

Contractors: Beware the Contractual Liability Limitation Endorsement

Scenario #1: A structural steel erection firm wins a contract for the construction of a five-story office building in an urban location. The contract requires the firm to assume the general contractor's legal liability for accidents occurring during the project and arising out of the steel work. One week into the project, a crane lifting a load of steel bars topples over into a street, damaging cars, nearby buildings, and injuring drivers and pedestrians. Several of the victims file suit against the property's owner, the general contractor, and the steel firm. As per their agreement, the general contractor looks to the steel firm to defend it in court and pay any resulting judgments. The steel firm forwards the claim to its liability insurance company, which proceeds to defend both the steel firm and general contractor. The company settles with the victims and pays on behalf of both contractors, up to the policy's limits.

Scenario #2 is identical to #1, but this time the insurance policy contains a wrinkle. The policy includes a special endorsement, ISO form number CG 21 39 10 93, Contractual Liability Limitation. Accordingly, the insurance company defends the steel firm and pays an amount to settle its claims. However, it refuses to defend the general contractor or pay the amount of the loss the steel firm assumed under the contract. When the steel firm is unable to pay these sums out of pocket, the general contractor sues for breach of contract, setting off a long round of litigation.

What is the Contractual Liability Limitation Endorsement? What does it do, and why would an insurance company use it?

The Commercial General Liability Coverage Form states that it does not cover injuries or damages for which the insured must pay by reason of having assumed liability under a contract. However, it turns around and gives some coverage back: It will pay for liability the insured assumed under an "insured contract," a term that the policy further defines. The term includes a real estate lease, a railroad sidetrack agreement, an easement or license agreement not pertaining to railroad work, a requirement to indemnify a municipal government, an elevator maintenance agreement, and other agreements in which the insured assumes the tort liability of another party. The Contractual Liability Limitation Endorsement changes that definition: It completely removes the last part (other agreements in which the insured assumes another party's tort liability) from the definition. When a liability policy includes this endorsement, these types of agreements are not insured contracts, and the policy does not cover liability assumed under them.

In both scenarios, the steel firm (the insured) assumed the tort liability of the general contractor. In scenario #1, the steel firm had a liability policy without the Contractual Liability Limitation, and the insurance company paid for the amount of the loss the firm assumed. In scenario #2, the endorsement applies; the company does not pay anything for the general contractor's defense or liability. For many construction firms, this can be a catastrophic gap in coverage.

An insurance company may add the endorsement to a contractor's policy if it wants to selectively approve the insured's contracts on a case-by-case basis, rather than insuring them all on a blanket basis. This gives the company some control over its exposure, but it can be slow and cumbersome for the insured.

All construction firms should review their liability insurance policies with their agents to determine whether the company has added this endorsement. If it has, a discussion on what to do about it is essential. It will be too late to do solve the problem after a loss occurs.