Insurance Matters!

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A Newsletter of the **Insurance and Surety Committee**
of the Real Property Probate and Trust Law Section of The Florida Bar

Scott P. Pence, Tampa
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In This Issue:

Reforming Third-Party Contracts to Create Insurance Coverage

By: Lyndon F. Bittle, Carrington, Coleman, Sloman & Blumenthal, LLC, Dallas, TX

In a case that may have implications beyond its underlying facts, the Fifth Circuit recently affirmed a district court's reformation of an oil field master services agreement, which resulted in extending coverage for indemnity payments that otherwise would not have been covered under the indemnitor's liability policy. *Richard v. Anadarko Petroleum Corp.*, 850 F.3d 701 (5th Cir. 2017). This article describes common scenarios in which insurance coverage turns on the words of a contract between the policyholder and a third party. The potential effects of alleged errors in that contract will be viewed through the lens of the *Anadarko* case and a New York case with a very different outcome.

Many liability coverage questions, particularly concerning an insurer's duty to defend, are resolved by reading two documents—the insurance policy and the underlying complaint. In Florida, Texas, and many other states, this is called the "Eight Corners Rule," although the courts differ in the in the extent to which extrinsic evidence can affect the out-

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Recent Changes to AIA Standard Form Construction Insurance Provisions

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Rarely has the American Institute of Architects in its ten-year review and revision cycles of the A201 General Conditions of the Contract made a more significant and effective change in both form and substance as it has in the 2017 revisions pertaining to insurance. By shifting the identification of various insurance coverage from Article 11 – AIA Document A201-2017 to a separate exhibit, the AIA has "raised the profile that insurance is likely to play in the contract formation process."[1] The separate exhibit facilitates drafting to keep up with changes the insurance industry makes to standard form insuring agreements. A secondary benefit is the ease of distribution each user may find in negotiating and communicating critical requirements to multiple parties at every tier to expedite contracting and construction commencement.

A201-2017 Article 11 retains general requirements for insurance. Specifically, the provisions address: "(1) a description of insurance that the contractor is required to purchase and maintain, (2) a description of the insurance that the owner is required to purchase and maintain, and (3) the details of the parties' waiver of subrogation."[2] Article 11 states the requirements of notice in case of cancellation, liability for failure to procure required coverage, and also establishes the process for allocating loss proceeds in case of a fortuitous

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event triggering coverage.[3] Many transactional attorneys experienced with the standard AIA forms already maintain insurance provisions in a separate exhibit customized for a client and for efficient revision as market changes necessitate. Many parties prefer the exhibit for its easy distribution to other construction parties in the bidding and contracting process. Early communication of coverage types and limits is critical to avoid a coverage defense arising if a contractor commenced work before insurance was bound.

The AIA's changes are not all form over substance, however. Familiar categories such as property insurance, which includes builder's risk, general liability and excess or umbrella policies, auto, workers' compensation and employers' liability, professional liability, and pollution liability still feature prominently. However, now the parties have additional options under property and general liability coverage that have typically been familiar mostly to brokers and insurers. This information will enhance the user's insight into the existence and purpose of important optional coverage. The optional coverage may prove helpful to prompt further examination of premiums, deductibles, and risk coverage or limitations.

Property Insurance

The Insurance Exhibit provides clearer and more precise prompts to determine which party is to provide the project's property coverage, the extent of coverage required, and when and if the alternate party is later required to procure coverage. Property insurance, *i.e.*, Builder's Risk , provisions makes clear that coverage is to be maintained (by the party providing it) through the date of substantial completion, as opposed to through final payment, as previously required. A specific note directs that, whether provided by the Contractor during construction or by the Owner, it is the Owner who shall continue the coverage or replace it until expiration of the warranty period. These precise directions promote better processes to help the parties avoid a failure to extend critical coverage. Also, the requirement reminds the parties to identify not only named insureds under the policy but also to list loss payees, a reminder that is especially important when the Contractor provides the coverage. The Contractor may not be aware of any specific Owner's obligation under the project financing documents to maintain certain coverage and list loss payees.

"However, now the parties have additional options under property and general liability coverage that have typically been familiar mostly to brokers and insurers."

The Insurance Exhibit provides concise direction to the party's broker, stating exactly the coverage to be procured and which perils are not to be excluded under the policy. As all Builder's Risk coverage is written in manuscript form, rather than on standard policy forms, the insured must review the policy itself carefully to ensure it has met contract requirements to provide proper coverage. The broker is on notice exactly what risks must be covered. In the past, the owner or contractor had to rely upon a knowledgeable attorney to articulate the details of such insurance to be procured.

Optional coverage under the Owner's, or Contractor's, property insurance constitutes a checklist for: loss of use, business interruption, and delay in completion; ordinance or law; expediting cost; extra expense; civil authority; ingress/egress; soft costs; and cyber security insurance. Brief descriptions of each coverage are included for the party's better understanding of the risks covered. Now, the contracting party itself is made aware of certain insurance which exists in the market to cover project risks, not just their brokers or attorneys. The better informed contracting party can ask better questions and make better business decisions. Not all the insurance options may prove affordable or appropriate but examining what coverage would apply or not apply to pay claims is a valuable exercise.

Commercial General Liability Insurance

Article 11 of A201-2017 establishes the requirements for the certificate of insurance, disclosure of deductibles and self-insured retentions, and specifically identifies the extent of additional insured coverage based upon a minimum as provided in the ISO forms (CG 20 10 07 04 and CG 20 37 07 04). Given the

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fact that the Insurance Services Office (ISO) has issued more than thirty separate additional insured endorsements, this reference to a minimum standard is helpful, particularly to the user who may be seeking risk management advice without the assistance of an attorney. Using the Exhibit, the broker may consider multiple risks that are not to be excluded such as indemnity under Section 3.18 of A201-2017, residential, sinkhole, and ultra-hazardous work. These exclusions and more to coverage (ISO has issued 100 exclusions to coverage) are now set forth in the document so that the user can direct the broker more completely as to the risks the user expects to encounter in construction. These requirements help to establish a baseline for the broker to design the insuring strategy and also protect the contracting party from overlooking these important specifics. Likewise, the extent of coverage for certain perils is articulated clearly in this section of the Exhibit.

The Exhibit makes it clear that the Contractor may meet the insurance requirements by a combination of the general liability and any excess or umbrella insurance which will follow the scope of the underlying primary general liability policy. In addition to the familiar categories mentioned earlier such as auto, workers' compensation, and the like, the exhibit specifically calls out other insurance available in the market for Jones Act and Longshore & Harbor Workers' Compensation, familiar to any party constructing improvements on or using nearby waterways to stage work; combined policies of Professional Liability and Pollution Insurance; and insurance for use of unmanned aircraft, i.e., drones.

Performance and Payment Bonds

Bond requirements for performance and payment bonds are removed from Article 11 to the Exhibit. AIA Document A312 Payment and Performance Bond remain the standard form for the surety to issue.

The comprehensive exhibit makes it easier for the drafter to edit, rather than to originate, all optional coverage which may be appropriate for any individual project. Over the next ten years, we will look forward to further changes that could improve this important standard form for our construction clients.

PRACTICE TIP: While the Insurance Exhibit is listed as one of the Contract Documents in the accompanying A101, A102, and A103, the drafter may find it helpful to include a reference to the Exhibit in A201-2017, Section 11.1.1, as a reminder to consider the Insurance Exhibit for further details as to coverage for the project. Many additional revisions may be made depending upon the details of each project.

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[1] "The American Institute of Architects' New Approach to Insurance: The 2017 Insurance Exhibit", Patrick J. O'Connor, Jr., American Bar Association Forum on Construction Law, Boston: October 2017.

[2] "Chapter 11: Article 11 Insurance and Bonds", *The 2017 A201 Deskbook*, editors Peter W. Hahn, Joseph C. Kovars, Amanda S. MacVey, American Bar Association Forum on Construction Law, Chicago, 2017.

[3] "A fortuitous event is the condition which would trigger coverage under the property policy. *Coluccio Const. Co., Inc. v King Cnty*., 150 P.3d 1147, (Wash. Ct. App. 2007). IM

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come. *See, e.g., Washington Nat'l Ins. Co. v. Ruderman,* 117 So. 3d 943 (Fla. 2013) (extrinsic evidence seldom considered); *Composite Structures, Inc. v. Continental Ins. Co.*, 560 F. App'x 861, 866 (11th Cir. 2014) (allowing extrinsic evidence of insured's conduct not referenced in the underlying complaint). There are, however, several common scenarios in which liability coverage issues require reference to other documents, such as a contract between the named insured and a third party. Such contracts need not be considered "extrinsic" evidence, as they are deemed to be incorporated by reference in the policy. Additional-insured endorsements, for example, often extend coverage to parties for which the named insured has agreed in writing to provide such coverage. *See, e.g., In re Deepwater Horizon,* 470 S.W.3d 452, 464-65 (Tex. 2015); *Travelers Prop. Cas. Co. v. Amerisure Ins. Co.,* 161 F. Supp. 3d 1133, 1136 (N.D. Fla. 2015).

Other policies extend additional-insured status to "anyone with which [the named insured has] an agreement that is an 'insured contract.'" *Gilbane Bldg. Co. v. Admiral Ins. Co.*, 664 F.3d 589, 594 (5th Cir. 2011); *King Cole Condo. Ass'n v. Mid-Continent Cas. Co.*, 21 F. Supp. 3d 1296, 1298 (S.D. Fla. 2014) (similar provision). The standard definition of "insured contract" is: That part of any other contract or agreement pertaining to your business… under which you assume the tort liability of another party to pay for "bodily injury" or "property damage" to a third party or organization. (CG 00 01 04 13)

"[T]he language of the 'other' contract is generally dispositive, when read in conjunction with the policy and the underlying complaint."

In each of these situations, the language of the "other" contract is generally dispositive, when read in conjunction with the policy and the underlying complaint. ("Twelve Corners Rule," anyone?) But what if the parties to the "other" contract insist its written terms do not accurately reflect their agreement? Can they reform the contract, even if it means an insurer must pay for defense costs or damages that would not be covered under the contract as written? This is the question addressed by the courts in *Anadarko*.

Although at its heart a coverage dispute, the primary substantive issue in *Anadarko* was the meaning and effect of a "two-part chain of contractual indemnifications." Anadarko Petroleum and Offshore Energy Services (OES) had a long-standing master services agreement (MSA), under which OES provided casing and other services for Anadarko's drilling projects and agreed to indemnify Anadarko and its indemnitees (defined as including Anadarko's subcontractors). In connection with a project on a drill ship, Anadarko indemnified other contractors, including Dolphin Drilling and Smith International. When Raylin Richard, a casing supervisor for OES on that project, was injured, he filed tort claims against all of the above. Dolphin and Smith sought indemnity from Anadarko, which in turn sought indemnity from OES. Considering itself bound to indemnify the other three companies, OES spent almost $470,000 defending the lawsuit and ultimately paid $2.5 million for a full release of all four companies.

OES sought to recover its defense costs and its $1 million policy limit from its CGL carrier, Liberty Mutual. The insurer denied coverage for OES's expenditures related to Dolphin and Smith, on the grounds they were not encompassed by OES's indemnity agreement with Anadarko. The district court granted summary judgment for Liberty, holding that Dolphin and Smith "were Anadarko's 'contractors,' which the MSC's indemnity provisions did not cover, rather than 'subcontractors,' which the MSC's indemnity provisions would cover." On OES's motion for reconsideration, the court declined to revisit its construction of the indemnity agreement as not extending to Dolphin and Smith, but permitted Anadarko and OES to reform their MSC "to reflect a mutually-intended 'knock for knock indemnity scheme that would require . . . OES to indemnify Anadarko, Smith, and Dolphin.'" Liberty was therefore required to compensate OES for its defense costs, in addition to paying the policy limits (less the deductible).

Liberty appealed, and the Fifth Circuit devoted the bulk of its opinion addressing the propriety of the reformation order. First, the court confirmed the MSC was subject to federal maritime law, which was not disputed. Under that law, parol evidence was admissible to prove a mutual mistake, and the Fifth Circuit agreed OES and Anadarko had proven "a mutual error by clear-and-convincing evidence." Because maritime law did not clearly resolve whether reformation could be granted when the interests of a third party (here, Liberty) were adversely affected, the court referred to state law to answer that question. As to which state's law was applicable, the court held there was no conflict between Texas and Louisiana law on the issue, so applied the law of its forum, Louisiana. Although Liberty argued it should be protected from reformation because it "assumed obligations based on the original contract language," it was undisputed

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that Liberty "did not study, review, or rely on the language of the [MSC] prior to issuing its policy to OES." It reversed, however, the order that Liberty pay all the defense costs, holding the policy unambiguously required it to pay only a pro-rata share of those costs. It therefore modified the judgment to require payment of $169,000 rather than $469,000.

A trial court in New York, on the other hand, recently rejected additional-insured claims in the absence of an underlying contract strictly complying with the policy requirement. *See Colony Ins. v. American Empire Surplus Lines Ins. Co.*, 2017 WL 1955274 (N.Y. Sup. May 11, 2017). The policy in that case extended additional-insured coverage to "all entities required by written contract to be included for coverage as additional insureds." Although a subcontractor on a construction project agreed to make the owner and general contractor additional insureds on its liability policy, the relevant subcontract explicitly stated it was "not valid without the Subcontractor General Conditions Version 2012–003 signed and agreed to by all parties." In response to the insurer's motion for summary judgment, the contracting parties did not submit a fully executed copy of the contract or the required General Conditions. The court granted summary judgment declaring the insurer had no duty to defend or indemnify the putative additional insureds. The court rejected the arguments that the named-insured subcontractor had admitted it entered into an agreement to make the owner and general contractor additional insureds on its policy, and that fully executed documents might still turn up in discovery. Although not technically a "reformation" case, American Empire reflects the "by-the-book" attitude with which many courts approach such issues.

Florida law on reformation of contracts is similar to the elements applied in *Anadarko*, and can be invoked to correct a mutual—but not unilateral—mistake. *See Mt. Hawley Ins. Co. v. Miami River Port Terminal, LLC*, 228 F. Supp. 1313, 1327 (S.D. Fla. 2017). Although the case involved an insurance policy rather than a third-party contract, *Miami River* is instructive on the approach to reformation. The court denied a motion to reform an insurance policy to include as a named insured an LLC that was not named in the policy on the basis that the LLC had not offered "clear and convincing evidence" to overcome the "strong presumption" that the policy as written "correctly expresses the intention of the parties." The court also noted that although the policyholders had initially requested their agent to add both the LLC and the location to their policy, they had failed to notice the omission in several succeeding policy renewals.

What, if anything, do these cases portend for other coverage disputes? In most cases, the parties to the "other" contract have divergent interests in allocating policy proceeds, and are unlikely to agree to "reform" their contract to increase coverage for one of the parties. In *Deepwater Horizon*, for example, the named insured bitterly objected to the additional insured's claim to be covered for its own negligence. As Anadarko demonstrates, however, there are circumstances where the interests of the contracting parties are aligned in pursuit of insurance recovery. *American Empire* and *Miami River*, on the other hand, reveal some of the obstacles facing any attempt to avoid the actual language of written contracts.

Contemplate this scenario: A property owner-developer regularly retains a closely aligned general contractor, and the two companies structure their relationship to include mutual indemnifications and insurance requirements. The owner creates a different entity for each project, and the form contract is modified for each project to require the contractor to include the specific owner entity as an additional insured on its liability policy. On one of the projects, an accident at a worksite injures several employees and bystanders, and a lawsuit ensues. The construction contract on this project, however, inadvertently named the wrong entity as the owner entitled to additional-insured protection. (Any business that uses a form contract for a series of different projects knows how easily such a mistake can happen.) The owner entity tenders its defense to the contractor's liability carrier, the insurer looks to the contract for this project, and it determines the insurance provision does not satisfy the additional-insured endorsement. When the insurer denies coverage of the owner entity on this ground, the owner and contractor insist the misnomer in their contract was the result of a mutual mistake, and does not accurately reflect their actual agreement. The reformation approved in *Anadarko* gives the contracting parties a mechanism by which they might be able to correct their mistake and salvage coverage that would otherwise be lost. *American Empire* and *Miami River*, establish the burden required to reform the written terms is heavy, and situations in which this equitable remedy is appropriate are rare. But in desperate circumstances, policyholders might consider it. IM

When seeking reformation, "there is a 'strong presumption' that the [document] as written 'correctly expresses the intention of the parties.'"

Committee Mission Statement

The purpose of the Insurance and Surety Committee is to educate the RPPTL Section of the Florida Bar on insurance, surety and risk management issues. The ultimate goal is to grow the Committee to the point it can seek Board Certification in Insurance and Risk Management. IM

Leadership & Subcommittees

Interested in getting involved? Contact one of the persons below:

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Schedule of Upcoming Committee Meetings

- Do you know the difference between the various forms of additional insured endorsements?
- Do you understand your ethical obligations when representing sureties and their principals?
- Do you know what a "your work" exclusion is?
- Can you describe the difference between an additional insured and a loss payee?
- Do you understand the risks to your clients if they fail to obtain a waiver of subrogation?
- Do you know the difference between "claims made" and "occurrence" based insurance policies?

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The first part of each teleconference is devoted to Committee business, followed by an insurance/surety-related CLE presentation that lasts approximately 45-50 minutes.

If you, or someone you know, might be interested in presenting at an upcoming meeting, please let us know.

Schedule of Upcoming RPPTL Section Meetings

February 22-25, 2018
Executive Council & Committee Meetings
Casa Monica Hotel
St. Augustine, FL

May 31-June 3, 2018
Executive Council Meeting & Convention
Tradewinds Island Resort on St. Pete Beach
St. Pete Beach, FL

July 25-28, 2018
Executive Council Meeting & Legislative Meeting
The Breakers
Palm Beach, FL

Mariela Malfeld
Co-Editor

If you, or someone you know, would like to submit an article for possible inclusion in a future issue of ***Insurance Matters!***, please contact Mariela Malfeld at mmalfeld@watttieder.com

We Need You!

We are in need of persons to assist in leading various subcommittees. Please contact us if you would like to become more involved.

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