New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 160—NO. 20
MONDAY, JULY 30, 2018

Insurance Law

Expert Analysis

Procurement Provisions: What to Leave In, What to Leave Out

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Parties to commercial lease agreements and construction contracts often attempt to allocate the risk of losses through insurance. Typically, owners will require lessors and contractors to purchase insurance naming them as additional insureds on liability policies.

Owners and other entities such as general contractors seeking this coverage are often referred to as "upstream" parties, and those that owe the obligation are called "downstream" parties.

While upstream and downstream parties frequently have differing perspectives on risk transfer, once the parties have come to terms, it is in everyone's interest, including the parties' insurers, that the insurance procurement provision be clear and unambiguous.

Drafting precise, definite contract wording will optimize meeting parties' expectations, maximize additional insured (AI) coverage and minimize the possibility of a breach.

This discussion will first review how untangling poorly worded insurance procurement provisions has divided high courts, then examine the interdependence of these provisions with AI coverage and, finally, address how these provisions have recently evolved to become more comprehensive and sophisticated in response to developments in case law and changes in insurance forms.

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Interpretation

While it may seem obvious, there must be an expressed and specific requirement that the downstream party buy insurance providing the upstream party with AI coverage in order for risk transfer to work.

However, procurement provision wording varies widely, and the courts have struggled with what constitutes a clear requirement.

For example, in *Calvin v. Kassis*, 12 N.Y.2d 595 (2009), the Court of Appeals, in reversing the Fourth Department, found the following wording a "natural and intended" expression of a procurement requirement: "[contractor] at its sole cost and expense and for the mutual benefit of [owner] and Tenant, shall maintain a general liability policy … providing coverage against claims for bodily injury, personal injury and property damage with specified aggregate and per occurrence coverage amounts."

More recently, the Court of Appeals considered whether another, and arguably more confounding, procurement provision required AI be purchased in *Strauss Painting v. Mt. Hawley Ins. Co.*, 24 N.Y.3d 578 (2014).

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In *Strauss*, a trade agreement required a downstream contactor to buy various lines of coverage including the following: Workers' Compensation insurance; an Owners and Contractors Protective liability policy (OCP) with $5 million in limits; and CGL with $5 million in limits which might be met with an umbrella policy. Another paragraph stated "[l]iability should add [the owner] as an additional insured and should include contractual liability and completed operations coverage." Yet another

paragraph required the contractor to furnish the owner with the OCP policy and certificates for the Workers Compensation, CGL and excess policies prior to the commencement of the work.

The court was divided as to whether AI was required.

The majority and dissent agreed that there was no ambiguity in the wording but came to different conclusions.

The majority held that there was no AI requirement and that the reference to adding the owner as an AI could only refer to the OCP coverage. However, the dissent found that an AI obligation existed because "there is simply no other way to read it."

As noted by the dissent, the sentence beginning "[l]iability should add the owner as an additional insured" was "awkwardly phrased and infelicitously placed" within the insurance requirement.

In addition, an emerging line of cases addresses recurring incomplete wording requiring the downstream party to provide a certificate evidencing AI but failing to include any language requiring that AI coverage actually be purchased.[1] Even when procurement provisions are not missing operative wording, awkwardly phrased or infelicitously placed within the contract, other challenges can also arise when insurance policies refer back to these provisions.

Additional Insured Coverage

To fulfill insurance procurement obligations, downstream parties will typically buy liability policies with AI endorsements. These endorsements usually amend the "Who is an Insured" policy definition to include the upstream party either by name written into a schedule or by blanket wording which refers to a lease or contract AI requirement.

Blanket AI wording varies but generally amends the policy's definition of "Who is an Insured" to include "any person or organization for whom you are performing operations when you and such person have agreed in writing in a contract or agreement that such person or organization be added as an additional insured on your policy and … any other person you are required to add as an additional insured under the contract…." *See for example*, ISO CG20 38 04 13.

Because the downstream party's insurer is not a party to the trade contract or lease agreement, the insurer will not be bound by contract insurance requirement except where the insurance policy refers to the contract, as in blanket AI endorsements.

> Using clear, definite wording can increase the likelihood that downstream insurers will effectuate the parties' intent to maximize coverage, minimize breaches and help avoid litigation.

This dynamic between putative AI upstream parties and downstream insurers who are not in privity is at the heart of many declaratory judgment lawsuits involving procurement provisions and blanket AI endorsements.

Ambiguity

Generally, courts determining coverage will not consider extrinsic evidence such as the trade contract, certificates of insurance, the parties' expectations or underwriting pricing practices where the policy does not reference the trade contract and the policy is unambiguous. However, just as with procurement provisions, with AI endorsements whether wording is ambiguous can be a close call.

For example, in *Gilbane Bldg. Co./ TDX Constr. Corp. v. St. Paul Fire & Mar. Ins. Co.*, 31 N.Y.3d 131 (2018) the nature of an AI endorsement reference to a procurement provision recently divided the Court of Appeals.

In *Gilbane*, there was no dispute that the named insured was required to purchase AI coverage.

However, the parties, and ultimately the justices, disagreed as to whether the following blanket AI wording was ambiguous: "WHO IS AN INSURED (Section II) is amended to include as an insured any person or organization with whom you have agreed to add as an additional insured by written contract but only with respect to liability arising out of your operations or premises owned by or rented to you."

The majority found the wording contained a privity requirement between the named insured and the putative additional insured and, thus, no AI coverage was triggered.

Nevertheless, writing for a two-justice dissent, Justice Stein opined that, because the endorsement was subject to more than one reasonable interpretation, it was ambiguous. Specifically, the endorsement could be interpreted to have a privity requirement but also to mean that a written contract was merely a condition precedent to coverage.

Moreover, Justice Stein opined that the trade contract was not extrinsic evidence unnecessary to interpret the policy language but, instead, demon-

strated compliance with a condition of coverage. Therefore, the trade contract insurance requirement "cannot simply be discarded into the extrinsic evidence bin."

As *Gilbane* demonstrates, risk transfer can also be foiled by equivocal language in AI endorsements which reference procurement provisions.

New Requirements

Basic provisions have traditionally included requirements as to limits and lines of coverage such as CGL, automobile and pollution. Similarly, contracts have often required that the downstream party provide evidence of AI coverage through certificates or copies of the policies and ISO (Insurance Services Office) AI forms ideally before the work begins, and again upon renewal.

However, parties have adapted procurement provisions in response to their experience with obstacles to risk transfer, changing insurance forms and evolving case law. As a result, procurement wording has become increasingly comprehensive and sophisticated.

For example, provisions now commonly address priority of coverage, requiring that AI be primary and noncontributory in response to case law upholding downstream insurers' horizontal exhaustion positions.

Similarly, many provisions will reference preferred ISO AI endorsements, waiver of subrogation or cross claims and the duration of the AI obligation beyond the completion of the work into the completed operations period. In addition, such provisions now frequently specify what constitutes acceptable use of deductibles or self-insured retentions (SIRs) and forbid deviations from standard ISO exclusion wording on downstream parties' policies.

In addition, newer ISO 04 13 AI forms increasingly refer to the terms of the underlying procurement provision as to breadth and limit of coverage. This has prompted some upstream parties to change procurement requirements to include not only AI limits in specified amounts, but also wording such as "or the full breadth and limit of [the downstream parties'] policy whichever is greater."

Moreover, language will need to continue to evolve with the changing legal landscape. For example, by recent count, 15 states, either by statute or common law, have deemed unenforceable procurement provisions that require AI to cover risks otherwise barred by the jurisdiction's anti-indemnity statute. Although this trend has not reached New York, parties doing work in multiple jurisdictions will have to adjust accordingly.

Remedy

The remedy for breach of contract to purchase insurance in New York and various other jurisdictions is limited to "out of pocket expenses" where the upstream party has bought its own insurance coverage, i.e., the purchase cost of the insurance procured for itself, the premiums, and any additional costs as deductibles, co-payments and increased future premium. While some parties have attempted to craft contract wording to expand the remedy to all ensuing damages, case law provides little guidance on whether this is enforceable.

Nonetheless, higher SIRs and deductibles are making damages increasingly expensive. Moreover, such damages are typically not covered by a CGL policy pursuant to the contractual liability exclusion, thereby making breach an undesired outcome.

Conclusion

As this discussion has underscored, risk transfer through AI coverage starts with the procurement provision.

Using clear, definite wording can increase the likelihood that downstream insurers will effectuate the parties' intent to maximize coverage, minimize breaches and help avoid the costs of litigating coverage lawsuits.

In contrast to AI policy wording, which courts have noted is generally not negotiable, insurance procurement provisions are more often, but not always, negotiable.[2] However, pressures, deadlines and commitments to get the work started, too often result in ineffectively crafted procurement provisions.

As these provisions continue to change and grow, the importance of precise, definite syntax and grammar will be more important than ever.

1. *QBE Ins. Corp. v. Adjo Constr. Corp.*, 121 A.D.3d 1064 (2d Dept. 2014); *Christ the King Regional High School v. Zurich Ins. Co. of N. Am.*, 91 A.D.3d 806 (2d Dept. 2012); lv. to appeal denied, 19 N.Y.3d 806 (2012).

2. "Little bargaining, if any, is involved in insurance contracting and the insurer controls the drafting process." *Vivify Constr. v. Nautilus Ins.* Co., 94 N.E. 281 (Ill. 1st Dist. 2018).