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**RULING CLOSES THE LOOP ON RESTRICTIVE ADDITIONAL INSURED  
ENDORSEMENT – REASONABLE EXPECTATIONS OF INSURED BUILDER PREVAILS  
OVER INTENT OF INSURER**

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On June 5, 2019, the Court of Appeal in *McMillin Homes Construction, Inc. v. National Fire & Marine Insurance Company*, 35 Cal. App. 5th 1042 (Cal. Ct. App. 2019) issued an important opinion on the scope of additional insured insurance coverage for developers and general contractors in California. Specifically, the “care, custody and control” (“CCC”) exclusion will be read to only exclude coverage for additional insureds who exercised exclusive control over the damaged property. Thus, general contractors who share control of the property with their subcontractors, as is typical on most projects, will not be denied coverage under this exclusion.

**I. Facts & Procedural History**

McMillin Homes Construction, Inc. was a Southern California developer and general contractor. In 2014, homeowners sued McMillin for roofing defects in a case called *Galvan v. McMillin Auburn Lane II, LLC*. Pursuant to a subcontract, the roofer, Martin Roofing Company, Inc., provided McMillin with additional insured coverage under Martin’s general liability insurance policy. The insurer, National Fire and Marine Insurance Company, covered McMillin under an ISO Form CG 20 09 03 97 Additional Insured (“AI”) endorsement. After McMillin tendered its defense of the Galvan lawsuit under the AI endorsement, National Fire declined to provide McMillin with a defense to the homeowners’ lawsuit, relying on a CCC exclusion contained in the AI endorsement for property in the care, custody or control of the additional insured. McMillin then sued National Fire for breach of the policy, bad faith and declaratory relief in *McMillin Homes Construction, Inc. v. National Fire & Marine Insurance Company*.

In *McMillin Homes*, the trial court found the CCC exclusion in the AI endorsement applied and held in favor of the insurer, National Fire. The trial court found the exclusion for damage to property in McMillin’s “care, custody, or control” precluded coverage for the roofing defect

claims, as well as any duty on the part of the insurer to defend the home builder, McMillin. McMillin filed an appeal from the trial court's ruling.

## **II. Case Holding**

The Court of Appeal reversed to hold in favor of McMillin, interpreting the CCC exclusion narrowly and finding a duty on the part of the insurer to defend the general contractor pursuant to the AI endorsement on the roofer's insurance policy. It held that for the CCC exclusion to attach, it would require the general contractor's exclusive control over the damaged property, but here, the general contractor shared control with the roofer. The Court of Appeal noted that where there is ambiguity as to whether a duty to defend exists, the court favors the reasonable belief of the insured over the intent of the insurer. Here, that reasonable belief was that the coverage applied and the exclusion was narrow.

The Court of Appeal relied upon *Home Indemnity Co. v. Leo L. Davis, Inc.*, 79 Cal. App. 3d 863 (Ct. App. 1978) ("Davis"), as a judicial interpretation of the CCC exclusion. That case synthesized a string of case law into a single conclusion: that courts may hold the exclusion inapplicable where the insured's control is not exclusive. In the opinion in McMillin Homes, coverage turned upon whether control was exclusive: "[t]he exclusion is inapplicable where the facts at best suggest shared control." The Court of Appeal stated the "need for painstaking evaluation of the specific facts of each case. Here, McMillin coordinated the project's scheduling, but Martin furnished the materials and labor and oversaw the work; they therefore shared control.

Even if the rule in Davis did not apply and the exclusion was found to be ambiguous, the court stated that "control" requires a higher threshold than merely acting as a general contractor. Liability policies are presumed to include defense duties and exclusions must be "conspicuous, plain, and clear." Furthermore, because "construction defect litigation is typically complex and expensive, a key motivation [for the endorsement] is to offset the cost of defending lawsuits where the general contractor's liability is claimed to be derivative." This is especially true because the duty to defend is triggered by a mere potential of coverage. Under the insurer's construction of the exclusion, coverage would be so restrictive under the AI endorsement that it was nearly worthless to the additional insured.

## **III. Reasonable Expectation of the Insured Prevails over the Intent of the Insurer**

Like most commercial general liability policies, National Fire's policy excluded coverage for property damage Martin was contractually obliged to pay, with an exception for "insured contracts." Typically, "insured contracts" include prospective indemnification agreements for third party claims. The National Fire policy contained a form CG 21 39 Contractual Liability Limitation endorsement, which deleted indemnity agreements from the definition of "insured contracts" to effectively preclude coverage for the indemnity provision between McMillin and Martin. National Fire argued that this endorsement demonstrated its intent to exclude coverage to McMillin for the homeowners' defect lawsuit. The Court of Appeal stated that the insurer's intent

is not controlling and that the insureds reasonable expectation under the AI endorsement would control. As a result of its ruling, the Court also dealt a significant blow to the argument that the CG 21 39 endorsement is effective as a total bar to additional insured coverage for all construction defect claims.

#### **IV. Conclusion**

The decision is good news for developers and general contractors who rely on subcontractors to provide additional insured coverage. Unless the general contractor exercises exclusive control over a given project, the CCC exclusion in the CG 20 09 03 97 additional insured endorsement may not preclude the duty to defend. Demonstrating that a general contractor exercised exclusive control over the project would be extremely difficult to show under normal project circumstances because the any subcontractor participation appears to eliminate the general contractor's exclusive control.

The case also highlights the need for construction professionals to regularly review their insurance programs with their risk management team (lawyers, brokers, and risk managers). As is often the case, a basic insurance policy review at the outset of the McMillin project could likely have avoided the entire dispute. For owners and general contractors, CG 20 10 (ongoing operations) and CG 20 37 (completed operations) additional insured forms are preferable to the CG 20 09 form at issue in the McMillin case because they do not contain the CCC exclusion. The CG 20 10 and 20 37 forms are readily available in the marketplace and are commonly added to most policies upon request. Had those forms been added, AI coverage likely would have been extended to McMillin without the need for litigation. Similarly, carriers will routinely delete the CG 21 39 Contractual Liability Limitation endorsement upon request. Deletion of the CG 21 39 would have circumvented National Fire's second argument in its entirety.

Additionally, insurance policies, endorsements, and exclusions are subject to revision and are not always issued on standard forms. As a result, it is incumbent upon developers, contractors, and subcontractors to specify the precise coverage requirements for construction projects and to review all endorsements, certificates, and policies carefully. Due to the difficulty in monitoring compliance with insurance requirements, project owners and general contractors are finding that it is better to insure projects under project specific wrap-up insurance programs which eliminate many of the issues pertaining to additional insured coverage. Wrap-up programs vary greatly as to their terms and conditions, so however a project is insured, insurance requirements and evidence of coverage should be carefully reviewed by experienced and qualified risk managers, brokers, and legal counsel to assure that projects and parties are sufficiently covered.

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