carrier’s exposure.

b. Is it an Operations or Completed Operations Loss?

After workmanship and “occurrence” issues, identifying whether the claim against the “insured” falls within the “operations” or “completed operations” hazard is critical if the claim involves damage to the project (i.e. a construction defect claim).

Under the standard ISO form, it is theoretically possible to have a single lawsuit by the Owner against the contractors fall simultaneously within the operations and completed operations hazard of the Wrap-Up policy. Damage to the project will always be an “operations” loss as to the General Contractor until final acceptance and completion, but at least some of the subcontractors may have finished their individual work. Since different exclusions apply to damages because of “property damage” caused during the operation phase as distinct from “completed operations” phase, and unless the policy addresses this anomaly, the claims professional must identify what portion of the damages relate to each hazard and apply the exclusions to that damage. A solution employed by some carriers has been to simply eliminate operations coverage for damage to the project and provide completed operations coverage once an identified event has occurred (e.g. certificate of occupancy, notice of completion, etc.) such an approach makes the claims professionals and lawyers’ jobs much simpler if there is a single completion date established by contract. However, because the contractors have no coverage for any damage to existing work during construction, it arguably creates a gap in coverage if a contractor causes damage but it isn’t insured by the builders risk policy.


24 Exclusion J(5) and J(6) apply to damage to the project that occurs during operations, or “being worked on”; Exclusion L applies to damage to “your work”, and contains an exception for damage to, or caused by, subcontracted work.
c. Post construction premises liability claims

An interesting issue arises in post-construction premises liability claims for bodily injuries. In the typical Wrap-Up program, the contractors are covered for liability arising out of their construction of the project for 10 years after completion of the project. Ironically, the Owner of the project enjoys no such coverage for completed operations. Simply, the definition of the "Products-Completed Operations Hazard," absent a modification by endorsement, only covers each Named Insured for damage caused by work that has been completed, away from premises that the Named Insured owns or rents. In other words, if a Wrap-Up program is in place for the construction of a project that will be owned by the Sponsor of the Wrap-Up, the first Named Insured on the policy, the contractors will be protected for defect and post construction claims, but the Owner will not.

d. Overlapping or “other” insurance

Overlapping policy situations occur between different Wrap-Up policies, and between Wrap-Up policies and the contractor’s own coverage, sometimes called practice policies. Absent language that clearly identifies the risks covered by the different Wrap-Up policies, the potential exists for overlap between different types of coverage. For example, there could be a General Liability claim (operation of a bulldozer) causes a pollution-related damage (knocks into a building, spilling fuel) which is Contractors Pollution Liability risk excluded by the General Liability policy. There could be injury to an employee of a contractor (Workers Compensation) who sues the General Contractor for a third party over a liability claim (General Liability). There could be damage to the project during a rainstorm (Builders' Risk) caused by the negligence of an enrolled contractor in failing to protect the work (General Liability).25

Another “other insurance” situation arises when the contractors’ practice policies, or non-Wrap-Up policies, do not contain an effective Wrap-Up exclusion, which are designed to exclude coverage for liability associated with projects insured under Wrap-Ups. As a matter of common practice, most carriers for the Wrap-Up program will seek contribution and apportionment of legal fees and costs from the practice policies for enrolled contractors. The fact that the stated intent of the Sponsor and the carrier was to provide all coverage for the project participants under the Wrap-Up program is legally irrelevant if the actual contract language of the policies does not so provide. For example, in one case the umbrella carrier for the Wrap-Up paid the claim (excess of the primary Wrap-Up liability carrier) and sued the contractor’s own coverage that did not contain an exclusion for liability at a project insured under a Wrap-Up. The California Court allowed the subrogation claim despite the fact that the project was insured under a Wrap-Up.26

25 The typical ISO General Liability policy provides that it is excess over builders risk coverage, but what if the Builders Risk has a large Self Insured retention and there is no “Builders Risk” insurance?

26 [The evidence shows that]… the [practice] policy was intended to provide coverage for all of Okland’s activities at the time it was written, that the premium paid by Okland reflected that liability, and that affirmative steps should have been taken by Okland and American & Foreign if a different result was
It is very common for practice policies to contain Wrap-Up exclusions to avoid this problem. Unfortunately, there is no uniformity as to exactly what a Wrap-Up is, or its proper designation or description. For example, a New Jersey Appellate Court addressed carriers’ argument that the term “Wrap-Up” was undefined and therefore ambiguous. In that case, Hartford had issued a General Liability policy covering the General Contractor and the subcontractors. U.S. Fire had issued a practice policy, but it had an exclusion for projects insured under a consolidated or Wrap-Up insurance program. Hartford argued that the term “wrap up” was ambiguous, because a “wrap up” as generally understood included not just the contractors, but multiple lines of business (such as Liability and Builders Risk), and therefore the U.S. Fire exclusion did not apply.

The Court agreed that the term “wrap-up” was not a model of clarity and found that the term was ambiguous, however, it then looked to the intent of the parties to the U.S. Fire policy aside from the plain language used. The court noted that the insured and the retail broker had specifically excluded coverage for the project as being included under a “Wrap-Up”. The court reviewed other documents from the underwriting file that confirmed, according to court, that the intent of the Named Insured was to exclude coverage for the project under the practice policy because it was covered elsewhere, under the Hartford Wrap-Up policy. Therefore, the court upheld the exclusion and barred recovery by Hartford.

In another case involving “practice policies” and a “Wrap-Up” policy, the Court found that the terms “Wrap Up” and “OCIP” were synonymous and that an exclusion applicable to “any wrap-up, Owner controlled insurance program, contractor controlled insurance program or similar rating or consolidated program” was applicable and denied recovery by the Wrap Up carrier against the practice policy.

Finally, in a Nevada inter-carrier suit between two practice policy carriers, Plaintiff sued for contribution relative to several mutual insureds and several different construction defect lawsuits. As to one, Amber Ridge, the Plaintiff claimed that it was obligated to respond, having no applicable Wrap Up exclusion, and claimed that the defendant’s exclusion was inapplicable as well. The relevant exclusion provided:

[This policy] does not apply to . . . property damage arising out of either your ongoing operations or operations included within the "products completed operations hazard" at the location described in the schedule of this endorsement as a consolidated (wrap-up) insurance program has been provided.

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 Welcome vs. Just Apartments 2008 N.J. C. Super Unpub Lexis 2466

The Court did not find this to be an "escape clause," which would be void as against public policy, but rather a bargained-for exclusion where secondary insurance is already in place. Nevertheless, the court found that a genuine dispute of material fact existed regarding whether this exclusion applied to bar coverage for the Amber Ridge case. Specifically, the issue was “whether the occurrence/damage at issue in Amber Ridge arose out of either "ongoing operations" or "operations included within the 'Products-Completed Operations Hazard'”, such that the endorsement excluded coverage. The court therefore denied the defendant’s motion and did not apply the exclusion.  

Most practitioners would be surprised to learn that an exclusion that applies to both the Products-Completed Operations Hazard and ongoing operations does not apply to all operations.

It appears that courts are willing to enforce the exclusion, but given the lack of any uniform labeling, or approach to Wrap Up programs, the so-called ambiguities or “triable issues” provide judges with the leeway to use results oriented logic. For purposes herein, the coverage issue for the claims professional and lawyers is to determine which exposures belong to which policy and the art involves whether pursuit of those other policies is actually in the Wrap-Up carrier’s best interest.

e. Did the Injury Occur at the Project Site

A feature of Wrap-Ups is that they define a project or projects that are covered. One coverage issue that comes up is whether a particular injury has the required connection to the project site, and therefore covered. For example, it may be the case that windows and doors have the component parts manufactured oversees and shipped to a location near the project for assembly and transport to the project to be installed. Is the window installer covered for a construction defect case, if the defect is deemed to be the result of poor manufacturing (overseas) or assembly (away from the “designated premises”)? While not always a critical issue, the language of the endorsement that limits coverage to the designated premises is critical, and whether so-called “off site” coverage is provided for these kinds of risks.

III. THE EFFECT OF CONTRACTUAL INDEMNITY RIGHTS BETWEEN THE PARTIES ON THE PROJECT

The Wrap-Up “Program” is a misnomer. Rather than a single contract setting out the intent of the parties, it is actually several insurance policies bundled together by a Wrap-Up administrator. The insurance policies operate independently from the individual construction contracts between the parties on the project.


Typically, the General Contractor will have a broad indemnity agreement in its favor that obligates each of the contractors on the project to defend and indemnify it and the Owner from any claims that relate in any manner to the subcontractor’s work. In turn, most General Liability policies contain “contractual liability coverage.” In most states, liability of the subcontractor that is assumed under an “insured contract” is covered as a claim against the subcontractor.\(^{31}\)

Unlike an insurance policy, the indemnity agreement in the subcontract does not obligate the carrier to defend the indemnitee of the subcontractor. For example, in one case, the General Contractor was sued in a jobsite injury claim. The General Contractor tendered to the subcontractor, who denied the tender. The indemnitee (General Contractor) then sued the subcontractor’s carrier seeking a defense because of the indemnity contract, claiming that the carrier was obligated to pay for the cost of defending the General Contractor in that lawsuit. The court held that the indemnity contract created a right to recover against the subcontractor; that liability may in turn be covered by the subcontractor’s policy and the carrier was to indemnify the subcontractor for that liability.\(^{32}\) The subcontractor is protected for otherwise covered indemnity claims brought by the General Contractor.

Turning to a construction defect case, assuming all the contract language is correct, the only excluded damages would be damage to the subcontractor’s work caused by the subcontractor.\(^{33}\) Thus the obligation of the carrier to indemnify each subcontractor is slightly different under the “contractual liability” provisions of the contract, because each contractor is an insured. Nevertheless, an uncovered claim against one contractor insured may become a covered claim against another insured; the carrier and the practitioner cannot forget that there is both a claim for coverage by an “insured” for the claimant’s damages and a claim for indemnity against other contractors.

A contractual liability issue presents itself in the Wrap Up context ordinarily in two situations. First, in the operations phase, assume there is a claim against the General Contractor for an injury to a worker on the jobsite. The sole remedy of workers

\(^{31}\) In recent decisions from the state of Texas, the exclusion has been interpreted to preclude coverage for any liability imposed under the subcontract. Gilbert Tex. Constr., L.P. v. Underwriters at Lloyd’s London, 327 S.W.3d 118 (Tex. 2010)


\(^{33}\) Insurance Co. of North America v. National American Ins. Co., 37 Cal. App. 4th 195 (Cal. App. 4th Dist. 1995) – finding that the subcontractor’s insurer covered all the liability assumed, and the “your work” exclusion was limited to the liability of the subcontractor for damage it caused to its own work.
compensation will protect some contractors, while others will not be protected. Moreover, if any higher tier contractor is correctly sued, it can present a liability claim against lower tier ones. In that case, the General Liability policy of the lower tier may cover the contractually assumed liabilities despite the employee exclusion.

Another situation presents where there is a claim for damages caused by defective construction. Assume that a responsible (liable) higher tier contractor has no coverage for a particular event and therefore would assert rights of indemnity against lower tier contractors. For example, in an operations claim involving damage to the project under construction, the General Contractor would have no coverage (pursuant to the business risk exclusions J(5) and J(6)) but would have a right to indemnity against the contractor(s) who negligently caused damage to other trades’ work. While most risk managers would see this as a “builders’ risk” loss, depending on the size of the liability versus builders risk deductible or other business circumstances, that liability claim can be presented against the subcontractor. The carrier’s denial of coverage to the General Contractor, in other words, triggers that insured’s right to indemnity against enrolled subcontractors. The subcontractors may not have been sued directly by the Owner, but may have coverage for the indemnity claim presented by the Owner.

Indemnity by one enrolled contractor against another may be express indemnity or implied. Express indemnity would occur between the Owner and the General Contractor and a subcontractor. Often overlooked, however, are the rights of equitable indemnity. Each of the contractors on the project who is sued likely has equitable rights against every other involved party for indemnity relating to a given claim. A subcontractor that is sued for a personal injury claim, for example, would have the right to seek contribution from other subcontractors on the project that may have more directly caused the accident, subject to proof that those other contractors contributed to the hazard giving rise to the bodily injury.

Similarly, a right to equitable indemnity arises with regard to non-enrolled parties under the Wrap-Up as a result of a coverage declination. There may be no coverage due to a lack of “property damage” as to a window installer (enrolled contractor) for non-working windows, but the cause of the loss may be actually a non-insured entity (e.g., the window manufacturer). The non-enrolled manufacturer, however, may in turn present an indemnity claim against an enrolled contractor. A claim by the window installer against the window manufacturer could result in a claim by the manufacturer

34 Workers Compensation is the sole remedy against the employer (Labor Code Sec 3601); In most cases, the hirer of an independent contractor will not be liable for injuries to the employees of that contractor absent affirmative negligent acts in increasing the hazard or concealing the danger. (Kinsman v. Unocal Corp., 37 Cal. 4th 659, 680-681 (Cal. 2005))
against the framer on the project because the openings were not plumb and square, causing racking of the windows.

The Wrap-Up carrier, having denied coverage to the window installer for the windows themselves, could escape paying to deflect liability to the manufacturer, BUT defending the framer for the very same claim. In other words, the rights of indemnity create a parallel path for enrolled parties to seek recovery to offset their uninsured exposure. Indemnity rights create both opportunities and unique risks.

In one example highlighting the interplay between the right to indemnity and coverage, a General Contractor was sued for construction defects. The Wrap-Up carrier accepted the General Contractor's defense but claimed that some of the damages were not covered. The General Contractor, through carrier appointed counsel, asserted rights of contractual indemnity against the enrolled subcontractors to the extent not covered by insurance. When sued, the subcontractors, not surprisingly, tendered the indemnity claim to the Wrap-Up carrier. While the coverage case was never tried or adjudicated, it presented a surreal situation for the subcontractors where the Wrap-Up carrier denied coverage on the grounds that the carrier's appointed counsel only sued for uncovered damages. The party suing the subcontractors was both deciding what to sue for and whether it was covered, and denied a defense to the Insureds. Imagine another situation where the Plaintiff pleads that it is suing the insured for uncovered damages, and the carrier can deny coverage on that ground?35

Contractual indemnity and insurance coverage are two separate and distinct risk transfer tools. The challenge for the claims professional and lawyer is to analyze both before reaching a final conclusion. The carrier with one Named Insured can deny coverage and the insured will manage its uninsured loss by defending, suing the carrier or assigning rights against the carrier. The Wrap-Up carrier, however, may believe that a denial of coverage is correct, but nevertheless face a covered exposure for the same claim on behalf of another insured. Together, this is why some practitioners refer to the short hand that with a wrap scenario, the lawyer is to defend the project, or the Wrap-Up, rather than the client. Those issues, however, are addressed below and overlook some of the ethical issues presented in those situations.

35 In contrast, the California Supreme Court has said: “Defendant cannot construct a formal fortress of the third party's pleadings and retreat behind its walls. The pleadings are malleable, changeable and amendable. ...[C]ourts do not examine only the pleaded word but the potential liability created by the suit.” Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 276 (Cal. 1966)
IV. UNIQUE PROFESSIONAL LIABILITY AND ETHICAL CONCERNS PRESENTED BY WRAP-UP POLICIES

A. The Insurance Broker

Wrap-Ups, given their unique underwriting requirements, are a specifically negotiated and underwritten product. The forms are unique, and the endorsements are manuscripted and tailored for the particular project. The principle contact for the Wrap-Up program will involve the Sponsor (Owner) and the insurance broker. Likely the General Contractor will be involved in the process, but the Owner and the broker will decide on the lines of coverage, limits of coverage, retentions, and type of coverage provided. The insurance broker acts as intermediary between the Owner and the insurance company to make sure the coverage is consistent with the needs of the project. The insurance company, in turn, sells a product to the Owner, through the broker, but rarely makes any promises or assurances that the product is other than what is written in the policy (or the binder before it is issued). In other words, as to the Owner, the insurance broker is the one that advises on what coverage should be obtained; as to the insurance company, the broker is buying a product and has to decide for himself if it is the right one. The insurance broker, therefore, is uniquely situated to be responsible to make sure that the coverage to be obtained is accurately explained to the Owner, and that the coverage provided by the carrier is consistent with those explanations.

Under California law, the insurance broker has a limited duty to assure that coverage for their client is appropriately obtained. Assuring that the insurance company is solvent when the policy is issued, the broker must non-negligently obtain the coverage that is requested or advise the client that the coverage is not available. But what duty, if any, does the broker owe to enrolled contractors?

The risk of potential liability may be expanding. Under California law, for work that commences construction after January 1, 2009, the Owner, Builder or General Contractor must disclose policy limits, scope of coverage, basis of deductibles and whether other projects are included in the same program which could impact the available insurance for the particular project.

The new statutes have yet to be tested in the courts. However, there would appear to be an exposure for an insurance broker that assists its client (Owner) with the insurance requirements for the Wrap-Up program, and who agrees to provide the insurance disclosures required by the new Civil Code sections. An insurance broker

37 (California Civil Code §2782.95 (residential) and 2782.96 for commercial construction).
does not breach its duty to clients to procure the requested insurance policy unless “(a) the broker misrepresents the nature, extent or scope of the coverage being offered or provided …. (b) there is a request or inquiry by the insured for a particular type or extent of coverage …. or (c) the broker assumes an additional duty by either express agreement or by “holding himself out” as having expertise in the given field of insurance being sought by the insured.”

A logical concern for insurance brokers must therefore be whether the disclosure requirements by the California Civil Code would create an avenue of liability for professional negligence to subcontractors if there is any variation between those disclosures and the policy as issued. It is unclear whether the insurance disclosures required by statute would create a duty on the part of the insurance brokers that could be enforced by enrolled contractors, absent either a misrepresentation, a specific inquiry or assertion of expertise that is relied upon by the enrolled contractors.

In addition to the procurement of the policy, a broker must be mindful of a potential claim arising from any differences between the retentions in the policy and the contractor’s deductible or retention responsibility in the Wrap-Up program. If there are any provisions in the Wrap-Up that would be more narrow than a practice policy, the broker should avoid “assuming any duty” to advise regarding proper coverage for the Wrap-Up participants, or holding itself out as an expert such that the contractors would reasonably rely on that broker that the Wrap Up coverage was appropriate for their needs.

B. Wrap Administrator

The first key pressure point between the carrier and the Wrap-Up participants will be whether the party qualifies as an “insured.” If the job of enrollment is not with the insurance broker, the wrap administrator is normally responsible for ensuring that enrollment is done correctly. The question arises, therefore, whether the wrap administrator can be liable for negligently failing to enroll a party who otherwise qualified for coverage, and what the measure of damages would be. The second question is whether the wrap administrator is an agent for the Owner, the carrier, or the insurance broker for purposes of vicarious liability if a contractor on the project suffers an uninsured loss. To date, enrollment has been the subject of published court decisions, but only to the extent of determining whether parties seeking coverage were enrolled or not, not whether they “should have been” enrolled. One can imagine a significant injury or damage claim occurring if the responsible contractor “should have been” enrolled in

the program, but was not. The measure of damages would be the amount that should have been covered by the Wrap Up program.\textsuperscript{39}

Aside from enrollment questions, the Wrap-Up administrator may be involved in other project related functions, such as safety inspections. In a South Carolina case, the Wrap-Up plan provided that the insurance broker for the policy was an “administrator” under the plan and responsible for safety inspections. The evidence established that the broker in fact took no actual responsibility for safety inspections and was in no manner involved in ensuring safety on the project site. Based upon the provisions of the Wrap-Up program, however, the broker was held to have a legal duty to serve this function and possessed potential liability for a workplace injury to the employee of a contractor allegedly resulting from unsafe work conditions.\textsuperscript{40}

Two California cases have addressed similar issues. In one, the insurance broker, as part of implementing a Wrap-Up, developed a safety program for the project, which identified risks attendant with the project. It then undertook to monitor compliance with that safety program. The court held that the broker could be held liable for negligently monitoring the program.\textsuperscript{41} Another court, however, found that an Owner implementing safety programs through a Wrap-Up was not the equivalent of control over a contractor’s employees, and therefore the Owner would not be responsible for the independent contractor’s negligence.\textsuperscript{42}

C. Defense and Coverage Lawyers Hired by Wrap-Up Liability Carriers

Who is the client of the lawyer? Is the client a particular insured under the Wrap-Up program, the insurer of the Wrap-Up program or all of the insureds under the Wrap-Up program? More so for the lawyer than the insurance broker or administrator, these issues are critical because statutes govern the duties and loyalties of the lawyers to their clients, adverse parties, the courts, and insurers. They face malpractice exposure, or even disbarment for ethics violations, if they do not properly represent their clients.

\textsuperscript{39} Greenfield v. Insurance Inc., 19 Cal. App. 3d 803, 812 (Cal. App. 5th Dist. 1971)


1. **Multiple Party Representation**

If a lawyer is to represent multiple parties (enrolled contractors) being sued by a single claimant, and those two parties have a potential conflict of interest between them, the lawyer has a duty to advise the clients of the potential conflict of interest and obtain informed written consent from the parties to continue the representation.\(^{43}\) In the Wrap-Up program, the insurer and the Owner/Sponsor have no control over plaintiff’s attorney’s decision who to sue on the job site. Assuming, in a not unreasonable scenario, that there is a job site injury that results in a lawsuit against multiple subcontractors and the General Contractor, the issue of who is the lawyer’s client becomes a threshold question. Most carriers are attuned to this issue and respect the ethical boundaries of the lawyers they hire. Others, however, that are new to Wrap-Ups, may be tempted to lower costs by hiring fewer lawyers.

Specifically, multiple parties involved in a Wrap-Up program could have potential conflicts with one another because of equitable rights and contribution alone. If policy limits are sufficient, it is likely a conflict of interest that can be waived by the parties and a single lawyer is all that would be required. This is often the “golden rule” of insurance defense litigation: the carrier has the gold and, so long as it is willing to pay for the result, can make the rules.\(^{44}\)

2. **Inadequate Limits**

Conflicts can and do arise, however, because the Wrap-Up program is not all-encompassing, and therefore the individual contractors face at least potential uninsured exposure. The first example would be if the Wrap-Up program has inadequate limits to cover the value of the claim, such as a $5,000,000.00 insurance policy to cover a $25,000,000.00 construction defect lawsuit. California law would hold that the value of the claim does not create a conflict of interest that would entitle the insured to independent counsel paid for by the insurer, however, the reservation of rights is not creating the conflict with the carrier\(^{45}\); rather, the issue is the conflict of interest between multiple clients for the same lawyer who have rights of indemnity against one another once the insurance policy is exhausted. Arguably, so long as there is an uninsured exposure faced by a client, the lawyer should not represent multiple contractors with rights against one another, or make sure to get a written conflict waiver before proceeding to represent any of them.

\(^{43}\) California Rule of Professional Conduct 3-310, Model Rule 1.7

\(^{44}\) With apologies to Leviticus and Sunday School teachers everywhere.

\(^{45}\) California Civil Code §2860(b)
3. The Carrier’s Reservation of Rights

Carriers reserve rights to invoke coverage limitations, if the facts in the lawsuit ultimately prove that the insureds’ liability is on a claim that is not covered by the policy, even if the potential exists and the carrier must defend. The carrier, however, has broad latitude to decide what rights to deny coverage it is reserving.

Assume a construction defect claim is presented against subcontractors and General Contractor of a high-rise condominium. The generic reservation of rights letter is sent out that would affect coverage for all of the subcontractors and, to the extent it is enforced, creates uninsured exposures for individual subcontractors even if, taking all of the contractors together, the loss is covered. Aside from the question of whether the reservation of rights creates a right to independent counsel (because of the conflict with the carrier), a reservation of rights presents an ethical prohibition to a lawyer representing multiple clients with indemnity claims against one another. After all, lawyers are forced to withdraw from representing all clients if there is a conflict that arises between them. Lawyers must be very careful, therefore, to understand who their client is precisely, and act within the confines of their responsibilities to those clients, rather than the insurer. Most insurers would expect their counsel to advise them of a conflict that will affect their representation.46

4. Deductibles and Retentions

Occasionally, counsel for the developers or General Contractors will seek to recover the deductible, a form of uninsured exposure, from the enrolled contractors as an indemnity payment. Some of the enrolled contractors will be responsible for their own deductible or retention, but they may feel the loss is not their responsibility. If a contractor is asked to pay a retention pursuant to the Wrap-Up documents, has that contractor waived the right of recovery of that deductible against other responsible parties? In a construction defect matter, where the Sponsor of the Wrap-Up is the only party sued by the plaintiff, can it trigger an obligation to pay a retention by demanding it from subcontractors who it feels may have contributed to the loss? In short, the retentions and the pursuit of the payment for retentions potentially creates conflicts between Wrap-Up participants that can cause the retained counsel’s ethical obligations to derail a joint defense agreement. Counsel should consider refusing to represent parties that have potential conflicts with other enrolled parties, or who have paid a deductible or SIR, until informed written consent is obtained.

46 At least one carrier is now insisting on return of any paid fees if there is a conflict that should have been disclosed at the onset of the case as part of the litigation guidelines.
5. **Contractual Joint Defense Provisions**

In response to problems created by “non-cooperating” contractors, some carriers have inserted “joint defense” provisions and arbitration clauses into their Wrap Up liability insurance policies. The joint defense language provides that by accepting the insurance, the contractor/insured is prospectively waiving conflicts of interest that may occur as to other contractors on the same job site, and agree to both waive rights of contribution and agree to be represented by a single lawyer. These provisions have not yet been tested in published decisions, but present some difficult issues.

For example, if a carrier reserves the right to deny coverage for some of the damage claims, thereby creating a conflict of interest between two subcontractors on the project, may it enforce the “joint defense” provision to deny coverage for both subcontractors unless they agree to be jointly represented? Could a lawyer have ethical concerns if he or she accepts representation of multiple parties (with a waiver) knowing that he will be discovering evidence and taking positions that could undermine one or the others’ claim in some subsequent action? Or another scenario: if the limits of insurance are grossly less than the reasonable value of plaintiff’s claims, may the carrier rely on the joint defense provision; must each contractor waive rights of indemnity and contribution against other contractors and allow a judgment to be entered against them to receive even a defense from the carrier? Who is to advise the contractors of potential indemnity claims, and the effect of the contractual waiver? It is an ethical minefield.

With the joint defense provisions, insurers are trying contractually to limit the ability of insureds to increase the carrier’s defense costs by filing claims for indemnity and contribution that do not affect the overall value of the case or the insurer’s exposure. While a reasonable goal, it is basic that an insured is entitled to a conflict-free defense to a lawsuit, and therefore, arguably, such joint defense provisions are potentially at odds with the “separation of insureds” conditions in the policy.\(^\text{47}\) Likely, the best course of action for the lawyer will be to understand generally the coverage limitations, the rights of indemnity, and their ability to actually defend those claims without impacting the clients’ uninsured exposure and get an informed consent. He or she might also suggest that clients obtain independent counsel as to whether to waive the conflict before agreeing to represent multiple parties. Ultimately, it is likely that courts will view the lawyer’s ethical obligations as Public Policy, and find that to the

\(^{47}\) see e.g. *Villicana v. Evanston Ins. Co.*, 28 Cal. App. 4th 631 (Cal. App. 2d Dist. 1994), where the court remarked that a carrier was not entitled to Summary Judgment on coverage claim because it failed to establish that it provided a conflict-free defense.
extent any carrier seeks to enforce a provision that would conflict with that policy to be void.\textsuperscript{48}

6. One of the Clients Has an Affirmative Claim or Indemnity Claim

A liability insurer is ordinarily not obligated to hire counsel to prosecute indemnity or affirmative claims on behalf of the insured.\textsuperscript{49} The best practice for a defense lawyer, however, would include advising the insured that should they wish to pursue affirmative claims against others they should consult another lawyer, and to work directly with the insurer over how and whether those claims will be pursued (in the same action by cross complaint or third party complaint, or a separate action). Without a waiver and proper informed consent, it follows, if a subcontractor’s personal counsel files a lawsuit (or insists that a cross-complaint be filed in the action) against other enrolled contractors, or other clients of the lawyer, there may be a conflict for the lawyer to represent any of the contractors. Does the defense counsel now have to withdraw because of a conflict between his clients created by personal counsel, not the carrier?

In many construction settings, a client’s contractual retention is withheld pending resolution of the Owner’s closeout of the project. If the subcontractor files a mechanic’s lien action against the Owner and General Contractor for payment under the contract, some of the same ethical problems for a carrier-appointed defense counsel may arise. The client has an affirmative claim against the Owner, and the Owner will assert that any amount owed is an offset to the affirmative claim. The lawyer’s client (the subcontractor) will want the construction defect claim paid so the Owner will pay off on the contract. The lawyer(and the carrier), on the other hand, will want to vigorously defend the merits of the defect claim, potentially against the wishes of the client.

Given the obligation of a lawyer to withdraw from representation of all clients if there is a conflict between them, it behooves the carrier to assess the ethical responsibilities of the lawyer at the time that the defense is being assigned in light of the likely progression of the lawsuit. It is not just a lawyer’s ethical duties and malpractice insurance that are at issue here, however. If the carrier hopes to realize the cost savings that it bargained for with the Wrap-Up product, it needs to consider all of its options, including taking unusual steps like waiving coverage limitations in order to avoid conflicts for retained counsel, where the value of the uncovered damage claim is less than the cost of separate counsel. Counsel, on the other hand, must be tuned in to these potential conflicts of interest to avoid ethics violations, or later lawsuits by clients

\textsuperscript{48} Maxwell v. Allstate Insurance Companies, 102 Nev. 502, 506; 728 P.2d 812 (Nev.1986)

\textsuperscript{49} James 3 Corp. v. Truck Ins. Exch., 91 Cal. App. 4th 1093, 1105 (Cal. App. 6th Dist. 2001)
who claim that they were forced to settle, or waive indemnity claims, because the conflicts were not adequately disclosed to them.

V. CLAIM HANDLING AND BAD FAITH CONCERNS FOR WRAP-UP CARRIERS

The claim professional and outside coverage counsel often see themselves as the driver of the Wrap Up liability “car”, i.e. the claim presented. As such, the carrier personnel must be aware of all of the above issues of conflicts and challenges, as they impact the claims decisions that need to be made: Is the party being sued an “insured?” Is the injury caused by a failure of a safety professional, supervision, or outside consultant that is not an enrolled party? Can the insurer hire a single law firm to represent the Insureds that are involved? There is a perspective that is unique to the carrier, not shared by the other members of the team, -- the Owner, Insurance Broker, Wrap Up administrator, Lawyer or contractor.

A. The choice of counsel issues peculiar to Wrap-Up claims

Whenever a lawsuit is tendered to the insurer, the carrier must respond by either accepting or rejecting coverage, or by agreeing to defend under a reservation of rights. If the carrier reserves rights and the outcome of the coverage issue can be controlled by the defense counsel the carrier hires, a conflict of interest likely exists and the insured is entitled to independent counsel.\(^{50}\) Since the right to independent counsel under those circumstances exists via state law, the carrier should seek outside advice before insisting on enforcement of a provision in the policy that would eliminate the right to independent counsel or that would infringe on an insured’s right to a conflict-free defense. For example, a “joint defense” provision that would require insureds to waive their claims against one another would likely not be enforceable if the carrier’s reservation of rights letter gave that insured a right to independent counsel, or creates a right of indemnity for the uncovered damages from another enrolled contractor. Because there are so many enrolled contractors that may be involved in a single Wrap-Up claim, care must be taken as to which rights are reserved. Reservations should be limited to damage claims that are not covered for any liable enrolled subcontractor, and/or those claims that can be pursued against non-Wrap-Up participants.

A second form of reservation is where the carrier reserves its rights to recover amounts spent for defense or indemnity. In California, the carrier has the right to defend the lawsuit, and then seek reimbursement from the insured for uncovered defense costs,\(^ {51}\) or settlement costs,\(^ {52}\) under certain circumstances. Faced with a

\(^{50}\) c.f. California Civil Code §2860

\(^{51}\) Buss v. Superior Court, 16 Cal. 4th 35 (Cal. 1997)

\(^{52}\) Blue Ridge Ins. Co. v. Jacobsen, 25 Cal. 4th 489, 497 (Cal. 2001)
claim against the Owner or General Contractor in a Wrap-Up situation, the carrier may be very tempted to reserve the right to recover uncovered defense expenses or settlement amounts from the insured. Ordinarily, such a reservation does not trigger the insured’s right to independent counsel.\footnote{James 3 Corp. v. Truck Ins. Exch., \textit{supra}}

That decision, however, may have consequences. If an insured is faced with an uninsured exposure, according to the insurer’s reservation of rights, does the insured have a right to protect itself to recover the amount of any judgment that is not covered by enforcement of their indemnity claims? Leaving aside the cost of that prosecution, it would be difficult for defense counsel hired by the carrier to prevent prosecution of those claims by their client, the insured, and arguably subject the carrier to bad faith liability if it prejudiced the insured’s right to establish a right to indemnity for damages the insurer contends are not covered by the policy. The liability for damages remains with the carrier for bad faith, if its actions in controlling the litigation and settlement decisions adversely affect the insured’s right to pursue damages from third parties.\footnote{Barney v. Aetna Casualty & Surety Co., 185 Cal. App. 3d 966, 979-980 (Cal. App. 2d Dist. 1986)}

Many times, coverage limitations are legitimate, but likely of minimal value in the long term. The creation of a conflict will impact the cost of the case, as it may create indemnity claims or a right to independent counsel. Are the costs created by the present conflict worth the likely offset in the carrier’s indemnity obligation? One way to avoid such a conflict would be to waive the reservation of rights that created the potential for an uninsured loss in the first place. This is another example of the golden rule.

\textbf{B. The duty to defend multiple parties}

In the attempt to lower the allocated legal expense, carriers may seek to hire only the lawyers that are absolutely necessary. It may be one lawyer for all the parties, or a limited number of lawyers to represent multiple parties with potentially waiveable conflicts of interest.

Recalling that the Wrap Up creates a separate obligation to defend any “insured”, the carrier’s downside risk for failing to defend any of them creates an independent bad faith exposure to each contractor. The duty to defend, in addition, extends to a “conflict free” defense; it may not discharge its duty to defend by hiring counsel that is incapacitated from fully and completely defending the insured. The consequences for failure to provide a conflict free defense are likely as significant as failing to defend at all.

\footnote{James 3 Corp. v. Truck Ins. Exch., \textit{supra}}
\footnote{Barney v. Aetna Casualty & Surety Co., 185 Cal. App. 3d 966, 979-980 (Cal. App. 2d Dist. 1986)}
For example, if a carrier wrongfully refuses to defend, the insureds are freed from the usual bond of cooperation and may enter into settlements to protect themselves and resolve the lawsuit against it. There is a risk, therefore, that where a carrier retains defense counsel with an actual conflict of interest, it could expose itself to the subcontractors’ self-help remedy of resolving the lawsuit by settlement or stipulated judgment. Proper claims handling, therefore, requires the professional to account for not only the coverage limitations and reservations, but also the separation of insureds condition so that a meaningful reservation of rights letter is used that actually protects the carrier from paying an ultimately uncovered claim.

C. Failure to settle

In the context of a Wrap-Up program, there is an additional issue: multiple insureds with a single policy limit. Assume, arguendo, that there are a sufficient number of subcontractors on the project that a demand is within the stated policy limit as to any individual subcontractor, but collectively it is well in excess of the Wrap-Up policy limits. The carrier must maximize the policy limits available to the benefit of each of the insureds under the policy. A careful balancing act is required. These are not idle considerations though they have not yet been the subject of a published opinion. The carrier that fails to settle, in response to a demand that is reasonable on behalf of all of its insureds, be subject itself to extra contractual liability for the entire judgment if it refuses to settle unreasonably. Looking at the problem from a macro level will likely avoid most problems for the carrier by looking at the total insured exposure.

Specific fact problems, however, could create difficulties for the carriers. For example, assume that there is one big defect issue that is not covered, but the balance of the lawsuit seeks damages, that are covered and fairly small. May the carrier assert a non-coverage position as to the large claim, while simultaneously attempting to settle the smaller claims against “different” insureds? We surmise that the answer is theoretically yes, but practically no. The attempt to segregate a large uncovered claim while settling others would create conflicts and infighting between the insureds (for either using the policy limits or denying coverage), competing claims on the policy, and demands for independent counsel. Furthermore, at least one State Bar has opined

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58 See e.g., Novak v. Low, 77 Cal. App. 4th 278, 284 (Cal. App. 1st Dist. 1999), where the court disapproved of the carrier attempting to settle only the covered claims.
that counsel retained by the carrier could not engage in any activity to resolve the covered claim if the balance is uncovered. Nevertheless, the temptation for a primary liability insurer paying defense costs in addition to the limit of liability will be to settle some combination of claims to cut off future defense cost liability.

D. Subrogation and indemnity and the anti subrogation rule

As an alternative to denying coverage for all or a portion of the loss, a carrier may try to settle the lawsuit (thereby eliminating claims against all of the enrolled contractors) and pursue its rights of indemnity or subrogation against others. As a preliminary matter, the carrier may likely not pursue any claims against parties that are enrolled in the Wrap-Up program, unless the claim is for uncovered damages pursuant to California law. A Washington Court has actually found that by participating in a Wrap-Up program, it is an implied waiver of the carrier’s rights of subrogation, and the court reasons that insurance is a contract to shift the risk of loss from the insured to the insurer. In a Wrap-Up situation, therefore, all of the parties to the wrap contemplated shifting the risk of loss to the wrap carrier and thus the wrap carrier should not be in a position to satisfy the loss and then pursue subrogation against an enrolled party.

Such limitations would not exist, however, as between the wrap carrier and non-wrap parties. Similar to the recommendation to “defend the project,” the wrap carrier must identify exposures that are “non-wrap” rather than covered versus uncovered. There is no prohibition on pursuing a loss and suing a non-enrolled party.

VI. CONCLUSION

Wrap-Up programs are an entirely manageable approach to construction insurance and, we predict, are here to stay. The cost savings and coverage enhancements make them invaluable to Owners, developers and General Contractors. As coverage for contractors becomes more scarce and limited, larger customers of insurance products continue to be drawn to the Wrap-Up product. This article is intended to update the article entitled OCIP Liability Claim Challenges (published by International Risk Management Institute, 2005). As experience with Wrap-Ups and their

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59 Oregon Bar Ethics Formal Opinion number 2005-121 concludes that a lawyer may not make a motion or settle the covered claims and leave the client facing only uncovered claims.

60 In Aetna Cas. & Surety Co. v. Certain Underwriters, 56 Cal. App. 3d 791 (Cal. App. 2d Dist. 1976), the court approved of the primary carrier settling individual claims involving the Santa Barbara oil spill, exhausting the policy limits and cutting off defense costs. The distinction, however, is that with a Wrap Up, the carrier would be settling certain claims for some, but not all the insureds.


application to a wider audience continues, claims professionals and lawyers gain experience in unusual facts and applications that were never considered by the underwriters and the Owners at the time that the policies were drafted and sold, and are just now becoming claims and litigation.

The simplicity of a Wrap-Up program design, however, masks the difficulties of providing a single point of coverage for multiple intended risks and insureds, while simultaneously preventing infighting between Wrap-Up participants that destroy the cost advantages of the Wrap-Up program. Carriers will continue to experiment with policy forms but the fundamentals for the claims professional remain: coverage, liability and damages. The carrier, by its choice of counsel and reservation of rights letter makes calculated business decisions that will affect allocated legal expense and the ultimate indemnity expense. Lawyers, insurance brokers and wrap administrators must work in concert with their insurer clients to plan the defense strategy to minimalize conflict occasioned by disputes over uncovered damages and indemnity claims. Then, the promise of the Wrap-Up will be realized.