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CITY COUNCIL MEETING

1992

City Attorney Stein apprised the Council that he had been asked how the City of Lodi adequately protects itself from suits resulting from injuries caused by defective materials and/or products used in Public Works Projects.

POLICY ESTABLISHED  
TO PROTECT CITY  
FROM SUITS  
RESULTING FROM  
DEFECTIVE  
MATERIALS

City Attorney Stein presented for Council's perusal, an analysis of the question which analysis determined that the City could require all general contractors doing work for the City of Lodi to maintain in addition to normal bodily injury and property damage insurance, independent contractor's insurance.

Discussion followed with questions being directed to Staff. Council, on motion of Council Member Pinkerton, Murphy second, set forth a policy whereby the City will henceforth require all general contractors doing work for the City of Lodi to maintain in addition to normal bodily injury and property damage insurance, independent contractor's insurance.

MEMORANDUM

To: Honorable Mayor and City Council  
From: City Attorney  
Re: Protection for City from Suits Resulting From Defective Materials and/or Products  
Date: May 11, 1983

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**QUESTION:** HOW CAN THE CITY OF LODI ADEQUATELY PROTECT ITSELF FROM SUITS RESULTING FROM INJURIES CAUSED BY DEFECTIVE MATERIALS AND/OR PRODUCTS USED IN PUBLIC WORKS PROJECTS?

**ANSWER:** Require all general contractors doing work for the City of Lodi to maintain in addition to normal bodily injury and property damage insurance, independent contractor's insurance.

**ANALYSIS:** In order to adequately protect the City of Lodi from suits which result from injury caused by defective materials and/or products used in public works projects, it is my recommendation that the City of Lodi require all general contractors to maintain, in addition to the normal bodily injury and property damage insurance, independent contractor's insurance and to submit copies of same to the City of Lodi upon the execution of any contract with the City.

The aforementioned requirements become necessary because of two very significant problems which face all cities today:

(1) Oftentimes, the contractor or subcontractor uses substandard materials and/or products which do not meet plans and specifications and the City is not aware of same.

(2) The cities' coffers are thought to have "deep pockets" and they become the target defendant in many lawsuits where an individual is injured due to a defective product in a subdivision.

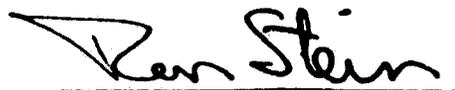
With the lack of ability or desirability on the part of the Legislature to protect public entities from large claims, the cities must find ways in which to protect themselves where an individual has been injured due to a defective product used in a public works project.

As I have said previously to this Council, at the present time, if the City has 1% liability for an injury, the City could be saddled with 100% of the damage award. Oftentimes, in an injury caused by the failure of a particular substandard or defective product, it is difficult to determine where and by whom a particular product was manufactured, in order for the city to be able to sue said manufacturer for a failing product on an indemnification theory. The indemnification theory works thusly:

If the city is sued because of a product which has caused injury to a person, the city under normal circumstances can go back and sue the manufacturer of said product for his negligence in manufacturing same. However, oftentimes, it is difficult if not impossible to determine who manufactured a particular product. Further, even when you have determined who manufactured the product, said manufacturer may or may not have adequate insurance to cover the loss. Due to the "joint and several liability" theory in California, a city would be required to pay all damages with no hope of recovery against the manufacturer.

It is therefore necessary for the city to ask the general contractor to have independent contractor's insurance. This would protect the city where a manufacturer, supplier, or subcontractor of a product was unable to be found and/or was uninsured or under insured.

I have spoken with Jim Elson of Max Elson Insurance, the City's Agent of Record, and he did tell me that this type insurance coverage is available at a modest cost to the contractor. At the present time, I am reviewing along with Mr. Elson and Mrs. Reimche our specification requirements for contracting with the City as those specifications relate to insurance requirements, and it is my recommendation that the City, in order to protect itself, include a requirement for independent contractor's insurance coverage in said specifications.

  
RONALD M. STEIN  
City Attorney

RMS:vc

## PROTECTIVE LIABILITY INSURANCE

### *Separate Coverage Part for Owners and Contractors*

When a property owner hires a contractor to make alterations to an existing building, construct a new building, or do other work, the owner can become vicariously liable for the acts or omissions of the contractor carrying out the work. See Public Liability Ai- for the legal basis of this liability. A similar exposure attaches to a general contractor that hires subcontractors to do part of a job. For either the property owner or the general contractor, it is desirable to employ some means of protecting against this exposure. As described on the Ai- pages, the "independent contractors hazard" can be covered in the owner's or contractor's own General Liability policy, but many owners and contractors prefer to place the burden of insuring upon the independent (or sub-) contractor.

One method of doing this is to stipulate in the construction agreement that the owner be added to the contractor's Liability insurance as an additional insured, at the contractor's expense. The drawbacks to this approach are that (1) in the event both the owner and the independent contractor are sued, both parties must share the single amount of insurance, and (2) the owner, merely an *additional* insured, has no control over payment of premium or other contractual duties that the contractor, the *named* insured, must perform in order to keep coverage in force. Similarly, the additional insured does not necessarily receive notice of cancellation from the insurer and may be completely unaware that the insurance company or the contractor has cancelled the policy.

Another method of dealing with the independent contractors hazard is to transfer the owner's liability in connection with the project to the contractor through a hold harmless agreement. Normally, the contractor will fund its contractual obligation to protect the owner through Contractual Liability insurance. (See Public Liability B- pages.) This method, too, can present problems. Unless the contractor has considerable assets, the contractor's Contractual Liability insurance will be the only source of protection for a large judgment against the owner. If the Contractual Liability coverage fails, in other words, the contractor may be financially *unable* to hold the owner harmless. As in the additional insured situation, the owner is not a party to the contractor's insurance and so may be unaware of policy cancellation or lapse. Another potential drawback to relying upon a hold harmless agreement is that courts have been known *not* to enforce hold harmless agreements in certain situations. Certainly, sound legal advice is a prerequisite to full reliance upon a hold harmless agreement.

A third method of protecting the owner is the purchase of Protective Liability insurance by the contractor in the name of the owner. (Likewise, a general contractor can gain protection by being the named insured of a Protective Liability policy purchased by a subcontractor.) Because the property owner is the named insured, the owner receives any lapse or cancellation notices from the insurer. If the contractor has not paid premium as stipulated and



the policy is in danger of lapse, the owner can pay the premium himself to continue the policy until other arrangements can be made. If Protective Liability insurance is to be written in this way, a separate coverage part entitled "Owners and Contractors Protective Liability Insurance — Coverage for Operations of Designated Contractor" (OCP) is used. Like any other standard coverage part, the OCP form is attached to the General Liability jacket. The pages that follow describe the provisions of the OCP coverage part.

It is always possible, of course, that the contractor will be in a stronger bargaining position than the owner, and insuring the independent contractor hazard will be the responsibility of the owner. In that situation, Protective Liability insurance as it is arranged in General Liability policies — Owners, Landlords, and Tenants (OL&T), Comprehensive General Liability (CGL), and so forth — is more appropriate. See Public Liability Ai- pages.

### Insuring Agreement

In a General Liability policy such as OL&T, CGL, or other, the independent contractors hazard is covered simply because there is no exclusion pertaining to the hazard (or the exclusion has been deleted). The separate OCP coverage part applies *only* to the independent contractors hazard, and so the insuring agreement refers specifically to the exposure to be insured: bodily injury or property damage "caused by an occurrence and arising out of (1) operations performed for the named insured by the contractor designated in the declarations at the location designated therein or (2) acts or omissions of the named insured in connection with his general supervision of such operations." The *designated contractor* and the *designated location* are stated in the declarations. The designated contractor, of course, is the contractor (or subcontractor) that purchases the OCP coverage in the name of the owner (or general contractor), and the designated location is the site of the project.

The insuring agreement includes the usual provisions regarding the insurance company's duty to settle or defend suits or claims against the insured. This is an important aspect of OCP coverage, in that a suit for damages is likely to name all possible parties.

### Exclusions

The exclusions of the OCP coverage part are of course instrumental in defining the insuring agreement. Of the ten exclusions, two are unique to the OCP form. The first of these exclusions, exclusion "b," eliminates any coverage under the OCP form for bodily injury or property damage occurring after the designated contractor has completed the project at the described location. Service, maintenance, or repairs following completion are specifically excepted from this portion of the exclusion, however. The exclusion goes on to state that there is also no coverage for bodily injury or property damage occurring after "that portion of the designated contractor's work out of which the injury or damage arises has been put to its intended use by any person or organization other than another contractor or

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subcontractor engaged in performing operations for a principal as a part of the same project." The effect of the exclusion is to restrict OCP coverage to operations in progress.

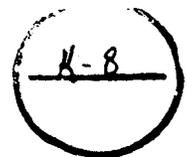
If the named insured of an OCP form is a property owner, exclusion "b" eliminates coverage in the OCP form for occurrences that are already covered in the insured's Premises and Operations Liability insurance. That is, once the contractor's work is completed, any liability resulting from that completed work and falling upon the owner is a subject of the owner's Premises and Operations coverage. Naturally, if the ultimate fault for the injury is attributable to the designated contractor, the owner's Liability insurer has the right to take action against the contractor.

If the named insured of an OCP form is a general contractor (that is, a subcontractor has purchased the policy in the name of the general contractor), exclusion "b" eliminates any coverage that the general contractor would have for bodily injury or property damage arising out of completed operations performed by a subcontractor. If, for example, a guest in the property owner's establishment were injured by a defect in the subcontractor's completed work and succeeded in winning damages from the general contractor, the general contractor would not have coverage under its OCP form. Rather, the general contractor's appropriate source of insurance recovery would be its own Completed Operations coverage. (See Public Liability Prb- pages.) (Note, however, that even Completed Operations coverage does not cover liability for property damage to work performed by or on behalf of the named insured. See Public Liability Pri- pages for further comment on the so-called Injury to Work Performed exclusion.)

Another exclusion unique to the OCP form is of bodily injury or property damage arising out of any act or omission of the named insured or an employe of the named insured, other than the named insured's supervision of work performed by the designated contractor. This exclusion is actually more in the way of a reinforcement of the OCP insuring agreement than a limitation on coverage. Any act or omission of the named insured falling outside the supervisory role is more properly a subject of the insured's Premises and Operations Liability insurance.

### Care, Custody, or Control Exclusion

The Care, Custody, or Control exclusion of the OCP form has two notable differences from the usual wording. The exclusion, which in other General Liability forms applies to property damage to (1) property owned or occupied by or rented to the insured, (2) property used by the insured, and (3) property in the care, custody, or control of the insured or as to which the insured is for any purpose exercising physical control, is broadened in the OCP form with the addition of a fourth section: "property damage to . . . (4) work performed for the insured by the designated contractor." The effect of the added language can be seen, for example, where the insured is the general contractor of a project and the desig-



named (sub-) contractor is erecting a wall. If, because of the subcontractor's faulty workmanship, the wall collapses during construction and injures a passerby, the OCP will apply to a resulting claim against the general contractor. If, however, the property owner lodges a claim against the general contractor for damage to the wall itself, the added language will prevent coverage under the general contractor's OCP policy.

The other alteration of the Care, Custody, or Control exclusion is the *deletion* of the two exceptions that normally follow the exclusion in other General Liability forms. The first exception covers damage to property used by or in the care, custody, or control of the insured, provided that responsibility for the property was assumed under a written sidetrack agreement. The second exception provides that property in the care, custody, or control of the insured—other than property owned, occupied, rented, or used by the insured—damaged as a result of use of an elevator at premises owned, rented, or controlled by the named insured is covered (except damage to the elevator itself). With respect to the sidetrack exception, it seems highly unlikely, if not impossible, that the named insured of an OCP policy could become vicariously liable for a designated contractor's obligation under a sidetrack agreement. Likewise, the elevator exception has no conceivable application within the OCP framework. In other words, neither exception is relevant to the independent contractors hazard and their deletion does not raise a coverage problem for the OCP insured. For further comment on the Care, Custody, or Control exclusion in general, see Public Liability Dpc- pages.

### Business Risk Exclusion

Although exclusion "j" of the OCP form is identical to an exclusion common to other General Liability forms, it deserves special comment in regard to its OCP context. To paraphrase, the exclusion applies to loss of use of tangible property that has not been physically injured or destroyed resulting from (1) delay or lack of performance of a contract or (2) failure of products or work to perform as represented.

Application of the Business Risk exclusion, as it is called, might arise in the OCP context as follows: a general contractor is the named insured under an OCP form. The designated (sub-) contractor fails to complete his portion of the work on time, causing a delay in completion of the project that prevents the owner from opening business as planned. If the owner sues the general contractor for loss of use of the premises, the OCP will not protect the general contractor, because of the Business Risk exclusion.

There is an important exception to the exclusion, however. The exclusion does not apply to loss of use of undamaged property if the loss of use results from *sudden and accidental* damage to work performed by or on behalf of the named insured *after the work has been put to use by any person other than an insured* (of the OCP form).

There are few possibilities of application of this exception under the OCP form. First, there is exclusion "b," discussed earlier, of bodily injury or property damage occurring after all work at the premises is completed or after that particular part of the designated contractor's work has been put to its intended use by anyone other than another contractor or subcontractor. Say, for example, that a general contractor for the construction of a new store is the named insured of an OCP form purchased by the heating and electrical subcontractor. Following the completion of the building, the furnace fails because of faulty installation by the subcontractor, and the store is forced to close down for a week. The store makes a loss of use claim against the general contractor. Will the general contractor's OCP apply to the loss?

If the furnace merely failed to meet the level of performance warranted by the named insured, perhaps because it was not of sufficient capacity for the building, the named insured's coverage for the claim is flatly excluded by the Business Risk exclusion.

If, instead, the furnace's failure resulted from a sudden and accidental burnout of its wiring, the Business Risk exclusion would *not* apply, because of the exception to the exclusion described earlier. Still, however, there would be no coverage for the claim, because of exclusion "b." *All work on the project was completed at the time of the loss.*

Even if all work on the project had not been completed at the time of loss and the furnace had not been put to use by the owner, the possibilities for coverage are still slight. If, for example, the subcontractor had completed work on the furnace and only the general contractor had put the furnace to use at the time of its injury, exclusion "b" would not apply to the owner's loss of use claim — but the Business Risk exclusion would. Simply, the exception to the exclusion would no longer apply. The injury to the furnace, although sudden and accidental, occurred after the subcontractor's work had been put to use by the named insured. The exception to the Business Risk exclusion is applicable only when the work has been put to use by someone "other than an insured."

The only possibility for coverage in this instance, it seems, is if the subcontractor had put its work to use but had not yet turned it over to the general contractor or owner. In these circumstances only, exclusion "b" *does not* apply and the exception to the Business Risk exclusion *does* apply.

### Other Exclusions

The remaining exclusions of the OCP form are also common to other General Liability forms and do not present special complications. Exclusion "a," of assumed liability, is substantially the same as found in other forms. The effect of Exclusion "a" in the context of the Independent Contractors coverage of other General Liability policies is discussed on Public Liability Ai-3.

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**Public Liability**

**Aic-6**

December, 1988

**OCP COVERAGE PART**

**F. C. & S. BULLETINS**

The other OCP exclusions are identical to those of other forms: the exclusion of pollution or contamination (see Public Liability Cop-); the War exclusion; the exclusion of obligations under workers' compensation or similar laws; the exclusion of employment related injuries or any obligation of the insured to indemnify another because of damages arising out of such injuries; and the exclusion of the use of mobile equipment in prearranged or organized racing, etc., or the use of snowmobiles or their trailers.

The OCP form has no exclusion of automobiles, and so the named insured is protected for liability resulting from the use of an automobile within the scope of activities described in the insuring agreement.

**Limits — Rating**

The OCP coverage part is written subject to three limits — a limit for bodily injury to all persons injured in a single occurrence, a limit for all property damage per occurrence, and an aggregate property damage limit. The form stipulates that if more than one project is designated in the schedule, the aggregate limit is to apply separately to each project.

Premium development for the OCP coverage part is governed by the same Commercial Lines Manual rules and rates that apply to the independent contractors hazard of General Liability policies. See Public Liability Ai- pages.