CRISIS MANAGEMENT IN THE GAS PATCH (PART 3): ADDITIONAL INSURED COVERAGE

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Oil & Gas and Insurance Coverage Alert

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In a challenging business climate, such as when oil and gas are selling at low prices, exploration and production companies are not only increasingly selective with their drilling programs and capital expenditures, but are also taking measures to limit unnecessary expenses and protect critical investments through insurance and other cost-recovery mechanisms. Among these measures, companies need to consider advanced preparation to minimize costs in the event of a crisis, such as a well blowout, which may jeopardize valuable revenue streams and lead to significant costs incurred to bring a well under control and to ensure regulatory compliance.

This alert is the third in a series (*see* Part 1 and Part 2) addressing various legal issues that exploration and production companies should carefully consider with respect to crisis management practices in a challenging market environment. This alert focuses on common issues related to additional insured coverage.

An "additional insured" is an entity that is added to an existing insurance policy by operation of contract or at the request of the policyholder. In the oil and gas context, a common scenario in which this arises is where, for example, an exploration and production (or "E&P") company enters into a master services agreement (or "MSA") with a service provider, which provides that that provider will indemnify the E&P company for certain losses or risks. As part of that contract, oftentimes, the E&P company will also require that it be added as an additional insured to the service provider's insurance policies, usually (but not always, as further discussed below) as a financial backstop for certain indemnity obligations in the MSA.

In adding an E&P company as an additional insured to a service provider's insurance policies, care should be taken in: (i) the language of the additional insured provisions of the insurance policy, (ii) the language of the MSA, and (iii) the parties' intent in how those two should intersect. In this alert, we discuss these three considerations, as well as some important drafting considerations for both E&P companies and service providers alike.

BECOMING AN ADDITIONAL INSURED

In either being added as an additional insured or adding a business partner as an additional insured, it is important to understand the insurance policy's language as it relates to how an additional insured must be added and the scope of the coverage provided by the insurance policy.

One important initial consideration is knowing the type of additional insured language in the service provider's insurance policies. Some policies have an "automatic" or "blanket" provision, such that simply entering into an MSA in which the service provider agrees to add the E&P company to its policies will be sufficient.[1] Other policies have an "express" provision, which would affirmatively require the service provider to name the E&P company on an additional insured endorsement to the policy for the E&P company to be properly covered as an additional insured.[2] Therefore, for both the E&P company and service provider, it is important to know what kind of additional insured language is in the policy, so that the E&P company can be properly added.

POLICY LANGUAGE AND SCOPE OF COVERAGE

All additional insured coverage is not created equal. Particularly for the E&P company that might be added as an additional insured, it is important to understand the scope of the policy that it may look to for protection. For example, some policies provide coverage for the additional insured's own acts, while others only provide coverage for the named policyholder's acts for which an additional insured may be vicariously liable. This is a potentially critical distinction, as the indemnity language in many MSAs provides indemnification for risks and losses that may cover independent acts of the E&P company. To then reduce the scope of the insurance that may back the indemnity and limit it to instances of vicarious liability could provide illusory protection for significant risks.

Additionally, differences in the scope of coverage are not always apparent to those unfamiliar with how courts have interpreted various policy forms. For example, several courts, including the U.S. Court of Appeals for the Tenth Circuit, have held that a policy covering an additional insured's liability "arising out of" operations performed for the additional insured by or on behalf of the named policyholder includes liability arising out of the additional insured's own negligence.[3] In contrast, courts interpreting additional insured coverage where the policy covered the additional insured's liability "because of" the policyholder's actions have held that any liability attributable to the additional insured's own negligence is not covered.[4]

In other words, whether the policy has "arising out of" or "because of" language may impact whether the policy may or may not provide coverage for situations where the E&P company has been alleged to have been negligent. Careful attention should be paid to not only the policy language, but also to how courts have interpreted different policies, including in the jurisdictions where the policy is placed and whose law is likely to govern.

THE MSA

In addition to the policy, parties should understand and make clear in the MSA at issue various aspects of insurance for which the E&P company may be named as an additional insured. These include the following.

Limits. MSAs providing for additional insured coverage should include a provision identifying the minimum acceptable coverage limits that are to be available to the additional insured. Limits should be specifically referred to as minimum limits (e.g., "at least $5,000,000") to facilitate maximum available coverage. Many policies provide that additional insured limits are the lesser of the policy limits or limits agreed to under contract. Attention should also be paid to the mechanism by which limits are eroded. In some cases, for example, losses paid on behalf of the policyholder or other additional insureds may erode the available limits, providing fewer dollars for the E&P company to access.

Retentions. Contracting parties are also advised to pay attention to and specify in their MSAs the value and treatment of any deductibles or self-insured retentions. Important considerations include: (i) how high is the retention and (ii) who bears the responsibility for covering the retention? A large retention can significantly reduce the value of additional insured coverage. And while a service provider may be willing to specify that it will bear the burden of satisfying any self-insured retentions, this may not be satisfactory if the service provider is a small vendor with insufficient assets.

Proof of Coverage. Parties seeking additional insured coverage under an MSA should seek a copy of the policy, at minimum a copy of the additional insured endorsement, as evidence that the contracted-for coverage has been issued. Certificates of insurance ("COI") issued by insurance agents or brokers are often provided to contracting parties as proof of additional insured coverage, in lieu of providing copies of the actual insurance policies. COIs, however, generally do not provide sufficient information to the additional insured for the optimal pursuit of a claim. An additional insured may lack information on critical terms of the policy, such as notice and reporting obligations, scope of coverage, and any exclusions. Further, in the event of a coverage dispute, an additional insured with only a COI may face a challenge to the existence of coverage in the first instance.[5] Thus, access to the policy is critical to protect an additional insured's rights in the event of a potentially covered incident. Failure to comply with policy conditions, e.g., a requirement that the insurer be notified immediately of a potential claim, may diminish or eliminate an additional insured's potential recovery. An additional insured without access to the policy is at the mercy of the diligence — or lack thereof — of the policyholder.

INTERACTION OF THE INSURANCE POLICY AND THE MSA

The scope of additional insured coverage can also be affected by the terms of commercial contracts. Oftentimes, parties view additional insurance obligations as simply providing the financial backing to satisfy the indemnity obligations in the MSA. However, on other occasions, the contracting parties intend that the indemnity obligations be separate from the additional insurance obligations; in other words, even if a loss may not be covered under the scope of the MSA's indemnification provisions, there may be coverage as an additional insured for the loss.

Some additional insured forms explicitly make this connection and require that the policy's scope be limited to the MSA's indemnification obligations. ISO Policy Form No. CG 20 10 04 13 provides:

> If coverage provided to the additional insured is required by a contract or agreement, the insurance afforded to such additional insured will not be broader than that which you are required by the contract or agreement to provide for such additional insured.

Even without explicit policy language, apparent conflicts between contractual indemnities and the scope of additional insured coverage under an insurance policy can drastically alter the scope of available coverage. Perhaps no case better illustrates this danger than the Texas Supreme Court's 2015 decision in *In re Deepwater Horizon*.

In *In re Deepwater Horizon*, the Texas Supreme Court held that a commercial contract between Transocean, the policyholder, and BP, the additional insured, affected the scope of additional insured coverage available to BP.[6] Transocean and BP entered into a drilling contract whereby Transocean agreed to add BP as additional insureds to its insurance policies "for liabilities assumed by [Transocean] under the terms" of the drilling contract.[7] The drilling contract also stated that Transocean would indemnify BP for pollution above the surface of the water and that BP would indemnify Transocean for all other pollution risks.[8]

The insurance policies at-issue were of the automatic type, extending additional insured coverage to parties to whom Transocean was "obliged by oral or written [contract] . . . to provide insurance."[9] BP sought coverage as an additional insured under Transocean's policies for subsurface pollution and the insurers resisted.[10] The Texas Supreme Court held that the policy language, by reference to outside contracts, necessitated "consulting the drilling contract to determine BP's status as an additional insured"; that "the only reasonable construction of the drilling contract's additional-insured provision is that BP's status as an additional insured is limited to the liabilities that Transocean assumed in the drilling contract"; and that as a result BP was not entitled to coverage for damages arising from subsurface pollution.[11]

Careful drafting of commercial contracts to keep indemnity and insurance obligations separate can help avoid scope of coverage issues like those discussed in *In re Deepwater Horizon*.[12] In *Getty Oil Co. v. Ins. Co. of N. Am.*, for example, the commercial contract included separate indemnity and insurance obligations.

> All insurance coverages carried by Seller, whether or nor required hereby, shall extend to and protect Purchaser . . . to the full amount of such coverages . . . Seller shall indemnify, defend and hold harmless Purchaser ... from any and all losses . . . or other damages . . . arising out of or incident to the performance of the terms of this Order by Seller. . . .Seller shall not be held responsible for any losses . . . or other damages, directly, solely, and proximately caused by the negligence of Purchaser. Insurance covering this indemnity agreement shall be provided by Seller. The liability of Seller, as herein above provided, shall not be limited by the insurance coverage required of Seller.[13]

The additional insured was found solely liable for an accident that killed a contractor, and the insurer denied coverage.[14] The *Getty Oil* court disagreed, finding that the contract's insurance requirement was separate and independent from the indemnity provision.[15]

DRAFTING TIPS

When drafting an MSA, the parties should attempt to ensure that the language furthers the contracting parties' intent of the scope of protection. Some tips include:

- From the perspective of the E&P company, define limits of coverage as minimums to ensure maximum available coverage.
- Define retentions and deductibles, including maximum amounts of such retentions and who bears the responsibility for paying them.
- Include a right for the additional insured to obtain copies of the insurance policy (as opposed to simply COIs).
- If intended by the parties, ensure that indemnity and additional insured obligations are separate and independent from one another.
- Review the language of the additional insured coverage form to determine whether, in the context of governing caselaw, the additional insured coverage will fulfill the parties' expectations on items such as

the E&P company's own negligence and the mechanics of how the E&P company will be added to the policy (or even mandating the type of policy form in the MSA).

CONCLUSION

Additional insured coverage can be a valuable source of recovery in the event of a well control or other crisis incident. Involvement of counsel with insurance coverage experience to review and negotiate the MSA and insurance requirements at an early stage can help maximize the value of this important source of potential cost recovery if an incident occurs.

Notes:

[1] The following is a typical example of an automatic policy:

> Who is an insured is amended to include as an additional insured any person or organization for whom you are performing operations when you and such person or organization have agreed in writing in a contract or agreement that such person or organization be added as an additional insured on your policy.

See ISO Policy Form No. CG 20 33 04 13.

[2] *See, e.g.*, ISO Policy Form No. CG 20 10 04 13.

[3] *See, e.g.*, McIntosh v. Scottsdale Ins. Co., 992 F.2d 251 (10th Cir. 1993) (Kansas law); *accord* Mid-Continent Cas. Co. v. Swift Energy Co., 206 F.3d 487, 498 (5th Cir. 2000) (Texas law); Markel Int'l Ins. Co. v. Centex Homes, LLC, No. CIV. 05-3540 (GEB), 2006 WL 278920, at *4 (D.N.J. Feb. 2, 2006) (New Jersey law); Roy Anderson Corp. v. Transcon. Ins. Co., 358 F. Supp. 2d 553, 562 (S.D. Miss. 2005) (Mississippi law).

[4] *See, e.g.*,Huber Engineered Woods, LLC v. Canal Ins. Co., 700 S.E.2d 220, 221 (N.C. 2010); Garcia v. Fed. Ins. Co., 969 So. 2d 288, 291 (Fla. 2007); Transp. Ins. Co. v. George E. Failing Co., A Div. of Azcon, 691 S.W.2d 71, 73 (Tex. App. 1985); Long Island Lighting Co. v. Hartford Acc. & Indem. Co., 350 N.Y.S.2d 967, 973 (N.Y. Sup. Ct. 1973).

[5] *See* Am. Hardware Mut. Ins. Co. v. BIM, Inc., 885 F.2d 132, 139 (4th Cir. 1989) ("[A] certificate insurance is not a contract of insurance but is merely the evidence that a contract has been issued, and . . . the validity of any certificate actually provided therefore is conditioned upon the issuance and existence of a policy.") (quoting in part 13A Appleman, insurance law and practice § 7530, at 19 (rev. ed. 1985 & supp. 1987) (quotations omitted).

[6] 470 S.W.3d 452, 455 (Tex. 2015).

[7] *Id.* at 457.

[8] *Id.* at 456.

[9] *Id.* at 457.

[10] *Id.* at 456.

[11] *Id.* at 455–56.

[12] *See id.* at 468.

[13] 845 S.W.2d 794, 797 (Tex. 1992).

[14] *See id.* at 798.

[15] *See id.* at 804; *see also* Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc., 256 S.W.3d 660, 670 (Tex. 2008) (refusing to limit additional insured coverage based upon the indemnity language of a commercial contract where the insurance and indemnity provisions were "separate and independent").

