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Eighth Circuit Court Holds that London Market Cannot Rely on Inferred Warranty Terms Not Included in Ocean Marine Policy

In a unanimous panel opinion, the United States Court of Appeals for the Eighth Circuit held that Lloyd's underwriters and other London market insurers cannot rely on survey warranty terms never expressly written into an ocean marine cargo insurance policy drafted and issued by the lead London underwriter and a London broker. The decision in ***Assicurazioni Generali S.P.A. v. Black & Veatch Corp.***, 362 F.3d 1108 (8th Cir. 2004) affirmed the District Court's application of Missouri law to the London-issued policy, and the District Court's holding that the unambiguous terms of the ocean marine cargo insurance policy prevail over allegedly conflicting extrinsic evidence concerning which shipments of equipment were subject to the policy's survey warranty provision.

BACKGROUND

MEP Pleasant Hill, LLC ("MEP") contracted with Black & Veatch Corporation ("Black & Veatch") to design, procure equipment for and build a combined cycle power plant near Pleasant Hill, Missouri known as the Aries project (the "Aries Project"). Black & Veatch subcontracted with Toshiba International Corporation ("Toshiba") to manufacture heat recovery steam generators ("HRSGs") for the Aries Project. *See id.* at 1110.

A syndicate of underwriters at Lloyd's of London ("London Underwriters") issued an ocean marine cargo insurance policy (the "Ocean Marine Policy") to Black & Veatch in November 1999 that established a facility (i.e., a framework) for coverage. Under the facility, two types of coverage were available up to a limit of $150 million. Section I of the Ocean Marine Policy made available coverage for physical loss or damage for the transport of equipment, machinery, supplies and materials. Black & Veatch was able to obtain such coverage merely by making a declaration of a particular ocean marine shipment (including making a declaration after a shipment had already left). *See id.*

Section II of the Ocean Marine Policy made available consequential loss coverage for delay-in-start-up losses and for expenditures incurred to avoid or mitigate such losses. However, Black & Veatch was only able to obtain Section II coverage in conjunction with Section I coverage and by endorsing a particular project to the Ocean Marine Policy if London Underwriters accepted the risk for that project. In the event of endorsement, the Ocean Marine Policy had a survey warranty provision that gave London Underwriters the right to manage the Section II risk by requiring a pre-shipment survey of "critical items." The Ocean Marine Policy did not define "critical items" but did reference that such survey warranty applied "in respect of the items listed below" and had a section which stated "List of Items: (If necessary to be listed on a separate schedule)." *See id.* On at least one prior occasion when Black & Veatch endorsed a particular project to a predecessor ocean marine cargo insurance policy, the London Underwriters specifically identified the particular shipments of "critical items" for that project.

Effective April 18, 2000, London Underwriters endorsed the Aries Project and added MEP as an

insured to the Ocean Marine Policy for both Section I and Section II coverage (the "Endorsement"). The Endorsement did not specifically identify any "critical items" and London Underwriters did not attach to the Ocean Marine Policy or provide to Black & Veatch or MEP a list of "critical items." *See id.* at 1111. The Endorsement did contain a "Rating Indication Sheet" on which Black & Veatch answered several questions asked by the London Underwriters. Two of those questions and answers referenced the HRSGs, stating:

> 4. Supervision surveys required on critical items at both loading/discharge – details to be agreed once shipping schedule confirmed – costs for B&V's account.
>
> We can arrange for these if required. Currently they are not required per our subcontracts. Only two subcontracts are shipping overseas: Toshiba from Japan HRSG and STG, BFPs and possibly motors from Europe.
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> 6. Rating indication is on the basis that the total value of Cargo (DIC) does not exceed US$50,000,000.
>
> Total value of all components may be larger tha[n] 50 million, but individually is less. Largest component is 24 million for HRSG which is made up of 10 separate shipments.

Id. at 1112.

In July 2000, Toshiba shipped components of the HRSGs from Japan without obtaining a pre-shipment survey. On July 24, 2000, those components were damaged in a typhoon off the coast of Japan. Toshiba's ocean marine insurance carrier agreed to cover the physical damage to the HRSGs and Toshiba agreed to remanufacture those components at no cost to MEP or Black & Veatch. However, Toshiba informed Black & Veatch that there would be a six-month delay in delivering the remanufactured components and thus a corresponding delay in completing the HRSGs. Black & Veatch in turn informed MEP that there would be a six-month delay to the Aries Project but advised that Black & Veatch could mitigate that delay by changing the construction sequencing and employing additional labor and supervision at a cost of $38 million. *See id.* at 1111. Black & Veatch completed the Aries Project without a delay in start-up, and MEP and Black & Veatch together incurred costs in excess of $20 million in doing so.

Black & Veatch and MEP, as named insureds, both made claims under Section II of the Ocean Marine Policy for the mitigation costs incurred in avoiding the delay in start-up. The London Underwriters denied those claims, asserting that the HRSGs were "critical items" that required a pre-shipment survey. London Underwriters then filed a lawsuit against Black & Veatch and MEP in the United States District Court for the Western District of Missouri seeking a declaration that the Ocean Marine Policy did not provide delay-in-start-up coverage for the damage to the HRSGs because Black & Veatch did not obtain a pre-shipment survey. MEP and Black & Veatch both filed counterclaims seeking a declaration of coverage. MEP also filed a counterclaim for breach of the Ocean Marine Policy and sought damages.

Following discovery, the London Underwriters filed a motion for summary judgment seeking a declaration of no coverage. MEP and Black & Veatch filed cross-motions for partial summary judgment seeking a declaration of coverage. The trial court denied the London Underwriters' motion for summary judgment and granted the cross-motions for summary judgment filed by MEP and Black & Veatch, holding that the Ocean Marine Policy was unambiguous and did not require a pre-shipment survey of the HRSGs. *See id.*

THE EIGHTH CIRCUIT'S DECISION

On appeal, the Eighth Circuit affirmed the decision of the trial court. The Eighth Circuit began by affirming the long-standing rule of *Wilburn Boat Co. v. Fireman's Fund Insurance Co.*, 348 U.S. 310, 316-21 (1955) that marine insurance policies are governed by state law, unless an established federal admiralty rule addresses the specific issue in dispute. On this basis, the Eighth Circuit concluded that Missouri law applied to the Ocean Marine Policy's survey warranty provision. *See Assicurazioni*, 362 F.3d at 1111.

The London Underwriters first argued that a list of critical items referencing the HRSGs that was contained in a proposed endorsement that was never added to Ocean Marine Policy demonstrated that the HRSGs were intended to be "critical items" under the Ocean Marine Policy. The Eighth Circuit rejected that argument, holding that the Ocean Marine Policy unambiguously stated that a survey is only required for equipment shown in "the list of items" described in

the Survey Warranty Wording, and no such wording was actually included in the policy. *See id.* at 1112.

London Underwriters also argued that the Endorsement demonstrated that the HRSGs were critical items because the answers provided by Black & Veatch referenced the HRSGs and demonstrated that the HRSGs were the most expensive equipment being shipped by ocean transport. The Eighth Circuit held that the Endorsement did not contain a list of "critical items." In particular, the Eighth Circuit held that nothing in the questions and answers appended to the Endorsement indicated that London Underwriters or Black & Veatch had agreed that surveys would be required. In fact, one of the responses indicated that Black & Veatch could obtain surveys "if required." The Eighth Circuit held that this response "put the onus on [London] Underwriters to gain agreement to a list of critical items if the Underwriters wished to oblige Black & Veatch under the terms of the policy to conduct a survey on particular 'items listed below'".... *Id.* at 1112-13.

The London Underwriters further argued that a post-lost endorsement retroactively confirmed that the HRSGs were "critical items." The Eighth Circuit rejected this argument, holding that, as a matter of law, a post-loss endorsement is insufficient to create a list of items that had not been created as of the date of the loss. The Eighth Circuit also stated that the post-lost endorsement was not supported by consideration because it would purport to eliminate coverage for claims worth millions of dollars without the payment of any consideration to the policyholders. *See id.* at 1113-15.

The London Underwriters also argued that a series of communications between London Underwriters, the London broker and MEP and Black & Veatch, including letters and e-mails, clearly demonstrated that the HRSGs were critical items requiring a pre-shipment survey. In fact, London Underwriters also argued that, because they were not power plant contractors, it was the responsibility of MEP and Black & Veatch, rather than the London Underwriters, to designate the "critical items" for the Aries Project. The Eighth Circuit rejected this argument, citing and relying on the testimony of the London Underwriters' own representative, that the insured was required to identify those items of equipment that may be critical but that it was London Underwriters' responsibility "to say these are critical, these are not critical." *Id.* at 1113, n. 2.

The Eighth Circuit also expressly rejected this "extrinsic evidence" argument in favor of time-honored rules from Missouri and other states, which provide that, where the language of an insurance policy is clear and unambiguous, that language controls and, if a different result were sought, then the insurer should have effected such a result by amending, altering or drafting different language in its policy. In the absence of such different language, the insurance policy should be enforced according to its unambiguous terms.

Finally, the Eighth Circuit noted the importance of these long-standing rules in the law of insurance, admonishing the professed resentment by which London Underwriters attacked the positions of MEP and Black & Veatch, stating:

> The Underwriters express great frustration that [MEP & Black and Veatch] must have known that the HRSGs were "critical items," given the value and importance of the HRSGs to the Aries project, and the contemporaneous statements and actions of certain employees of [MEP & Black and Veatch]. They characterize Appellees' contractual arguments as the afterthoughts of clever lawyers seeking to avoid what everyone knew or assumed about the status of the damaged cargo. The enforcement of contracts according to their unambiguous terms, however, serves an important purpose in the law. When the parties establish a clear mechanism for determining rights and obligations, lawyers and judges should not thereafter search through and interpret copious e-mail exchanges and deposition transcripts in an effort to discern whether the parties might really have intended that which they failed to articulate in the written agreement.
>
> Where an agreement is clear, the parties are entitled to rely on an expectation that it will be enforced as written. In this case, we cannot gainsay the possibility that if the Underwriters had caused the HRSGs to be designated as critical items in an endorsement before the shipment occurred, then perhaps the Appellees would have taken special note of that formal designation and been influenced to ensure that a survey was undertaken. We need not speculate about such things, because the rules were spelled out clearly in the policy, and for whatever reason, the Underwriters did not take steps to ensure that a list of critical items was included in the policy before they assumed the risk of insurance.

Id. at 1116-17.

CONCLUSION

The decision in ***Assicurazioni*** is of significance because it confirms the long-standing rule that an insurer is obligated to incorporate all intended terms and to eliminate ambiguities in the policy before accepting the risk of insurance. The decision is also of significance to owners, contractors and others involved in the construction industry because it prohibits an insurer from changing the unambiguous terms of an insurance policy by using: (i) extrinsic evidence that purports to demonstrate an intent differing from that found in the plain language of the policy; and (ii) an unbargained-for post-loss endorsement that would eliminate valuable coverage. Accordingly, policyholders are provided additional assurance that pre-policy and post-policy communications, as well as post-loss communications, with either their insurer or broker will not be permitted to alter the clear language in an insurance policy or dictate a different allocation of risk.

Joseph L. Luciana, III
jluciana@klng.com
412.355.8982

Charles E. McChesney, II
cmcchesney@klng.com
412.355.6449

MEP was represented by the Construction & Engineering practice of Kirkpatrick & Lockhart Nicholson Graham LLP. If you have any questions about this Alert or K&LNG, please contact the authors or one of the following members of our Construction & Engineering practice:

International Contact	John R. Dingess	412.355.6564	jdingess@klng.com
Boston	Mark E. Haddad	617.261.3116	mhaddad@klng.com
Dallas	Paul E. Ridley	214.939.4905	pridley@klng.com
Harrisburg	Carleton O. Strouss	717.231.4503	cstrouss@klng.com
	Andrew L. Swope	717.231.4512	aswope@klng.com
London	Kevin Greene	44.0.20.7360.8188	kgreene@klng.com
	James Hudson	44.0.20.7360.8150	jhudson@klng.com
	David Race	44.0.20.7360.8106	drace@klng.com
Los Angeles	Paul W. Sweeney, Jr.	310.552.5055	psweeney@kl.com
Miami	Robert B. Galt, III	305.539.3311	rgalt@klng.com
Newark	Anthony P. La Rocco	973.848.4014	alarocco@klng.com
New York	Michael R. Gordon	212.536.4855	mgordon@klng.com
Pittsburgh	George P. Foster	412.355.6709	gfoster@klng.com
	Richard F. Paciaroni	412.355.6767	rpaciaroni@klng.com
San Francisco	Jonathan M. Cohen	415.249.1029	jcohen@klng.com
	Edward P. Sangster	415.249.1028	esangster@klng.com
Washington	David T. Case	202.778.9084	dcase@klng.com

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