108 Selected Risk Management Issues for In-house Counsel

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Prior to joining Risk International, Mr. Anderson practiced insurance coverage law and was an attorney with the law firm of Kirkpatrick & Lockhart LLP, where he provided insurance coverage advice for clients such as Alcoa, DuPont, Mead, Merrill Lynch, PPG, Uniroyal Chemical, and United Technologies.

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Ms. Tade is vice president and president-elect of ACCA's Houston Chapter and is in charge of Chapter programs.

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108 SELECTED RISK MANAGEMENT ISSUES FOR IN-HOUSE COUNSEL

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HOT COVERAGE ISSUES

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HOT COVERAGE ISSUES

This session is entitled "Selected Risk Management Issues For In-House Counsel." One of the goals of this session is to emphasize the importance of communication and consensus building between the legal and risk management departments. Both departments have a duty to stay abreast of coverage issues so they can work together to maximize the company's insurance assets. By doing so, they will be able to "transform risk into opportunity."

The purpose of this paper is to address certain "hot" coverage issues, focusing on asbestos, mold, and environmental liabilities in the property policy context. Depending on a company's business, other "hot" issues that should be reviewed by in-house legal and risk management departments include medical monitoring claims, cellular phone claims, biogenetically modified food claims, e-business claims, and employment discrimination claims.[1]

A. THE NEW ASBESTOS ONSLAUGHT

In the last eighteen months, rapidly escalating asbestos claims caused several Fortune 500 companies to seek bankruptcy protection, including Armstrong World Industries (December 2000), Babcock & Wilcox (February 2000), G.I. Holdings (f/k/a GAF Corp.) (January 2000), Owens Corning (October 2000), USG Corporation (June 2001), and W.R. Grace (April 2001). In addition, it was reported in a recent *National Underwriter* article that the total cost for asbestos losses could total $200 billion in the United States, with insureds picking up 39% of the claim costs, U.S. insurance companies picking up 30% of the claim costs, and non-U.S. insurers picking up the remaining 31% of the claim costs. Epidemiologists believe that

[1] *See, e.g.*, James E. Scheuermann and Mark A. May, The Employment-Related Practices Exclusion: An Absolute Bar to Coverage? Absolutely Not, ABA Section of Litigation, Insurance Coverage Litigation Committee, Midyear Meeting 1001 (March 2001); James E. Scheuermann and John K. Baillie, Liability Insurance Coverage for Employment-Related Claims, 11B The Law of Liability Insurance (R.H. Long, ed., Matthew Bender 1995).

asbestos claims are not going to disappear until 2050. Although 25 years have passed since the peak usage of asbestos, claims are higher than ever.

With the major manufacturers of asbestos products in bankruptcy, asbestos plaintiff lawyers are now pursuing new industries. Today, companies that used small quantities of asbestos in their products, or companies that used asbestos insulation in their facilities and hired contract workers (who can sue because they are not covered by workers compensation) are being bombarded with asbestos claims. This recent wave of asbestos claims primarily is against oil companies, chemical companies, steel companies, utilities and railroads. These companies had either nominal or no asbestos liability claims in the past.

What should these companies do when they receive an asbestos claim? The simple answer is to look to their historic commercial general liability ("CGL") insurance policies, which provide broad coverage for property damage and bodily injury.[2] However, most oil, chemical, and steel companies have tapped into their historic CGL coverage in response to environmental and/or product liability claims. Accordingly, the critical question is whether any historic CGL coverage still exists.

Because of the structure of historic CGL policies, companies that are confronted with claims based on exposure to asbestos at the companies' manufacturing operations or places of business may have insurance assets that have not been exhausted. Most historic CGL policies contain split limits of liability: one set of limits for products and completed operations; and another set of limits for premises/operations. Typically, the products coverage and completed operations coverage have aggregate limits in the policies, that is, the insurance company only pays a certain amount of money in settlements (the aggregate limit) and, once that money is paid, the products or completed operations coverage is exhausted. Unlike products and completed

operations coverage, most historic CGL policies ***do not*** contain aggregate limits for premises/operations coverage, which provides insurance for claims arising from or relating to where a company conducts its operations or business. As a result, if a company has not sold back its rights to such coverage, a company faced with asbestos premises/operations claims can tap into its insurance coverage repeatedly.

To determine whether a company can obtain coverage for these new asbestos claims under its historic CGL policies, a company should:

(i) review its historic policies to determine whether the premises/operations coverage contains aggregate limits; and

(ii) review prior insurance settlements to determine whether such settlements were limited to certain types of claims (e.g., environmental or product liability claims) or were for all known and unknown claims (i.e., a policy buy back).

If a company did not sell back all of its rights to coverage in prior settlements, it should be able to use its premises/operations coverage to respond to asbestos claims.

For those companies seeing an increase of asbestos liability claims or receiving these claims for the first time, the value of insurance cannot be overstated. Because of the extensive coverage litigation over the past two decades, the critical asbestos coverage issues (notice, trigger, allocation, fortuity, etc.) have been resolved and vary only by jurisdiction. *See generally* P. Kalis, T. Reiter, and J. Segerdahl, *Policyholder's Guide to the Law of Insurance Coverage* (1997). The insurance companies recognize that there is coverage for the asbestos liability claims and, according to *A.M. Best*, have set aside an additional $10.3 billion in reserves to pay for them. Insurance carriers already have paid $21.6 billion for asbestos claims. Accordingly, the question no longer is whether historic CGL policies provide coverage for asbestos claims, but rather whether such historic coverage still exists.

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[2] Because asbestos exposures typically occurred over time, depending upon the relevant time period for each claim, insurance policies in place from the 1930s to when the absolute asbestos exclusion was inserted (as early as 1986) may provide coverage for asbestos claims.

B. MOLD: THE NEXT ASBESTOS?

Maybe, maybe not. Alexander Robertson, Erin Brockovich's attorney, recently commented that "mold is where asbestos was thirty years ago." Mold-related property damage claims - - like asbestos-related property damage claims 30 years ago - - are beginning to be filed at an accelerated pace. The property damage caused by mold is, for the most part, not in dispute. In contrast, mold-related bodily injury claims - - like asbestos-related bodily injury claims 30 years ago - - have been viewed with skepticism, principally because the bodily injuries allegedly associated with mold are not specific in nature, i.e., the alleged injuries are nasal congestion, bloody nose, cough, sore throat, fatigue, night sweats, low grade fever, rash, short-term memory loss and mood swings. Moreover, after the mold-related property damage is remediated, or a person is removed from the mold environment, the person's health appears to revert to its pre-exposure state. While there is no consensus as to whether mold causes permanent bodily injury, there are scientific studies addressing this issue. Depending on the findings of these studies over the next few years, mold-related bodily injury claims may or may not mirror asbestos bodily injury claims. It is clear, however, that mold-related property damage claims - - although different in certain factual respects - - will mirror asbestos-related property damage claims in both number and amount.[3]

Who will bear the financial burden of these mold claims? Can this financial burden be transferred to insurance companies? Before answering these questions, it is important to understand the cause of mold. Simply put, without the presence of water, mold will not exist.

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[3] *See, e.g., Bauer v. Barton-Marlow Co.* (1996) (Florida) ($8,860,000 settlement of a sick building mold claim arising out of a relatively new $38 million courthouse); *Centex-Rooney Construction Co. v. Martin County*, 706 So.2d 29 (Fla. Dist. Ct. App. 1997) ($11,550,000 jury verdict against construction company for construction defects that caused mold growth on 60-65% of exterior surface of building); *Latham v. Kite Hall*, Los Angeles County, Sup. Ct. (July 9, 1999) (jury verdict for homeowners in the amount of $560,146 for property damage and personal injuries caused by mold); *Billie Adams, et al. v. Oakland Housing Apartments, LTD., et al.*, (2000) (California) ($1,300,000 settlement of mold contamination claim brought by 130 residents of a housing project in Oakland, California). In addition, according to EPA statistics, mold has affected approximately 10-25 million workers and 800,000-1.1 million buildings.

(For mold to exist and grow, mold requires water, a food source, time, and bearable temperatures). Therefore, the focus of the mold claimants will be determining (i) how the water entered a particular building, and (ii) whether such entry was caused by negligent design or construction, or was caused by a defective building product. Accordingly, the companies that will bear the financial burden of mold claims are (i) companies involved in owning, designing, or constructing buildings (including landlords, commercial real estate developers, architectural and engineering firms, construction companies, landscapers, etc.), and (ii) companies involved in manufacturing building-related products, such as windows, doors, roofing materials, drywall, wall board, paints, sealants, etc.[4]

Depending on the facts of a claim and on the wording of their insurance policies, policyholders should be able to transfer some of the financial burden of mold claims to their insurers. The remainder of this section analyzes the main impediments to obtaining such coverage under CGL and property policies.

1. CGL Insurance

CGL policies provide coverage for "all sums which the insured shall become legally obligated to pay as damages because of bodily injury or property damage" subject to exclusions. Therefore, the issue of whether CGL policies provide coverage for mold claims turns on the applicability of the exclusions in the policies. Although the insurers may raise a number of exclusions that they believe bar coverage for mold claims, the exclusions that have the

[4] *See, e.g., Ficket v. Davis Management Corp., et al.*, No. SC-059598 (Los Angeles Super. 2000) (owner of California apartment complex was sued for negligently allowing mold to grow within the units, which allegedly caused residents to suffer personal injury and death from exposure to toxic fungi and bacteria); *Amay, et al. v. Behr, (Mealey's Mold*, 1/2001, p.20*)* (proposed class action by California residents for mold damage caused by defective paint).

potential to give policyholders the most trouble are the "pollution exclusion," product and/or workmanship exclusions, and, the recently expanded "prior incident(s)" exclusion.[5]

a. The "Pollution Exclusion"

In approximately 1973, the insurance industry inserted what is generally referred to as the "sudden and accidental pollution exclusion" into standard CGL policies. This exclusion bars coverage for environmental pollution unless the pollution was caused by a sudden and accidental event.[6] Because of the lack of the uniformity of court rulings as to the meaning of "sudden and accidental," the insurance industry amended the language in approximately 1986 in an effort to eliminate any ambiguity; the new pollution exclusion became known as the "absolute pollution exclusion."[7] Since the mid- to late-1990s, the absolute pollution exclusion has been at the epicenter of most toxic tort personal injury/property damage coverage litigation.

The absolute pollution exclusion has been effective in excluding traditional environmental pollution claims. However, it has been less effective in excluding coverage for nontraditional pollution claims (including lead, carbon monoxide, sick building syndrome, multiple chemical sensitivity, and now mold), especially when these claims involve indoor

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[5] Although there may be specific CGL policies that contain a mold exclusion, those situations are a-typical. However, because of the dramatic increase of mold claims, mold exclusions may become standard within the next year or two.

[6] The "sudden and accidental" pollution exclusion provides that:

> This insurance does not apply . . . to Bodily Injury or Property Damage arising out of discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any water course or body of water, **but this exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental.** (emphasis added).

[7] The typical "absolute pollution exclusion" excludes coverage for:

> (1) "Bodily injury" or "property damage" arising out of the actual, alleged or threatened discharge, dispersal, release or escape of pollutants:
>
> (a) At or from premises you own, rent or occupy; . . . . **Pollutants means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes,**

releases. In particular, a literal reading of the definition of "pollutants" contained within the absolute pollution exclusion, as set forth in footnote 7, suggests that the absolute pollution exclusion is inapplicable to mold claims.

State and federal courts have been inconsistent in their application of the absolute pollution exclusion to nontraditional pollution claims. Some courts have found that, unlike industrial pollution, the absolute pollution exclusion is ambiguous and, therefore, inapplicable to nontraditional pollution. In addressing whether or not the absolute pollution exclusion is applicable to a nontraditional pollution claim (e.g., mold, carbon monoxide, lead, etc.), courts have focused on the following factors: (i) was the resulting damage or injury caused by a "discharge, disbursal, release or escape," and (ii) was the resulting damage or injury caused by a "pollutant," as defined by the policy or a government agency.

It is extremely difficult to generalize how a court will rule in nontraditional pollution cases because of inconsistencies from jurisdiction to jurisdiction and, in some cases, within jurisdictions. For example, courts applying Maryland and Wisconsin law have found the absolute pollution exclusion ambiguous in one nontraditional pollution case and unambiguous in another.

- The Court of Appeals for the Fourth Circuit in *Assicurazioni Generali, S.p.A. v. Neil*, applying Maryland law, held that the absolute pollution exclusion barred coverage for carbon monoxide poisoning claims. 160 F.3d 997 (1998). The Maryland Court of Appeals, however, in *Sullins v. Allstate Ins. Co.*, had held three years prior that the exclusion did not bar coverage for lead paint claims. 667 A.2d 617 (1995). The Fourth Circuit found that the *Sullins* court did not expressly enunciate that the absolute pollution exclusion is limited to "traditional environmental pollution" and not to the contamination of indoor living space. *See Assicurazioni Generali,* 160 F.3d at 1005.

- The Wisconsin Supreme Court, in *Donaldson v. Urban Land Interests, Inc.*, held that the absolute pollution exclusion was ambiguous in a "sick building" case involving carbon monoxide and, therefore, found that the CGL policy

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acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed. (emphasis added).

provided coverage for the claim. 564 N.W.2d 728 (Wis. 1997). Two years later, however, the court distinguished *Donaldson* and held that the absolute pollution exclusion was unambiguous in a lead paint case. *See Peace v. Northwestern National Ins. Co.*, 596 N.W.2d 429 (Wis. 1999). In *Peace*, focusing on the carbon monoxide aspect of the sick building claim in *Donaldson*, the court explained that the basis for its holding in *Donaldson* was that the pollution exclusion does not encompass "claims that have their genesis in activities as fundamental as human respiration." 596 N.W.2d at 443. In contrast, the court stated that the basis for its finding that the absolute pollution exclusion barred lead paint claims was that "the toxic effects of lead have been recognized for centuries." *Id.*

By way of further example, courts in different jurisdictions disagree as to whether the absolute pollution exclusion bars coverage for the same type of nontraditional pollution claims.

- In *Stoney Run Co. v. Prudential-LMI Ins. Co.*, the Court of Appeals for the Second Circuit found that the absolute pollution exclusion did not apply to carbon monoxide poisoning claims brought by residents in a residential apartment building. 47 F.3d 34 (1995). The court held that the absolute pollution exclusion should be interpreted in light of its general purpose to exclude coverage for environmental pollution. The court found that the exclusion was ambiguous in this case because a reasonable policyholder might not characterize the release of carbon monoxide from a faulty residential ventilation system as environmental pollution. The court did not address whether carbon monoxide was a "pollutant" as defined by the policy.

- In contrast, as noted above, in *Assicurazioni Generali, S.p.A. v. Neil*, the Court of Appeals for the Fourth Circuit held that the absolute pollution exclusion barred coverage for a lawsuit brought by hotel guests for carbon monoxide poisoning. 160 F.3d 997 (1998). The court held that carbon monoxide "plainly falls within the policy definition of pollutant." *Id.* at 1000.

Courts that focus exclusively on the "bare language" of the absolute pollution exclusion usually have no difficulty in concluding that it is unambiguous. *See American States Ins. Co. v. Koloms*, 687 N.E.2d 72 (Ill. 1997). A policy, however, can be ambiguous in two ways, as written or, even if clearly written, as applied in certain factual situations. *Id.* In *Koloms*, the Illinois Supreme Court held that the absolute pollution exclusion was ambiguous when applied to cases that do not involve "pollution" in the "conventional, ordinary sense of the word" such as the release of carbon monoxide from a building's furnace.

Although there is much confusion and disagreement regarding the applicability of the absolute pollution exclusion to nontraditional pollution cases, courts that limit the absolute pollution exclusion to traditional pollution claims find that the policy as written is so broad as to be ambiguous in the context of nontraditional pollution. The Court of Appeals for the Seventh Circuit, in an often-cited case, explained this reasoning as follows:

> Without some limiting principle, the pollution exclusion clause would extend far beyond its intended scope, and lead to some absurd results. To take but two simple examples, reading the clause broadly would bar coverage for bodily injuries suffered by one who slips and falls on the spilled contents of a bottle of Drano, and for bodily injury caused by an allergic reaction to chlorine in a public pool. Although Drano and chlorine are both irritants and contaminants that cause, under certain conditions, bodily injury or property damage, one would not ordinarily characterize these events as pollution.

Pipefitters Welfare Education Fund v. Westchester Fire Ins. Co., 976 F.2d 1037, 1043 (1992). Courts limiting the absolute pollution exclusion in this manner take a "common sense approach" in defining the scope of the pollution exclusion. Courts find that the reasonable expectations of a policyholder do not include the belief that the pollution exclusion precludes coverage for "injuries resulting from everyday activities gone slightly, but not surprisingly, awry." *Id*. at 1044.

b. Product and/or Workmanship Exclusions

Standard CGL policy forms contain a "product" exclusion and a "workmanship" exclusion that the insurers will argue preclude coverage for mold claims. The "product" exclusion provides that this insurance does not apply to:

> "Property damage" to "your product" arising out of it or any part of it.[8]

[8] The policy defines "[y]our product" as:

> a. Any good or products, ***other than real property*** manufactured, sold, handled, distributed or disposed of by:
>
> (1) You;
> (2) Others trading under your name; or

The "workmanship" exclusion provides that this insurance does not apply to:

> "Property damage" to "your work" arising out of it or any part of it and included in the "products-completed operations hazard." **This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.** (emphasis added).[9]

On their face, neither of these exclusions precludes coverage for bodily injury resulting from a policyholder's product or work; nor are there other standard exclusions that purport to do so. Accordingly, if a mold claim includes allegations of property damage ***and bodily injury***, the insurer, at a minimum, has a duty to defend the policyholder in the underlying action and to indemnify the policyholder for any bodily injury liability.

Courts also have construed these exclusions narrowly. Courts hold that these exclusions do not preclude coverage for damage to ***other*** property or bodily injury resulting from the failure of the policyholder's product or work, i.e., these exclusions only preclude coverage for damage to a policyholder's own product or work. *See, e.g.*, *Green Constr. Co. v. National Union Fire Ins. Co.*, 771 F. Supp. 1000 (W.D. Mo. 1991) (applying Missouri law); *Blackhawk Corp. v. Gotham Ins. Co.*, 54 Cal. App. 4th 1090 (Cal. App. Ct. 1997); *Home Indem. Co. v. Wil-Freds, Inc.*, 601 N.E.2d 281 (Ill. App. Ct. 1992). The basis for this reasoning is that the purpose of standard CGL insurance is to protect a policyholder from third-party claims arising out of defective products or faulty work; but the risk of replacing or repairing a policyholder's defective

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(3) A person or organization whose business or assets you have acquired; and

b. Containers (other than vehicles), materials, parts or equipment furnished in connection with such goods or products. (emphasis added).

[9] The policy defines "[y]our work" as:

a. Work or operations performed by you or on your behalf; and
b. Materials, parts or equipment furnished in connection with such work or operations.

"Your work" includes:

a. Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of "your work"; and
b. The providing of or failure to provide warnings or instructions.

products or poor workmanship is a commercial risk that generally is not passed on to the insurer. *Id.*

The breadth of the workmanship exclusion also is limited by the subcontractor exception contained therein. For example, in the instances where the mold damage allegedly arose out of the work of a policyholder (e.g., a general contractor is sued for improperly constructing a home or a commercial building), but the policyholder can show that the work that led to the mold damage was performed by a subcontractor, the workmanship exclusion will not preclude coverage for any liability associated with such damage. *See National Union Fire Ins. v. Structural Systems Technology, Inc.*, 756 F. Supp. 1232 (E.D. Mo. 1991) *aff'd.*, 964 F.2d 759 (8th Cir. 1992) (applying Missouri law).[10]

However, in a situation where there is mold damage in a building constructed by the policyholder, the insurer may argue that the product exclusion bars coverage because the damage is to the policyholder's product (i.e., the building). If the insurance policy definition of "your product" does not contain the phrase ***"other than real property"***, unlike the definition in footnote 8, courts are split as to whether real property, such as a building, is a "product" within the meaning of the standard form CGL policy.[11] Therefore, depending on the jurisdiction and the wording of the insurance policy, the "product" exclusion may act as a bar to coverage in this scenario.

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[10] *See also Fireguard Sprinkler Systems v. Scottsdale Ins. Co.*, 864 F.2d 648 (9th Cir. 1988) (applying Oregon law); *Fejes v. Alaska Ins. Co.*, 984 P.2d 519 (Alaska 1999); *Stratton & Company, Inc. v. Argonaut Ins. Co.*, 469 S.E.2d 545 (Ga. 1996); *McKeller Development of Nevada, Inc. v. Northern Ins. Co. of New York*, 837 P.2d 858 (Nev. 1992); *Collett v. Ins. Co. of the West*, 64 Cal. App. 4th 338 (Cal. App. 1998).

[11] *See, e.g.*, *Fireguard Sprinkler Systems, Inc. v. Scottsdale Ins. Co.*, 864 F.2d 648 (9th Cir. 1988) (applying Oregon Law) (not a product); *Green Construction Co. v. National Union Fire Ins. Co.*, 771 F. Supp. 1000 (W.D. Mo. 1991) (not a product); *Maryland Casualty Co. v. Reeder*, 221 Cal. App. 3d 961 (Cal. App. 1990) (not a product); *Mid-United Contractors, Inc. v. Providence Lloyds Ins. Co.*, 754 S.W.2d 824 (Tex. App. 1988) (not a product); *Johnson v. National Union Fire Ins. Co.*, 289 N.Y.S.2d 852 (Sup. Ct. 1968), *aff'd*, 309 N.Y.S.2d 110 (N.Y. App. Div. 1970) (not a product); *Kissell v. Aetna Casualty & Surety Co.*, 380 S.W.2d 497 (Mo. Ct. App. 1964) (not a product). But see *Indiana Ins. Co. v. De Zutti*, 408 N.E.2d 1275 (Ind. 1980) (a product); *Westman*

c. The Prior Incident(s) Exclusion

Recently, the insurance industry expanded the prior incident(s) exclusion in the standard CGL form. This exclusion provides that:

> In consideration of the premium charged, it is hereby understood and agreed that no insurance coverage is provided under this policy to defend or indemnify any insured for "bodily injury" or "property damage" **which has first occurred or begun prior to the effective date of this policy, regardless of whether repeated or continued exposure to conditions which were a cause of such "bodily injury" or "property damage" occur during the period of this policy and cause additional, progressive or further "bodily injury" or "property damage",** all of which is excluded from coverage. (emphasis added.)

Obviously, the critical question regarding the applicability of this exclusion is whether mold-related property damage can be dated. If the insurer can show that the mold damage began prior to the inception of a policy, the insurer can argue successfully that the "prior incident(s) exclusion" bars coverage.

In general, mold begins to grow within 24 to 72 hours after a particular piece of property has been exposed to water. To date, there are no scientific methods that can determine specifically when mold-related property damage began. Accordingly, policyholders can take heart in this regard because insurers bear the burden of proving that this exclusion applies to a given claim.

2. Property Insurance

For those businesses that are faced with mold-related property damage in their buildings (e.g., landlords and commercial real estate developers), property policies may provide financial relief. Property policies provide coverage for physical loss or damage to the policyholder's own property (e.g., buildings). There are several types of property policies, including "all-risk" policies and named-peril policies. Named-peril policies, unlike "all-risk"

Industrial Co. v. Hartford Ins. Group, 751 P.2d 1242 (Wash. App. 1988) (a product); *J.G.A. Construction Corporation v. Charter Oak Fire Ins. Co.*, 414 N.Y.S.2d 385 (N.Y. App. Div. 1979) (a product).

policies, specifically enumerate the risks or causes of loss that are covered or not covered by the policy. Named-peril policies can include coverage for multiple perils such as fire, lightning, water damage, and earthquake. Under the named-peril policies, as opposed to the "all-risk" policies, the policyholder bears the risk of unknown or unforeseen causes of loss or damage. In contrast, "all-risk" policies provide coverage for all risks of loss, except those specifically excluded.

Historic (i.e., pre-1986) property policies generally excluded coverage for mold damage. The mold exclusion was part of the "contamination" exclusion discussed in Section C.2., *infra*. In 1986, however, when the contamination exclusion was replaced with the absolute pollution exclusion, the mold exclusion was not continued in many property policies. Thus, if a policyholder has an "all-risk" property policy and the policy does not contain a mold exclusion, the policyholder should be able to obtain coverage for the mold damage. *See, e.g.*, *Columbiaknit, v. Affiliated FM Ins. Co.*, 1999 U.S. Dist. LEXIS 11873 (D. Oregon 1999) (finding coverage for mold damage to fabric and garments under an "all-risk" property policy). Similarly, if a policyholder has a named-peril property policy and one of the insured perils is water leakage, the policyholder should be able to obtain coverage for mold damage as a resulting loss.

Other provisions of a property policy that may provide additional grants of coverage for mold property damage claims include "Rental Value", "Extra Expense", and "Soft Costs". The "Rental Value" provision provides that:

> This policy insures:
>
> 1. "Rental value" loss sustained by the Insured resulting from the necessary ***untenantability*** caused by loss, damage, or destruction by any of the perils not excluded during the term of this policy to real or personal property not excluded but not exceeding the reduction in rental value less charges and expenses which do not necessarily continue during the period of recovery.

2. For the purposes of this insurance, "rental value" is defined as the sum of:

    a. The total anticipated gross rental income from tenant occupancy of the described property as furnished and equipped by the Insured; and
    b. The amount of all charges which are the legal obligation of the tenant(s) and which would otherwise be obligations of the Insured; and
    c. The fair rental value of any portion of said property which is occupied by the Insured. (emphasis added).

Accordingly, if a commercial real estate building or an apartment building becomes "untenantable" because of mold damage, the owner of the building can recover the lost rental value while the mold damage is being remediated.

Similarly, if a policyholder is forced to vacate its own building and rent office space while the mold damage is being remediated, the policyholder should be able to obtain coverage for the extra rental cost under the "Extra Expense" provision. This provision provides that:

> This policy insures:
>
> 1. "Extra expense" incurred resulting from loss, damage, or destruction to property not excluded by a peril not excluded, during the term of this policy.
>
> 2. "Extra expense" means expenses incurred by the Insured during a "period of recovery" to avoid or minimize the suspension of the business and to continue normal business operations.

Finally, to the extent that a policyholder borrows money to finance the remediation of mold damage, the policyholder can recover the interest incurred for financing the remediation under the "Soft Costs" provision.[12]

Thus, if a building owner is faced with direct and indirect mold damage, the owner can turn to its property policy for financial relief.

[12] "Soft Costs" in a property policy includes, among other things, "additional interest on money borrowed to finance construction or repair."

C. UNMINED ASSETS: "ALL-RISK" PROPERTY POLICIES

Although most companies are familiar with obtaining coverage for environmental damage under their historic CGL policies, few companies are familiar with obtaining coverage for such damage under their historic property policies. Generally, property policies provide coverage for loss or damage to the policyholder's own property (e.g., soil) or property within the policyholder's care, custody, or control (e.g., groundwater). As noted in section B.2., *supra*, there are several types of property policies, including "all-risk" policies and named-peril policies. Courts consistently have recognized that the coverage provided by "all-risk" policies is the broadest form of property coverage available, covering all risks of loss except those risks specifically excluded.[13] A typical "all-risk" property policy provides as follows:

> This policy insures against ***all risks of physical loss or damage*** to property described herein, . . . except as hereafter excluded.
>
> . . . .
>
> [T]his policy covers:
>
> (1) The interest of the Assured in all real and personal property owned, used, or intended for use by the Assured, ...
>
> (2) The interest of the Assured in the real and personal property of others in the Assured's care, custody, or control, and the Assured's liability imposed by law or assumed by contract, whether written or oral, for such property. (emphasis added). [14]

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[13] *See* 12A G. Couch, R. Anderson & M. Rhodes, Couch Cyclopedia of Insurance Law, §48:141 (1983); 5 J. Appleman, Insurance Law and Practice § 3092 at 371 (1970); Annotation, Coverage Under All-Risk Insurance, 3- A.L.R. 5 th 170 (1995); *Dow Chemical Co. v. Royal Indem. Co.*, 635 F.2d 379, 396 (5th Cir. 1981) ("All-risk" policy provides coverage for all losses unless the policy contains a specific provision expressly excluding the loss from coverage); *Pillsbury Co. v. Underwriters of Lloyd's*, 705 F. Supp. 1396, 1399 (D. Minn. 1989) ("All-risk" coverage is expansive); *Ins. Co. of North America v. United States Gypsum, Co.*, 678 F. Supp. 138, 141 (W.D. Va. 1988), *aff'd*, 870 F. 2d 148 (4th Cir. 1989) ("All-risk" insurance contracts are a type of insurance where the insurer agrees to cover all risk of loss except for certain excluded events); *Hudson v. Prudential Property & Casualty Ins. Co.*, 450 So.2d 565, 568 (Fla. Dist. App. Ct. 1984) (Recovery under "all-risk" policies generally extends to all losses unless the policy contains a specific provision expressly excluding the loss from coverage).

[14] The historic "all-risk" property policies that may respond to environmental property damage are policies in effect from at least the 1970s through 1986, when the absolute pollution exclusion was inserted.

The provisions of an "all-risk" policy that have the greatest potential to derail a policyholder from obtaining coverage for environmental property damage are: (i) the land exclusion; (ii) the contamination exclusion; and (iii) the suit limitation provision. Accordingly, the first step that a policyholder should take in analyzing whether coverage exists under its "all-risk" property policy is to determine if the policy contains any of these provisions. If the policy does not, the policyholder usually will be able to obtain coverage for the environmental damage. If the policy does contain any of these provisions, the policyholder will have a difficult time in obtaining coverage and, therefore, must perform a cost/benefit analysis to determine whether it makes sense to attempt to overcome these coverage hurdles.

1. The Land Exclusion

Of the three provisions set forth above, the land exclusion is the most problematic for a policyholder. This exclusion provides that "[t]his policy does not insure: land . . . . " Courts hold that the land exclusion effectively precludes coverage for environmental damage to soil. *See e.g.*, *Royal Ins. Co. v. Tithell*, 868 F.Supp. 878 (E.D. Mich. 1993); *Tricentennial Eagle Limited Partnership v. The Bankers Standard Ins. Co.*, 1997 Mass. Super. Lexis 218 (1997). The land exclusion, however, may not preclude coverage for damage to groundwater that is in the policyholder's care, custody or control. *See Lapham-Hickey Steel Corp. v. Protection Mut. Ins. Co.*, 633 N.E.2d 1235, 1243 (Ill. App. 1994), *reversed on other grounds, Lapham-Hickey Steel Corp. v. Protection Mut. Ins. Co.*, 655 N.E.2d 842 (Ill. 1995). Thus, if the policy contains a land exclusion, the policyholder probably should not pursue coverage for soil damage.

2. The Contamination Exclusion

> The contamination exclusion provides that this policy does not insure against:
>
> Loss or Damage caused by or resulting from Moth, Vermin, Termites, or other Insects, Inherent Vice, Latent Defect, **Contamination**, Wear and Tear or Gradual Deterioration, Rust, Wet or Dry Rot, Mould, Dampness of Atmosphere, Smog Shrinkage or Expansion in Building or Foundation, unless other Insured Loss or Damage ensues, and then only for the ensuing Loss or Damage. (emphasis added).

In general, courts have construed the term "contamination" in the property policy context broadly to preclude coverage for property damage resulting from a wide variety of chemicals and pollutants.[15]

Depending on the facts of the claim, however, a contamination exclusion may be obviated under either a negligence or "concurrent cause" analysis. Under this doctrine - - which has been adopted in a number of states - - if there is more than one cause for the loss, and at least one cause is a covered peril, the loss is covered.[16] The concurrent cause doctrine has been used to defeat a contamination exclusion much like the one set forth above. In *McConnell Construction Co. v. Ins. Co. of St. Louis*, a homeowner sought coverage for damage to a brick floor caused by muriatic acid that had been applied to the flooring during construction of the home. 428 S.W.2d 659 (Tex. 1968). The insurance company classified the loss as being caused by contamination - - a specifically-excluded peril. However, an expert witness testified that the

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[15] *Falcon Products, Inc. v. Ins. Company of Pennsylvania*, 615 F. Supp. 37 (E.D. Mo. 1985), *aff'd* 782 F.2d 779 (8th Cir. 1986) (no coverage under nuclear exclusion clause because contact with cobalt 60 was "contamination"); *Hi-G, Inc. v. St. Paul Fire and Marine Ins. Co.*, 391 F.2d 924 (1st Cir. 1968) (oil film); *American Casualty Co. v. Myrick*, 304 F.2d 179 (5th Cir. 1962) (ammonia); *McQuade v. Nationwide Mutual Fire Ins. Co.*, 587 F. Supp. 67 (D. Mass. 1984) (chlordane); *Auten v. Employers National Ins. Co.*, 722 S.W.2d 468 (Tex. Ct. App. 1986) (oil-based pesticide), *writ denied*, 749 S.W.2d 497 (Tex. 1988); *J & S Enterprises, Inc. v. Continental Casualty Co.*, 825 P.2d 1020 (Colo. Ct. App. 1991), *cert. denied*, 1992 Colo. LEXIS 194 (Colo. Feb. 10, 1992) (asbestos); *Brodkin v. State Farm Fire & Casualty Co.*, 217 Cal. App. 3d 210 (Cal. App. 1989) (swamp sewage and other "corrosives").

[16] *See, e.g., Raybestos-Manhattan, Inc. v. Industrial Risk Insurers*, 433 A.2d 906 (Pa. 1981); *McConnell Construction Co. v. Ins. Co. of St. Louis*, 428 S.W.2d 659 (Tex. 1968).

damage was caused by "corrosion," which was not excluded under the policy. Because corrosion was found to be a concurrent cause of the damage, the contamination exclusion was held inapplicable. *Id; see also Shaffer v. State Farm Fire & Casualty Co.*, 852 P.2d 245 (Or. Ct. App. 1993); *Largent v. State Farm Fire and Casualty Co*., 842 P.2d 445 (Or. Ct. App. 1992).

A contamination exclusion also has been held inapplicable in a situation where third-party negligence was found to be a concurrent cause of the property damage. For example, in *Raybestos-Manhattan, Inc. v. Industrial Risk Insurers*, fuel oil was spilled into the policyholder's heptane tank as a result of third-party negligence. 433 A.2d 906 (Pa. 1981). The contaminated heptane caused serious damage to the production process. The insurance company denied coverage on the grounds that the fuel oil spill constituted "contamination." Rejecting this argument, the court held that the proximate cause of the insured's loss was the unintentional and negligent deposit of fuel oil, which the court held was not excluded. *Id.* at 908-909.[17]

Therefore, if a property policy contains a "contamination" exclusion, the policyholder should determine whether there was a "concurrent" cause (e.g., fire, explosion, rupture, negligent act, etc.) of the environmental damage. If the policyholder can point to such an event, the policyholder may be able to defeat the application of this exclusion. [18]

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[17] *See also Souza v. Corvick*, 441 F.2d 1013 (D.C. Cir. 1970); *New Zealand Ins. Co. v. Lenoff*, 315 F.2d 95 (9th Cir. 1963); *Jussim v. Massachusetts Bay Ins. Co.*, 610 N.E.2d 954 (Mass. 1993). But see *Auten v. Employers National Ins. Co.*, 722 S.W. 2d 468 (Tex. Ct. App. 1986) (Court held that the policyholder could not recover under its homeowner's policy for the damage to its house due to the negligence of an exterminator because the damage was caused by contamination, a peril excluded by the policy).

[18] A policyholder also may argue that, based on the principal of *ejusden generis* (things of the same kind, claim or nature), the contamination exclusion does not apply to sudden and accidental events. Under the concept of *ejusden generis*, contamination should be viewed in the same context as other words in the exclusions, i.e., losses that occur naturally over a period of time. *See The Fire, Casualty & Surety Bulletins.*

3. The Suit Limitation Provision

All-risk property policies sometimes contain a provision that purports to limit the amount of time within which the policyholder can bring suit against its insurer regarding a claim made under the policy. A typical suit limitation provision provides as follows:

> No suit, action or proceeding for the recovery of any claim under this policy shall be sustainable in any court of law or equity unless the same be commenced within twelve (12) months next after discovery by the Insured of the occurrence which gives rise to the claim, provided, however, that if by the laws of the state within which this policy is issued such limitation is invalid, then any such claim shall be void unless such action, suit or proceeding be commenced within the shortest limit of time permitted by the laws of such state.

Of particular importance in the application of a suit limitation provision is the point at which the limitation period begins to run. Suit limitation provisions either require that the suit be commenced within 12 months "after discovery by the insured of the occurrence which gives rise to the claim," as set forth above, or that the suit be commenced within 12 months "after the happening (or inception) of the loss." In construing the "discovery of the occurrence which gives rise to the claim" language, most courts hold that the limitation period begins to run "when the injurious effects [of the occurrence] first manifest themselves in a way that would put a reasonable person on notice of the injury." *See, e.g., Aluminum Company of America v. Aetna Casualty & Surety Co.*, 998 P.2d 856, 877 (Wa. 2000) (applying Pennsylvania law).

In contrast, in construing the "inception of the loss" language, courts are divided as to when the limitation period begins to run. Some courts hold that the period begins to run on the date of the actual loss or damage. *See Naghten v. Maryland Casualty Co.*, 197 N.E.2d 489 (Ill. App. 1964) (affirmed dismissal of the policyholder's suit because the policyholder failed to bring suit within one year of the time the loss actually occurred). Other courts hold that the limitation period begins to run at the date of the loss, but such period is tolled from the time the policyholder gives notice until the time the insurer denies coverage. *See, e.g., Peloso v. Hartford*

Fire Ins. Co., 267 A.2d 498 (N.J. 1970). Conversely, certain courts hold that the limitation period begins to run at the time the cause of action accrues, which is when the insurer denies coverage. *See, e.g., Meadows v. Employers' Fire Ins. Co.*, 298 S.E.2d 874 (W. Va. 1982); *Finkelstein v. American Ins. Co.*, 62 So.2d 820 (La. 1952). Finally, some courts hold that a discovery rule should apply for latent damages (i.e., the limitation period begins to run when a reasonable person should have discovered the loss or damage), even where the policy uses the more restrictive "inception of loss" language. *See, e.g., Prudential-LMI Commercial Ins. v. Superior Court*, 798 P.2d 1230 (Cal. 1990).

A suit limitation provision may be unenforceable if it purports to provide a shorter period of time than allowed by "applicable statute." Some courts hold that the "applicable statute" language in the suit limitation provision means that the statute of limitations for breaches of contract applies, which is typically longer than the one-year suit limitation period. *See, e.g., General Instrument Corp. v. American Home Assurance Co.*, 397 F.Supp 1074 (E.D. Pa. 1975); *Queen Tufting Co. v. Fireman's Fund Ins. Co.*, 239 S.E.2d 27 (Ga. 1977). But see *Graingrowers Warehouse Co. v. Central National Ins. Co. of Omaha*, 711 F.Supp. 1040 (E.D. WA. 1989); *Wabash v. Power Equip. Co. v. International Ins. Co*, 540 N.E.2d 960 (Ill. App. Ct. 1989).

Moreover, a minority of courts will not enforce a suit limitation provision that causes a forfeiture of coverage if the insurer has not suffered prejudice as a result of the policyholder's failure to comply with the suit limitation provision. *See., e.g., Estes v. Alaska Ins. Guar. Ass'n*, 774 P.2d 1315 (Alaska 1989); *Roberts Oil Co. v. Transamerica Ins. Co.*, 833 P.2d 222 (N.M. 1992). But see *Sieba v. Middlexes Mut. Assurance Co.*, 549 F. Supp. 1318 (D. Conn. 1982); *Brandywine One Hundred Corp. v. Hartford Fire Ins. Co.*, 405 F. Supp. 147 (D. Del. 1975).

Depending on the facts of the claim and the wording of the policy, a suit limitation provision can act as a complete bar to coverage. Therefore, a policyholder must conduct a careful analysis of this issue in deciding whether to file a claim for coverage.

* * * *

If a land exclusion, contamination exclusion, and suit limitation provision are absent from an all-risk property policy, there are no other major impediments to coverage for environmental property damage. As a result, "all-risk" property policies can be used along with CGL policies to lessen or eliminate a company's financial burden in remediating environmental property damage.

D. CONCLUSION

Asbestos, mold, and environmental claims are only a few of the liabilities that are causing financial strains for many companies today. As discussed above, insurance policies, if analyzed and used properly, can be effective in transferring some or all of these financial burdens to insurers. In order to respond to such claims in an efficient and effective manner, in-house legal and risk management departments must adopt a team approach for resolving claims so that the company can benefit from their respective expertise. By doing so, a company will be able to maximize its insurance assets and "transform risk into opportunity."

Selected Risk Management Issues for In-house Counsel

Lisa B. Brown
Jeanmarie B. Tade

ACCA 2001 Annual Meeting
Adding Value

San Diego, California October 15 - 17, 2001

Overview

- Goals of risk allocation
- Basic indemnity drafting considerations
- Developing a risk allocation scheme
- Potential drafting pitfalls
- Interplay of indemnity, insurance, applicable law, and existing contracts
- Important insurance issues
- Choice of law issues

Goals of Contractual Risk Allocation

- Risk management
- Allocate risk consistent with underlying contracts and insurance program

Risk Management

- Identify and evaluate particular risks
- Determine your own insurance needs
- Promote certainty between the parties and reduce cost
  - avoid costly disputes concerning fault
  - promote unified response to suits by third parties

Allocate Risk Consistent With Underlying Contracts and Insurance Program

- Evaluate your other contracts and your insurance program
  - what protection do you need?
  - what protection can you afford to give?
- What does the other party need?
- What are the options for solving an impasse?

Drafting Successful Indemnity Agreements

- Understand the parties' expectations
- Use clear, precise wording
- Comply with any form requirements
- Understand the legal framework
- Make sure "forms" are recognized as a starting point, not necessarily a final result

What Are the Parties' Expectations?

- Achieving clarity
- To remove doubt - adhere to the strictest standard
- Texas "fair notice" standard

Using the Right Words

- Effect of specific wording
- Clarity of intent
- Use of talismanic language

Location Can Have Significant Effects on Enforceability

- Is the provision visible?
- Does it meet the "conspicuousness" requirement
- Examples from the case law

Legal Framework

- Stay alert to changes in the law
- Be aware of anti-indemnity statutes
- What law will govern may determine enforceability

Use of Standard and Form Contracts

- A good place to start
- Whose contract form is used is driven by economics and/or efficiency
- Form contracts are no panacea — most require at least moderate changes to be adaptable to your situation

Three Keys to Developing a Risk Allocation Scheme

- Know your existing risks
- Understand impact of different "reciprocal" indemnity provisions
- Evaluate your need for "pass-through" indemnity protection

Understanding Existing Risks

- Review contractual risk allocations to determine what protection you have from others
  - factor in enforceability issues
- Evaluate your existing insurance coverage
  - identify uninsured risks and risks for which you want to minimize your exposure
- Analyze types of risk, magnitude, likelihood, and existence of other protection

Understanding Impact of Different Types of "Reciprocal" Indemnity Provisions

- Narrow reciprocal indemnity
- Broad reciprocal indemnity
- Consider possible alternatives

Narrow Reciprocal Indemnity

- Each party is responsible for their own employees and property
- Simplest means of providing indemnity
- Does not require reliance on indemnities owed by other contractors
- Provides no protection for claims by contractors or subcontractors

Broad Reciprocal Indemnity

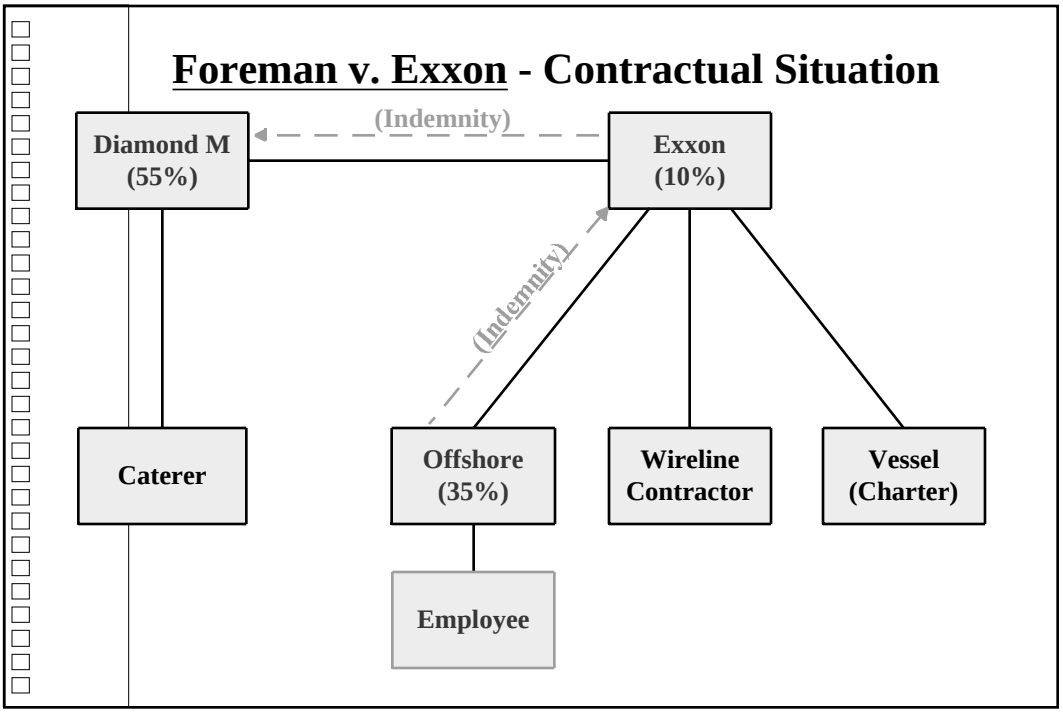
- Includes contractors and subcontractors
- Can create extensive potential liability
- Without "pass-through" provision, there may be no back-up indemnity
  - some property risks may not be covered by your insurance program

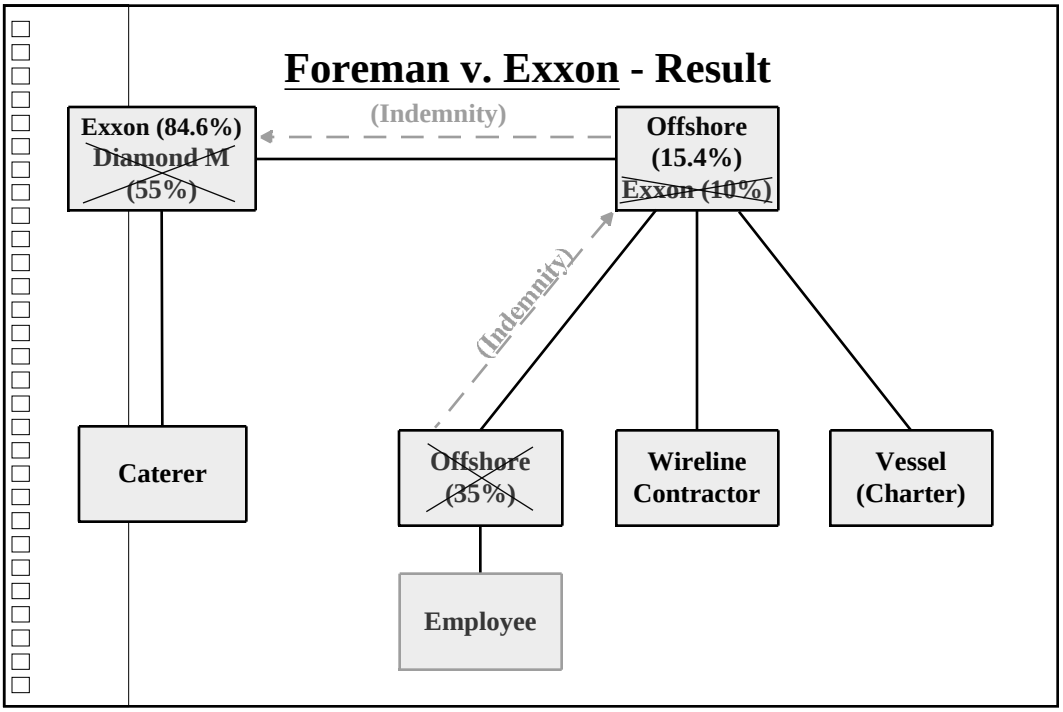
Evaluate Your Need for "Pass-Through" Indemnity Protection

- Indemnity provision from Company X generally will not cover your contractual liability to others
- If indemnity received by you does not extend (or "pass-through") to those you owe, your liability will significantly increase
- If you owe broad reciprocal indemnity, but underlying contract has no "pass-through" provision, you have no recourse

Interaction Between Drilling Contract and Other Contracts

- Indemnity scheme of underlying contracts affects drilling contract and vice versa
- Absence of "pass-through" in MSA or Charter creates significant exposure for broad reciprocal indemnity in drilling contract
- Beware of enforceability issues as well





Obtaining "Pass-Through" Protection

- Can include contractual liability within scope of indemnity
- Alternative is to include your contractors and subcontractors as indemnified parties
- Use a broad defined term (such as "Company Group") to refer to a broadly defined group of indemnitees

Sample Definition of "Company Group"

- Company, its parent, subsidiary, affiliated and related companies, its and their co-lessees, co-owners, partners, joint venturers, and contractors and subcontractors, and the officers, directors, employees, agents, and representatives of all the foregoing (hereafter referred to as "Company Group")

Expand Use of "Company Group"

- Allows consistent and uniform risk allocation scheme
- Use same definition in insurance requirements and certificate of insurance
- Use same definition in other contracts if at all possible

Be Sure "Pass-Through" Is Clear

- Broad definitions in preamble, particularly without cross-reference in indemnity provision or a clearly defined separate term, may not be enforced (Walter Oil & Gas v. Safeguard; Green v. Questor)
- Use broad definition only as indemnitee, not as indemnitor

Potential Indemnity Pitfalls

- Scope of indemnity should fit within a risk allocation plan
- Indemnity must be broad enough to extend to all intended beneficiaries
- Must have valid "magic language" to obtain indemnity for one's own negligence
- Consider possible limitations on indemnity

Scope of the Indemnity

- Identify employees and property covered
- Consider claims arising out of particular operations or particular type of damage
  - pollution
  - downhole operations
  - reservoir damage
  - blowout and well control
  - consequential damages

Vessel Operations Present Special Issues

- Beware Lanasse v. Travelers Ins. Co.
  - include "ingress and egress"
  - include "loading and unloading of cargo" - Gaspard v. Offshore Crane and Equipment
- Be sure that insurance provisions address Lanasse issues

Who Are the Indemnitees?

- Use defined term such as "Company Group"
- Consider all parties you may want protected
- Parent, subsidiary and affiliated companies
- Its and their co-owners, co-lessees, partners and joint venturers
- Include contractors and subcontractors if at all possible
- Consider lessor and/or sharing companies

"Magic Language" - Reference to Negligence Should Be As Clear and As Broad As Possible

- Include sole or concurrent negligence of indemnified Group
- Include reference to strict liability, unseaworthiness, and pre-existing conditions
- Consider including gross negligence and/or punitive damages
- Include "release" and "defend" and specific reference to attorney's fees
- Be aware of "conspicuousness" requirements

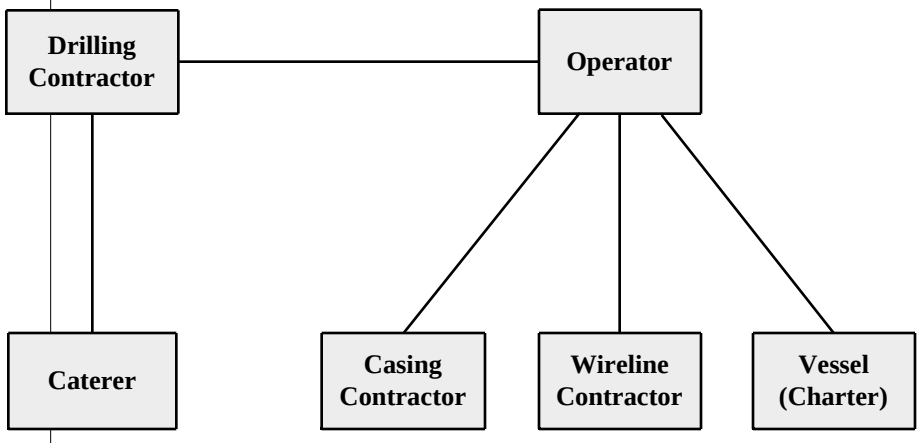
Interplay of Indemnity, Insurance, Applicable Law, and Existing Contracts

- Applicable law will be critical
- Multiple laws may be potentially applicable
- Type of contract may determine risk and enforceability
- Protection available in existing contracts determines flexibility

Determining Applicable Law

- Contract for vessel is maritime
- Drilling contract for jack-up is maritime
- Contracts for some work on a jack-up may not be maritime
  - casing contract on jack-up - maritime
  - wireline contract - non-maritime (even on jack-up)

General Contracting Scheme



Determining Applicable Law (Cont'd)

- OCSLA applies law of adjacent state if maritime law is not applicable on its own
  - contracts for work on fixed platforms are governed by state law
- OCSLA is considered mandatory choice of law provision; reverse is not true

Determining Applicable Law (Cont'd)

- "Adjacent state" is determined by multi-factor test:
  - Geographic proximity
  - Federal agencies' determination
  - Prior court decisions
  - Projected boundaries
- See Snyder Oil Corp. v. Samedan Oil Corp.

Effect of Applicable Law

- Maritime law - indemnity and insurance generally fully enforceable
  - drilling contract for jack-up is maritime
- Texas, Louisiana, and New Mexico law - significant restrictions

Effect of Applicable Law (Cont'd)

- Contracts performed at same time may be subject to different law
  - indemnity to drilling contractor is enforceable while indemnity in underlying wireline MSA is not
  - indemnity to vessel owner in charter is enforceable, but indemnity with platform drilling contractor is not

Maritime Law

- Indemnities generally fully enforceable
  - except § 905(b) of LHWCA (no indemnity for a "vessel" from employer of a longshoreman, but insurance is enforceable and there is an exception under § 905(c) for reciprocal indemnity on OCS)
- Insurance protection is enforceable
  - but beware Lanasse

LHWCA - Section 905(b)

- "Vessel" cannot obtain indemnity from employer of a longshoreman
- "Vessel" includes charterer
- Reciprocal indemnity on OCS allowed under section 905(c)
- Insurance protection not invalidated

Texas Anti-Indemnity Act

- Applies to property damage and personal injury/death
- Exceptions for indemnity supported by insurance
  - unilateral indemnity ($500,000)
  - mutual indemnity (up to amount of insurance obtained "for the benefit of the other party as indemnitee") – no longer required to specify equal amounts)
- Act does not apply to insurance that does not directly support the indemnity

Texas - Unilateral Indemnity

- "Unilateral" indemnity requires provision that indemnity will be supported by insurance or self-insurance not to exceed $500,000
- Prior cases allowed indemnity/insurance in excess of $500,000 if contract asked for proper amount, but those cases have been questioned

Texas - Mutual Indemnity

- Must be "mutual"
- Prior to amendment, some cases required contract to state that each party would support indemnity with insurance "in equal amounts" (i.e.,Greene's Pressure Testing v. Flournoy; Ken Petroleum; Weber)
- Some indication that unsuccessfully asking for "mutual" indemnity may be interpreted as precluding "unilateral" indemnity

Texas - Mutual Indemnity (Cont'd)

- Ken Petroleum Corp. v. Questor Drilling Corp. statement of "equal amounts" is not required - where insurance is not equal, indemnity is limited to lower common amount
- Mid-Continent v. Swift - Mutual indemnity does not require exact reciprocity, i.e., in identity of indemnitees

Amendment to "Mutual" Requirement

- Texas act amended in 1999
- "Equal amounts" no longer required
- "Mutual" indemnity is limited to coverage and dollar limits of insurance or qualified self-insurance "each party as indemnitor has agreed to obtain for the benefit of the other party as indemnitee"

Texas - Independent Insurance is Enforceable

- Insurance not directly supporting the indemnity is enforceable
  - Getty Oil Co. v. Insurance Company of North America
  - Certain Underwriters at Lloyd's v. Oryx Energy Co.
- Two prongs - not sure if both are critical
  - separate general insurance requirements from insurance supporting indemnity
  - general insurance should apply to all policies

Louisiana Law

- Louisiana Oilfield Indemnity Act ("LOIA") restricts indemnity and insurance
- LOIA only applies to contracts relating to a well
  - different analysis depending on whether onshore or offshore
  - focus is on extent of commingling of different wells

LOIA

- Voids indemnity if indemnitee is at fault
- Applies to personal injury/death, not property damage
- No insurance exception unless operator pays contractor's insurance premium under Marcel v. Placid Oil Co.
- Impact of Amoco Prod. Co. v. Lexington is unclear

Louisiana - Marcel Exception

- Party receiving insurance benefit must bear all material cost of insurance
- If Marcel applies, LOIA is inapplicable
- Unwritten "working policy" whereby contractors could factor in the cost of procuring insurance is insufficient (See Hodgen v. Forest Oil Corp.)
- Lexington Ins. Co. v. Amoco suggests that calculating premium for additional protection may be difficult

New Mexico Law

- New Mexico anti-indemnity act is similar to Texas in basic scope
  - applies to property damage claims as well as personal injury/death claims
- Very different as respects exceptions
  - no insurance exceptions

New Mexico (Cont'd)

- Reagan v. McGee Drilling Corporation made it appear that a New Mexico court would allow enforcement of an insurance exception if the Texas Act was held applicable under a choice law provision
  - court in Reagan said Texas and New Mexico had same public policy – to promote safety – and insurance exception was not against public policy

New Mexico (Cont'd)

- Texas choice of law may now be invalid
- 1999 amendment to New Mexico Act invalidates "a provision in an insurance contract indemnity agreement" naming a person as additional insured or requiring waiver of subrogation as contrary to public policy
- Wording of amendment is not completely clear

Important Insurance Issues

- Insurance requirements should dovetail with indemnity provisions
- Extend insurance protection to same parties (i.e., "Company Group")
- Insurance can provide more protection than indemnity

Basic Insurance Protections

- Waiver of subrogation
- Additional insured
- Coverage should be primary for risks assumed
  - See Hodgen v. Forest Oil Corp.
- Extend all protection to "Company Group"

Specific Insurance Pitfalls

- State that minimum limits are not a limitation or restriction on indemnity
- Include limit of $500,000 for Texas "unilateral" indemnity
- Include requirement for both parties to provide insurance or self insurance "for the benefit of the other party as indemnitee" if seeking Texas "mutual" indemnity
- Include critical maritime insurance extensions

Maritime Insurance Extensions

- Endorse maritime policies to avoid impact of limiting coverage for Company Group to liability "as owner of the vessel"
  - Lanasse v. Travelers Insurance Co.
  - Helaire v. Mobil Oil Co.
  - Texas Eastern Transmission Corp. v. McMoRan Offshore Exploration Co.
  - Gaspard v. Offshore Crane and Equipment, Inc.

Maritime Insurance Extensions (Cont'd)

- Delete any reduction in limits as respects Company Group based on contractor's right to limit liability under Limitation of Liability Act
  - Crown Zellerbach Corp. v. Ingram Industries, Inc.

Depending on Applicable Law, Insurance May Provide More Protection Than Indemnity

- Texas - Getty and Oryx
- Louisiana - consider application of Marcel
- LHWCA - insurance protection is enforceable even if indemnity is invalid under § 905(b)

Consider Using Your Own Certificate of Insurance

- Tailor the Certificate to your own requirements
- Insure that all required coverages are obtained
- Simplify administrative review of compliance
- Other form Certificates may provide only limited protection

Domestic Choice of Law Issues

- Choice of law clause generally upheld if reasonable connection unless application of chosen law would violate public policy
- Anti-indemnity statutes are based on public policy, and choice of law clause will not be enforced contrary to anti-indemnity statute
- Reverse is not true - if Louisiana law is chosen, LOIA will apply even if provisions would have been enforceable

Effect of OCSLA

- Law of the adjacent state is adopted as surrogate federal law for fixed platforms under OCSLA
- Treated as mandatory choice of law
- If OCSLA does not apply, however, there is some room for enforcement of a choice of law provision

Possible Conflict of Laws Analysis

- Roberts v. Energy Development Corp. - Louisiana rules should be used to determine enforceability of choice of law in contract for work on fixed platform in state waters. But the Texas choice of law provision was invalid as applied to a Louisiana contractor due to LOIA.
- Reagan v. McGee Drilling Corporation - Texas choice of law clause enforced by New Mexico court, despite absence of any similar exceptions under New Mexico's anti-indemnity statute, because the two states' polices were the same - to promote safety
- Reagan has apparently been overruled, but analysis might still offer some hope

Use Choice of Law that Maximizes Parties' Intent

- Particularly important in a multiple use contract
- Maritime law
- Maritime law to maximum extent permissible; then laws of _____
- Beware of effect of "laws of state where work is performed"
- Consider law applicable to "special" provisions
  - such as a Marcel or "statutory employer" provision

Conclusion

- Maximizing your contractual risk allocation:
  - comprehensive risk allocation scheme
  - understanding your existing contracts and enforceability issues
  - identifying the protections that you need and the benefits you can give afford to give
  - thread the needle through the drafting process
  - keep your contracts current