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Additional Insured Coverage Dispute: Vivify v. Nautilus



Additional insured coverage for bodily injury to a downstream party's employees is one of the foremost considerations in any traditional risk transfer scheme. Upstream and downstream parties alike generally intend for the downstream party's insurance to respond to these claims—before the upstream party's insurance and in lieu of a contractual indemnity claim. But, without careful contract drafting and insurance program review, that goal can often be frustrated, as a recent Illinois decision illustrates.

Acknowledgment

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A standard general liability policy—Insurance Services Office, Inc. (ISO), form CG 00 01—is intended, by use of the employers liability exclusion ("e."), to preclude coverage to insured entities for bodily injury to their own employees. Statutorily imposed workers compensation requirements shield the employer from tort liability while still providing insurance coverage for the employee for its injuries, thus, eliminating the need for general liability coverage.

The exclusion applies only to claims by employees of "the insured" (that is, the insured making a claim on the policy), and thus, it should not apply to the nonemployer insured.¹ As a failsafe, the employers liability exclusion also contains an exception for liability assumed in an "insured contract."² In that scenario, the upstream party could assert a contractual indemnity claim against the named insured for the bodily injury exposure, and the named insured's claim (based on an "insured contract") would fall within the exception to the exclusion.

Vivify Construction LLC v. Nautilus Insurance Co.

In *Vivify Construction, LLC v. Nautilus Ins. Co.*, 2018 IL App (1st) 170192, 419 Ill. Dec. 743, 94 N.E.3d 281 (App. Ct. 2018), the Appellate Court of Illinois held that a subcontractor's insurer did not owe a duty to defend to the general contractor, an additional insured, for a bodily injury claim despite the existence of a requirement for said coverage in the subcontract agreement. The court reasoned that an employee exclusion placed the claim outside the scope of coverage.

Background

In 2014, Vivify Construction, a general contractor, entered into a subcontract agreement with Victoria Metal Processor LLC, a subcontractor, that required Victoria to indemnify Vivify against bodily injury claims resulting from Victoria's work under the subcontract. In conjunction with the indemnification requirement, the subcontract also required Vivify to procure general liability coverage that included Vivify as an additional insured for claims caused in whole or in part by Victoria's negligent acts or omissions. To that end, Victoria

procured a general liability policy with Nautilus Insurance Company (Nautilus) and, undisputedly, named Vivify as an additional insured for bodily injury caused by Victoria's, or those acting on its behalf, acts or omissions.

In 2015, a Victoria employee fell from the second-story scaffold and was injured. The employee filed a negligence action against Vivify, alleging that Vivify failed to supervise work at the project. Vivify filed a third-party complaint against Victoria alleging that its negligence caused the injury and simultaneously tendered its defense to Nautilus. Nautilus denied any duty to defend.

Application of Employee Exclusion

The Nautilus policy coverage form originally excluded coverage for bodily injury to "a[n] 'employee' of *the* insured," however, that exclusion was replaced by a manuscript employee exclusion designed to apply more broadly that reads as follows:

This insurance does not apply to:

e. Injury to Employees, Contractors, Volunteers and Other Workers

'Bodily injury' to

1. 'Employees', 'leased workers', 'temporary workers', 'volunteer workers', statutory 'employees', casual workers, seasonal workers, contractors, subcontractors, or independent contractors *of any insured*; or
2. *Any insured's* contractors', *subcontractors*', or independent contractors' *employees*', 'leased workers', 'temporary workers' 'volunteer workers', statutory 'employees', casual workers, seasonal workers, contractors, subcontractors or independent contractors *arising out of and in the course of*:
 - a. Employment by any insured; or
 - b. Directly or indirectly performing duties related to the conduct of any insured's business...."

In addition to precluding coverage for the insured's employees, the modified exclusion also removes coverage for "any insured's contractors,' *subcontractors*' or independent contractors' *employees*" and removed the exception for liability assumed in an insured contract.

In the dispute over the application of this exclusion, Vivify argued that the policy's separation of insureds provision, which states that the terms of insurance apply separately to each insured, requires the court to hold that the injured party's status as Victoria's employee has no bearing on Vivify, a nonemployer additional

insured. Alternatively, Nautilus argued for a plain language reading that the exclusion barred liability for employees of "any insured."

The court found that the exclusion, by its own terms, did not bring this claim into the scope of the policy. As a result, Nautilus did not have a duty to defend Vivify. The broadening modifications to the exclusion in the second subsection preclude bodily injury to any insured's *subcontractor's employees* regardless of the subcontractor's status as an insured. Victoria was Vivify's subcontractor—in other words, an insured's subcontractor. An employee of that subcontractor was injured, and thus the exclusion applied. This interpretation, according to the court, did not render the separation of insureds provision meaningless as it still applied to other exclusions in the policy.

Consideration of the Terms of the Subcontract Agreement

Vivify also argued that the court must consider the terms of the subcontract agreement between itself and Victoria to effectuate the meaning of the insurance policy in determining the duty to defend. The subcontract agreement between the parties contained this insurance requirement:

[Victoria] shall cause the commercial liability coverage required by the Subcontract Documents to include: (1) [Vivify] . . . as [an] additional insured[] for claims caused in whole or in part by [Victoria's] negligent acts or omissions during [Victoria's] operations; and (2) [Vivify] as an additional insured for claims caused in whole or in part by [Victoria's] negligent acts or omissions during [Victoria's] completed operations.

The court rejected Vivify's argument and explained that, under Illinois law, it must give the policy words their plain and ordinary meaning as written where reasonable, as it was with the employee exclusion.³

Interestingly, the court noted that Vivify failed to explain how the terms of the subcontract agreement impacted Nautilus's intent in entering the contract. Though not discussed in the opinion, if perhaps Vivify had some rationale for its argument and focused on how it bore on Nautilus's intent in contracting the policy, or if the policy exclusion at issue were ambiguous, perhaps the outcome may have been different.

Lessons Learned

There are a few key lessons for upstream parties to learn from Vivify's mistakes. First, clear contract requirements are a key starting point. Having specific requirements invites discussion about compliance and forces all of the parties to think critically about their obligations and to carefully examine their insurance programs.

Second, upstream risk managers must implement appropriate vetting protocols to review a subcontractor's insurance program to ensure that they align with the terms of the intentionally crafted subcontractor agreement. If an upstream party is contractually requiring additional insured coverage as a risk transfer mechanism, it must do its part to confirm the mechanism is functional. Acquiring and reviewing a complete copy of the policy is oftentimes impractical, but targeted requests for key provisions and endorsements that most closely align with the primary risk transfer goals can address the most significant concerns.

Third, when reviewing policies, upstream and downstream parties alike must make it a point to understand how the endorsements attached modify the standard terms of their policies. The employee exclusion on the ISO CG 00 01 form is tailored to ensure coverage remains for an additional insured, but the broadened manuscript form discussed above completely negates that intent. As the Illinois Appellate Court expressed, "Vivify could have protected itself by reading the policy to ensure that it satisfied the subcontract. We cannot rewrite an insurance policy to suit Vivify's needs." A party will be better protected if it understands the implications of its policy terms and endorsements prior to any loss so that it may make any necessary changes to ensure it has the coverage it intended to procure and make those changes before it's too late.

Lastly, recognize that, in many cases and for many issues, the nuanced obligations of the trade contract will not influence the terms/obligations of the additional insured insurer, nor the court interpreting those requirements. Those obligations are largely, if exclusively, governed by the policy. A disconnect between the trade contract requirements and the downstream policy is more likely to tee up a breach of contract dispute between the upstream and downstream parties.

¹ This article does not discuss the impact of "statutory employer" obligations on this analysis.

² Exclusion e., CG 00 01 04 13, at pg. 2 ("This exclusion does not apply to liability assumed by the insured under an 'insured contract.'")

³ The court explained that it might consider some extrinsic evidence outside of the terms of the policy agreement if the policy terms at issue were ambiguous, but, here, it was not.

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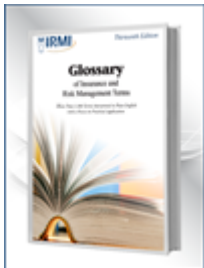
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