

THE RED-HEADED STEPCHILD: THE CRUCIAL BUT OVERLOOKED ROLE OF INSURANCE CONTRACTS IN BUSINESS

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SPEAKER'S BIO

Damian J. Arguello is the founding partner of Colorado Insurance Law Center, a law firm dedicated to serving businesses and their lawyers in risk management and insurance matters, including coverage disputes, prospective coverage advice, contract drafting, and expert witness services. He formerly was a partner at the venerable Colorado law firm of Davis Graham & Stubbs LLP.

Before law school, Damian was the claims manager and errors & omissions claims manager for Talbot Agency, a national, top-20 insurance brokerage, where he mediated coverage disputes between policyholders and insurers, and also led the brokerage's internal risk management program. Prior to that, Damian was a multi-line adjuster for CNA Insurance Companies and Crawford & Company and a member of CNA's Claims Reengineering Team.

GOALS FOR TODAY

- Understand the relationship of insurance to other commercial contracts
- Understand how insurance interconnects with other forms of contractual risk transfer
- Identify key issues that arise with contractual insurance requirements and interplay with other contracts
- Understand certain ethics issues involved with insurance matters

BP DEEPWATER HORIZON – CAUTIONARY TALE #1

- Transocean contracted to indemnify BP for spills above the surface
- Contract required Transocean to name BP as additional insured
- Texas Supreme Court held Transocean's coverage was contingent upon the scope of indemnity
- The drilling contract's additional insured language stated that BP, "its subsidiaries and affiliated companies, co-owners, and joint venturers, if any, and their employees, officers, and agents shall be named as additional insureds in each of [Transocean's] policies, ***except Workers' Compensation for liabilities assumed by [Transocean] under the terms of this contract.***"

BP DEEPWATER HORIZON – CAUTIONARY TALE #1

- The \$750 million comma: The court rejected BP's argument that the comma placement before "workers compensation" made the "liabilities assumed by Transocean under the terms of this contract" limitation applicable only to workers compensation liabilities.
- The court instead found that Transocean's indemnification of BP's tortious conduct extended only to the liabilities assumed by Transocean in the entire drilling contract.
- Since Transocean was not obligated to provide insurance for subsurface pollution risks, BP lacked status as an "insured" under the Transocean policies.

HOTEL PURCHASE – CAUTIONARY TALE #2

- National hotel REIT purchases resort property on Sanibel Island, FL
- Sale to close on August 10, 2004
- Hurricane Charley is bearing down on the Gulf of Mexico and ultimately strikes Sanibel on August 13
- REIT's property insurer refuses to extend policies to new purchase under the circumstances
- Closing delayed until after storm passes
- Hotel suffers major damage, ultimately scuttling the deal

FACTORY PURCHASE – CAUTIONARY TALE #3

- Client is negotiating to purchase industrial property site, home to former factory
- Buyer discovers during Phase I ESA that there is active cleanup
- Seller insists that it has insurance coverage to address cleanup and policy is assignable to buyer
- Buyer's coverage counsel undertakes thorough review of policy, determines substantial problems with scope of coverage, questions assignability
- Despite intense pressure from seller, buyer withdraws

LITIGATION COUNSEL – CAUTIONARY TALE #4

- Developer hired litigation counsel to defend lawsuit by contractor
- Counsel filed compulsory counterclaims on behalf of developer
- Concerned that contractor would be unable to pay if counterclaims succeeded, developer asked counsel to review contractor's insurance policies to determine if they would cover a judgment against contractor
- Counsel opined that there was \$2-\$4 million in coverage
- Counsel withdrew, and new counsel demonstrated the lack of coverage for counterclaims
- Developer sued first counsel, obtained \$2.7M judgment against counsel plus \$1.6M prejudgment interest, partially affirmed on appeal

WHAT IS INSURANCE?

FORMS OF RISK MANAGEMENT

- Avoidance
- Retention
- Contractual Risk Transfer
 - Identify risk being transferred
 - Identify risk recipient
 - Specify means of addressing transferred risks

CONTRACTUAL TRANSFER TOOLS

- Indemnity, defense, hold harmless provisions
 - Distinction among the three?
- Insurance requirements
 - Purpose: Assure financial viability for retained risks

INSURANCE COVERAGE REQUIREMENTS

PURPOSES OF INSURANCE REQUIREMENTS

- Tactical Considerations
 - Motivate party's behavior proactively
 - Enable recourse if event occurs

TYPES OF INSURANCE TYPICALLY ADDRESSED

- General Liability
- Workers Compensation
- Excess Liability/Umbrella
- Commercial Auto
- Commercial Property
- Builders Risk
- Professional Liability
- Pollution
- D&O Liability
- EPLI
- Cyber
- Fidelity/Crime
- Key Person

TYPES OF CONTRACTS WITH INSURANCE COVERAGE REQUIREMENTS

- Leases
- Master Service Agreements
- Construction Contracts
- Distributor Agreements
- Shipping Agreements
- Equipment Rental Agreements
- Car Leases
- Licensing Agreements
- Purchase & Sale/M&A Agreements

CONSIDERATIONS

- Practical Considerations
 - Allow time to fully consider implications and work with clients, brokers, and other attorneys
 - Is the assumption of risk equitable and practicable?
 - Understand what is insurable generally and for the other party
 - Unrealistic provisions are likely unenforceable

CONSIDERATIONS

- Legal?
 - Are the requirements compliant with statutes or regulations?
 - Example: common interest community property manager requirements
 - Required to carry E&O insurance, crime insurance
 - Do the requirements violate statutes or regulations?
 - Anti-indemnity statutes
 - Choice/conflict of laws issues

STRATEGIES FOR DRAFTING INSURANCE COVERAGE REQUIREMENTS

- How stringent or lenient should they be
 - Too stringent, insurers will object, premiums rise, contract prices rise
 - Too lenient, coverage gaps, unintentional risk retention
- Specifying Levels of Coverage/Degree of Risk Retained
 - Limits
 - Deductibles, coinsurance, periods of restoration
- Consequences of Noncompliance
 - Material breach
 - Force-placed insurance

STRATEGIES, CONT'D

- Acceptability of insurers
 - Financial strength and size
 - Reputation for paying claims
- Self-Insurance
 - Verification of financial stability
 - Contingencies
- Two approaches to insurance requirements
 - Specifying risk exposures to be insured
 - Specifying the type of policies to be purchased ***and maintained***

INDEMNITY AGREEMENTS

PURPOSES OF INDEMNITY PROVISIONS

- Specify who assumes risk
- Streamline defense, reduce litigation costs
- Do indemnity obligations and insurance coordinate (belt and suspenders) or are they separate?
 - This decision is sometimes driven by policy language

KEY CONSIDERATIONS

- Anti-Indemnity Statutes
- Which Documents Control the Additional Insured Determination?
- Waiver of Subrogation v. Additional Insured Status
- Which is primary – indemnity agreement or insurance?

ANTI-INDEMNITY STATUTES

- Limit ability to transfer indemnity for own negligence
- Many states have them
- Apply to construction and energy contracts, transportation, healthcare
- Affect ability to transfer liability through insurance
- Absent statute, transfer narrowly construed, must be unequivocal
- Statutes may not apply to additional insured status, need to check

COLORADO ANTI-INDEMNITY STATUTE

- C.R.S. § 13-21-111.5(6)
- “Any provision in a construction agreement that requires a person to indemnify, insure, or defend in litigation another person against liability for damage arising out of death or bodily injury to persons or damage to property caused by the negligence or fault of the indemnitee or any third party under the control or supervision of the indemnitee is void as against public policy and unenforceable.” C.R.S. § 13-21-111.5(b)
- “This subsection (6) does not apply to contract clauses that require the indemnitor to purchase, maintain, and carry insurance covering the acts or omissions of the indemnitor, nor shall it apply to contract provisions that require the indemnitor to name the indemnitee as an additional insured on the indemnitor's policy of insurance, but only to the extent that such additional insured coverage provides coverage to the indemnitee for liability due to the acts or omissions of the indemnitor. Any provision in a construction agreement that requires the purchase of additional insured coverage for damage arising out of death or bodily injury to persons or damage to property from any acts or omissions that are not caused by the negligence or fault of the party providing such additional insured coverage is void as against public policy.” C.R.S. § 13-21-111.5 (d)(I)

SUCCESSORSHIP ISSUES

- *Henkel Corp. v. Hartford Accident and Indemnity Co.*
 - Rejected traditional chose in action
 - Launched a wave of insurer litigation
- *Fluor Corp. v. Superior Court*
 - Overruled *Henkel* on narrow ground but with broad public policy rationale
 - Won't end the debate
 - Lesson – provide for clear and narrowly tailored transfers of liability and insurance benefits
- Colorado – Still Chose in Action but not settled
 - *Parrish Chiropractic Centers, P.C. v. Progressive Cas. Ins. Co.*, 874 P.2d 1049 (Colo. 1994) (general rule that assignments of post-loss benefits are enforceable, but public policy in favor of freedom of contract and health insurer's right to deal only with the party with whom it contracted outweigh general rule).
 - *But see Rooftop Restoration, Inc. v. Ohio Sec. Ins. Co.*, 15-CV-00620-LTB-KTM, 2015 WL 9185679, at *3 (D. Colo. Dec. 17, 2015) (enforcing assignment of property policy's post-loss benefits to roofing contractor and because "(1) post-loss assignments of the benefits due under the policy are viewed as transfers of a chose in action and public policy favors the free alienability of choses in action, and (2) such assignments would not materially increase the insurer's risk or obligation under the policy.")

ETHICAL CONSIDERATIONS

- Do the requirements violate the attorney's ethical obligations?

Example: Contract requires party to provide certificate of insurance stating that insurer will provide 30 days' advance notice of cancellation when certificate boilerplate says only that insurer will give notice in accordance with policy provisions, which don't obligate insurer to give notice to certificate-holders. State regulations prohibit insurance producers from misrepresenting policy provisions.

Issue: Can an attorney ethically require a certificate that induces a regulatory violation?

GENERAL CONSIDERATIONS

- Insurance requirements should be:
 - Clear
 - Use current terminology
 - Reflect common industry practices

TERMS SHOULD BE CLEAR

- Make the requirements concise and simple
- Specify the scope of protection to cover the primary risks involved
- Specify who is to be insured and for what
- Organize the requirements logically
- Use terminology commonly understood in insurance industry and in the subject industry

CURRENT TERMINOLOGY – OUTDATED CGL TERMS

- Comprehensive general liability
- Public liability insurance
- Manufacturers and contractors (M&C) liability insurance
- Owners, landlords, and tenants liability insurance (OL&T)
- Contractual liability insurance
- Additional named insured
- Coinsured
- Cross-liability endorsement
- Broad form property damage endorsement
- Combined single limit

INDUSTRY PRACTICES – EXAMPLE

- Property managers for common-interest communities traditionally required the community to carry CGL insurance and add the manager as an insured
 - In fact current ISO CGL forms make the property manager an automatic additional insured
- However, with increasingly larger and more sophisticated property managers managing properties, many contracts require the opposite: the manager provides CGL coverage and community is additional insured
 - May depend on the size, sophistication of parties

CERTIFICATES OF INSURANCE

VERIFYING COMPLIANCE

- Various ways to verify initial compliance
 - Certificates of insurance/evidence of property insurance
 - Copies of additional insured endorsements
 - Copies of policies

VERIFYING COMPLIANCE

- Consider verifying ongoing compliance in multi-year contracts
 - Must provide certificates/endorsements/policies annually
 - Loss runs to verify limits not impaired
 - Right to revisit requirements or audit policies

VERIFYING COMPLIANCE: CERTIFICATES OF INSURANCE

- Certificates of insurance
 - Does not create or alter coverage in policies
 - Merely a temporally limited “snapshot” representation by agent or broker
 - Many courts have declined to find justifiable reliance when cert holder has access to actual policy (ability, but failure, to ask for it)
 - Note, agent/broker legal status often murky
 - May be agent of insurer, policyholder, dual agent

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CERTIFICATES OF INSURANCE

AUTOMOBILE LIABILITY <input type="checkbox"/> ANY AUTO <input type="checkbox"/> OWNED AUTOS ONLY <input type="checkbox"/> HIRED AUTOS ONLY <input type="checkbox"/> SCHEDULED AUTOS <input type="checkbox"/> NON-OWNED AUTOS ONLY								COMBINED SINGLE LIMIT (Ea accident) \$ BODILY INJURY (Per person) \$ BODILY INJURY (Per accident) \$ PROPERTY DAMAGE (Per accident) \$ \$
<input type="checkbox"/> UMBRELLA LIAB <input type="checkbox"/> EXCESS LIAB <input type="checkbox"/> OCCUR <input type="checkbox"/> CLAIMS-MADE DED RETENTION \$								EACH OCCURRENCE \$ AGGREGATE \$ \$
WORKERS COMPENSATION AND EMPLOYERS' LIABILITY ANY PROPRIETOR/PARTNER/EXECUTIVE OFFICER/MEMBER EXCLUDED? <input type="checkbox"/> Y / <input type="checkbox"/> N / A (Mandatory in NH) If yes, describe under DESCRIPTION OF OPERATIONS below								<input type="checkbox"/> PER STATUTE <input type="checkbox"/> OTHER E.L. EACH ACCIDENT \$ E.L. DISEASE - EA EMPLOYEE \$ E.L. DISEASE - POLICY LIMIT \$
DESCRIPTION OF OPERATIONS / LOCATIONS / VEHICLES (ACORD 101, Additional Remarks Schedule, may be attached if more space is required)								
CERTIFICATE HOLDER					CANCELLATION			
					SHOULD ANY OF THE ABOVE DESCRIBED POLICIES BE CANCELLED BEFORE THE EXPIRATION DATE THEREOF, NOTICE WILL BE DELIVERED IN ACCORDANCE WITH THE POLICY PROVISIONS.			
					AUTHORIZED REPRESENTATIVE			

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ADDITIONAL INSURED STATUS

WHAT IS AI STATUS?

- Form of contractual risk transfer
- Require other “subordinate” party to contract to name requesting party as an additional insured under subordinate party’s insurance
- Force subordinate party’s insurer to bear primary risk of loss
- Preserve requesting party’s insurance and reduce insurance costs

PROBLEMS FOR SUBORDINATE PARTY

- Could be insuring the requesting party's sole negligence (but consider anti-indemnity statutes)
- Insured claims could be only tangentially connected to subordinate party's operations, resulting in disproportionate risk transfer
- Dilution of subordinate party's limits
- Increased insurance costs

REQUIRED INSURANCE VS. ADDITIONAL INSURED COVERAGE

- Merely requiring subordinate/opposing party to carry insurance does not automatically equate to additional insured coverage
 - Language unequivocally requiring additional insured coverage usually necessary
- Certain policies are not amenable to additional insured coverage
 - Professional
 - Workers compensation

NOTICE OF CANCELLATION/LAPSE

- Many contracts purport to require insurer or subordinate party to provide notice to additional insured of cancellation, lapse, erosion of limits, etc.
 - Insurers generally not bound by contract provisions
 - Imprudent to rely on these provisions to extent they purport to bind insurer
 - As with certificates, burden remains on additional insured to monitor to ensure coverage viable

INSURANCE AGENT/BROKER ISSUES



LAW OF AGENCY – INTRODUCTION

- Unique nature of American agency system
 - Federalism: State-by-state variations
 - Agent/broker distinction
 - Dual agency
 - Singular “producer” – C.R.S. 10-2-401(1)
- Serving two masters (at least)
 - Duties to stakeholders
 - Conflicts of interest

LAW OF AGENCY

- Agency: Voluntary legal relationship where one party represents another
 - Agent & principal
 - Who is the principal?
- Common agency relationships
 - Employee/employer
 - Attorney/client

CAUSES OF E&O LOSSES

- Product changes
 - Constantly changing coverage forms and endorsements
 - New products, e.g., rep & warranty insurance
 - Wide variation among carriers offering types of coverages, e.g., D&O, cyber
 - Insufficient training on new developments
 - Lack of mentorship
 - Non-use of available tools, e.g., checklists

LEGAL STATUS OF PRODUCERS

- Changing client relationships
 - Order-taker vs. special relationship of entrustment
 - In Colorado, default is order-taker unless there is special relationship
- Law determining what constitutes special relationship unclear
 - Compensation beyond commissions
 - Contract with client
 - Making coverage decisions for client

STANDARD OF CARE

- Contractual duties to insurers
 - Traditional distinction between agent and broker
 - Does not apply in Colorado – generic term “producer”
 - Duties to insurer determined by contract
 - Duties to insured can have various sources

“DEEMER” STATUTE – C.R.S. § 10-2-401(1)

“Every insurance producer who solicits or negotiates an application for insurance of any kind on behalf of an insurer shall be regarded as representing the insurer and not the insured or any beneficiary of the insured in any controversy between the insurer and such insured or beneficiary.”

STANDARD OF CARE

- Types of authority under agency contracts
 - Express authority
 - Binding, timeframe for transmitting info, premium collection
 - Implied
 - Generally arises from express authority
 - Implied from circumstances – e.g., certificates
- Apparent – conduct implies person has authority and other person relies on that apparent authority

STANDARD OF CARE

- Duty of care to client when no contract
 - In Colorado – unless there is a special relationship of entrustment, agent's duty is limited to procuring the coverage requested by insured or informing the insured that s/he is unable to do so
 - What is a special relationship of entrustment?
 - No bright-line test
 - Various factors courts weigh

SPECIAL RELATIONSHIP

- Is there a difference between order taker and special relationship of entrustment?
- *Bayly Martin & Fay* – If producer agrees to procure requested coverage s/he must obtain it or notify insured of inability to do so
- Coverage must be generally available in the industry and to insured

SPECIAL RELATIONSHIP

- *Kaercher v. Sater*: Agent has no affirmative duty to advise or warn customer of provisions contained in insurance policy
- Special relationship depends on “entrustment” – whether broker assumes additional responsibilities beyond of an “ordinary, reasonable agent possessing normal competencies and skills”
- *Sewell v. Great N. Ins. Co.*: generic website marketing statements not actually relied upon are insufficient; there must be evidence the broker “undertook to comprehensively advise [insured] concerning their insurance coverage needs”

SPECIAL RELATIONSHIP

“Even when an agent represents that he or she is knowledgeable about insurance coverages, and regularly in the course of his or her business, informs, counsels, and advises customers about their insurance needs, the agent does not incur duties beyond those of the standard policyholder-insurance agent relationship. Thus, in most circumstances, an insurance agent does not have a duty to advise of additional and available insurance coverages suitable for the customer's needs.” *Apodaca v. Allstate*

MORE ETHICAL ISSUES

- Ethical obligation to “stay in your lane”
 - “In all professional functions a lawyer should be competent, prompt and diligent.” Colo. R. Prof. Conduct Preamble.
 - “A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.” Colo. R. Prof. Conduct 1.1.
 - An attorney owes a client the duty to anticipate reasonably foreseeable risks. *Boulders at Escalante LLC v. Otten Johnson Robinson Neff and Ragonetti PC*, 412 P.3d 751, 760 (Colo. App. 2015) (aff’g liability for erroneous coverage opinion).

CONCLUSIONS

- Insurance provisions require specialized knowledge, lead time, and teamwork
- Required provisions, additional insured status, indemnity agreements, certificates of insurance are separate issues requiring coordination
- Need to monitor a constantly changing landscape
- Cannot rely solely on insurance brokers, even really good ones