Strategic Insurance Considerations for Energy Company Policyholders

Large energy corporations are complex organizations engaged in a host of diverse operations. In-house counsel must be prepared to handle a broad variety of legal issues, sometimes in areas where they may have practical experience but not detailed subject matter expertise. This is the first in a series of seven articles discussing how these corporate policyholders go about addressing the sophisticated sorts of insurance problems arising from their corporate activities, and what outside counsel can learn and do to assist them most effectively. This series is based on a paper supporting a panel discussion presented at the 14th Annual Advanced Insurance Law Symposium in San Antonio in June, 2017. The panel included Keith Calcote, Associate General Counsel, Litigation, Motiva Enterprises, Eric S. Eissenstat, Senior Vice-President, General Counsel, Chief Risk Officer and Secretary, Continental Resources Incorporated, Ingram Lee III, Senior Counsel, Anadarko Petroleum Corporation, Ernest Martin, Jr., Haynes and Boone, and Robert M. "Randy" Roach, Jr., Roach & Newton, L.L.P. The panel discussion was moderated by John D. Sullivan of Roach & Newton, L.L.P.

PART 1 OF 7:

IDENTIFYING WHETHER THERE IS AN INSURED LOSS OR CLAIM

Step One can be more difficult than it seems: identifying whether coverage may be available for a particular claim or loss. Unlike simpler businesses, large energy corporations usually possess a deep and wide portfolio of insurance covering a myriad of risks. On the other hand, these corporations often retain significant risk by carrying extremely high deductibles or self-retentions that must be exhausted before insurance comes into play, and claims-handling may be handled under an arrangement that simply passes through the total administrative and indemnity costs directly to the corporation.

The first challenge, then, is to review and understand the issues raised by a particular loss or claim, compare those issues to the inventory of insurance policies, and determine which if any coverage(s) may apply. At that early stage, counsel should also assess what law governs the policy interpretation, and in some instances whether less-than-obvious coverage might nonetheless apply.

A. Inventory potentially applicable policies / coverages to match-up with facts presented

Insurance typically is distinguished as "first party" and "third party" coverage. In first-party insurance coverage, the insured is covered for its own loss; in third party insurance coverage, the insured is covered for liability to another for their loss. *Warrilow v. Norrell*, 791 S.W.2d 515, 527, n.2 (Tex.App.- Corpus Christi 1989, writ denied)(opinion on rehearing).

The Texas Supreme Court has described the difference in first and third party coverage as follows:

> We distinguish first-party and third-party claims based on the claimant's relationship to the loss. '[A] first-party claim is stated when "an insured seeks recovery for the insured's own loss," whereas a third-party claim is stated when "an insured seeks coverage for injuries to a third party."
> *Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc*., 256 S.W.3d 660, 674 -675 (Tex. 2008), *citing Lamar Homes, Inc. v. Mid–Continent Cas. Co.*, 242 S.W.3d 1, 17 (Tex. 2007).

1. Standard insurance for third party liability claims

Complex corporations typically carry a host of general and more specialized policies covering a variety of potential liabilities to third parties. Depending on the nature and size of a claim, however, deductibles / self-retentions may minimize the utility of the coverage in a particular instance. The third-party liability policies often include:

Commercial General Liability

Excess / Umbrella policies, often in multiple layers or "towers" issued by different insurers and differing over sequential years

Employment Practices Liability Insurance (EPLI), sometimes including Sexual Misconduct

Directors & Officers (D&O)

Fiduciary / Employee Benefit Liability Policy (ERISA liabilities)

Errors & Omissions (E&O, professional liability / malpractice)

Workers Compensation

2. Direct loss to policyholder

First party property insurance for corporate policyholders typically requires extensive documentation of assets, usually accompanied with schedules listing properties and declared values. Corporations also may hold insurance to protect against loss of revenues when a loss results in a period of business decline of shutdown. Specific policies may also be issued to cover risks involved in particular projects, especially for construction. These first-party policies often include:

Policyholder-owned property loss (1st party property)

Business Interruption (BI) / Loss of Profits (LOPI)

Construction All-Risk / Builder's Risk

3. Specialized coverages

Worldwide and integrated operations require a host of coverages not often encountered by smaller corporations. Energy companies consequently may carry a number of policies with specialized coverage. Some of these may include:

Cyber loss or liability

New type of coverage, multiple forms, manuscripted (customized) rather than standard form, little precedent

Energy Package, typically comprising some or all of:

Onshore / Offshore property loss / property damage;
Operator's Extra Expense (OEE) providing well blowout, well control, redrilling & restoration, and associated pollution cleanup;
Excess liability;
Oil Spill Financial Responsibility; and
Loss of Profits

Hull (vessel loss) / Protection & Indemnity ("P&I", covering maritime liabilities, including Jones Act)

Cargo loss and liabilities
Warehouse / Bailee

Boiler & Machinery

Crime, Theft & Fraud coverage

Pollution cleanup and/or liability

B. Choice of Law

Counsel should make an initial determination what law applies to the particular policy(ies) that potentially apply to a loss or claim.

In the insurance context it is not particularly unusual for the insurer and policyholder to reside in different states or even different countries, and the accident or loss precipitating a claim for insurance coverage may have occurred in or be closely related to a third location. In those circumstances, what law should be applied to determine the intent of the parties in their insurance contract or to determine the standards for obligations and responsibilities of each?

Insurance law may differ significantly from state to state on particular issues, so the ultimate outcome may well depend on what law governs the insurance policy. The determination of applicable state law cannot be underestimated as a significant factor - - indeed, potentially the single most decisive factor - - in resolving the substantive question of insurance coverage. Even early issues like the policyholder's satisfaction of obligations to provide notification to the insurer may be determined by the law that applies.

Given the host of policies and widespread operations of the corporate energy policyholder, it may not be simple to determine governing law. And different policies may be governed by different

law(s).

1. Most Significant Relationship Test & Restatement

Ever since the decision of the Texas Supreme Court in *Duncan v. Cessna Aircraft Co.*, 665 S.W.2d 414, 421 (Tex. 1984), contractual choice of law questions in this state have been governed by reference to the "most significant relationship" standard set forth in the Restatement (Second) of Conflicts of Laws (hereinafter "Restatement"). Likewise, federal courts in diversity jurisdiction also must apply this Texas choice of law rule where applicable to determine what law governs a contract. *Klaxon v. Stentor Electric Mfg. Co.*, 313 U.S. 487, 61 S.Ct. 1020, 85 L. Ed. 1477 (1941).

In practice, the project of applying these Restatement standards is extremely fact-intensive and each element must be weighed with reference to the specific dispute and contacts involved in the particular case. The relationship between the contacts and the policy factors must be determined on a case by case basis. *See Maxus Exploration Co. v. Moran Bros., Inc*., 817 S.W.2d 50, 53 (Tex. 1991); *Minnesota Min. and Mfg. Co. v. Nishika Ltd.*, 953 S.W.2d 733, 735-37 (Tex. 1997). Under this approach, the law governing an insurance policy will focus not on where the accident happened or where the loss occurred or where a lawsuit was filed against the insured; rather, the inquiry will focus on the indices of contract negotiation, formation, and issuance by the insurer to the policyholder.

But two predicates must be considered before applying the Restatement factors to determine Texas's "substantial relationship" to the issue presented in a choice-of-law question: (a) whether the parties have expressly chosen the law to be applied to their contract. *Duncan v. Cessna*, at 421 and (b) whether a statute of the forum state applies which resolves the issue. *Hefner v. Republic Indem.Co. of America*, 773 F.Supp. 11, 12 (S.D. Tex. 1991).

Texas generally will honor a contractual choice of law provision in an insurance policy, that bears a reasonable relationship to the parties or risk, and does not conflict with a fundamental public policy of Texas. *See DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670 (Tex. 1990) cert. denied, 498 U.S. 1048, 111 S.Ct. 755, 112 L.Ed.2d 775 (1991); see also TEX. BUS. & COM. CODE ANN. § 1.105(a); and also Restatement at §187, Law of the State Chosen by the Parties.

TEX.INS.CODE, Art. 21.42, Texas Law Governs Policies, constitutes a "statutory directive" under Restatement § 6(1), thus trumping the significant relationship test where it is applicable. Article 21.42 has existed with essentially unchanged wording for almost a century, being enacted originally in 1903 as an antidote to the virtually automatic application of the then-prevailing "lex loci contractus" rule favoring out-of-state insurers to the detriment of Texas residents. The statute's application to a "citizen or inhabitant of Texas" has been interpreted, however, to refer only to corporations actually incorporated in Texas, even if the corporation also is headquartered or has substantial operations in Texas. *See Reddy Ice Corp. v. Travelers Lloyds Ins. Co.*, 145 S.W.3d 337, 340 (Tex.App.- Houston [14th Dist.] 2004, pet. denied).

Finally, it is not unusual for some policies - - particular for upper level or specialized risks - - to include not only choice of law but also arbitration or venue provisions. These can be especially challenging where multiple policies may apply (as with sequential layers of excess policies across a period of time), but each has its own unique requirements of applicable law, venue or arbitration.

C. Coverage not always obvious

Counsel may need to exercise a certain amount of creativity and diligence in determining whether insurance may apply to a particular claim or loss, and should resist what "everybody says" is a restricted scope of coverage. While insurers typically balk at paying beyond a traditional, established framework, Texas jurisprudence is replete with example where a persistent policyholder prevailed against conventional wisdom, where coverage was not necessarily obvious. For a few random examples:

1. In *Lamar Homes Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007), the policyholder successfully persuaded the Court - - over a vigorous dissent by some Justices - - that the standard CGL insuring agreement is not limited to tort actions but can include contractual liability from deficiently performing a contract.
2. In *Don's Building Supply, Inc. v. OneBeacon Ins. Co.*, 267 S.W.3d 20 (Tex. 2008), the Court determined that CGL coverage is triggered by "injury in fact" and not by when the damage became evident, so that multiple policies might apply where multiple injuries occurred over a period of time.
3. The Court applied a similar approach in *Zurich Am. Ins. Co. v. Nokia, Inc*., 268 S.W.3d 487, 490 (Tex. 2008) in concluding that cellular level biological injuries from use of policyholder's cell phone product, as alleged in pleadings, potentially stated a claim for bodily injuries under the policies, much like the subclinical injuries alleged by plaintiffs who have been exposed to asbestos.
4. In *Excess Underwriters v. Frank's Casing Crew & Rental Tools, Inc*., 246 S.W.3d 42, 47 (Tex. 2008), the Court refused to allow an insurer to apply equitable subrogation against its insured by seeking reimbursement of settlement payments made to third party claimant.
5. The Court clarified its prior precedents in *In Re Deepwater Horizon*, 470 S.W.3d 452 (Tex. 2015), allowing consideration of contractual limits on additional insured status where the wording of the direct policyholder's insurance policy referenced the underlying contract obligations to establish the scope of coverage.
6. In *McGinnes Indus. Maint. Corp. v. Phoenix Ins. Co.*, 477 S.W.3d 786 (Tex. 2016) the Court determined that the insurer's obligation to defend a "suit" under standard CGL provision includes EPA enforcement proceedings issued to the policyholder.
7. Most recently, in *USAA Tex. Lloyds Co. v. Menchaca*, No. 14-0721, 2017 WL 1311752, __ S.W.3d __ (Tex. Apr. 7, 2017), the Court clarified the "substantial confusion" caused by its prior precedents, and held that damages consisting of policy benefits may result from and be recoverable under a statutory cause of action for bad faith without requirement for separate, independent damages.

In the second article in this series we will discuss proper notification of occurence-claim-suit-loss.