COMMERCIAL LIABILITY INSURANCE FOR THE ENERGY INDUSTRY

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Commercial Liability Insurance for the Energy Industry

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Introduction

This course—Commercial Liability Insurance for Energy Industry Professionals—is one of the core curriculum courses leading to the Energy Risk and Insurance Specialist (ERIS) certification. The ERIS program is a specialized curriculum focusing on the insurance and risk management needs of the energy industry projects and companies involved with those projects.

This course will examine each of the three coverage parts of the commercial general liability (CGL) policy—bodily injury and property damage (Coverage A), personal and advertising injury (Coverage B), and medical payments (Coverage C)—including the insuring agreement and exclusions. Although energy industry companies may avail themselves of the coverage provided under all of the coverage parts, the most significant coverage section for operators, drilling contractors, oilfield service contractors, consultants, independent contractors, and for most other business entities in the energy industry, is Coverage A—"bodily injury and property damage." Consequently, that section of the policy receives the most emphasis in this course. After a careful review of the basic policy's coverage parts, key policy provisions and conditions are examined, such as who is an insured, limits of insurance, and notice requirements. Various endorsements that can be attached to the policy to broaden or restrict the scope of coverage or otherwise alter the basic policy terms and conditions are reviewed. The course concludes with a brief discussion of umbrella liability insurance for energy industry companies.

Learning Objectives

Students who successfully complete this course will be able to:

- identify the major categories of insurable liability risk faced by energy industry companies and explain how each is covered by the standard CGL policy;
- differentiate the two coverage triggers used in CGL insurance policies and explain how each trigger defines what policy will apply to specific liability insurance;
- define and give examples of: (1) "bodily injury" and (2) "property damage" and differentiate "bodily injury" from "personal injury";
- analyze the scope of the CGL exclusions, such as contractual liability, pollution, professional services, and underground resources and equipment, and explain how claims may be covered *despite* the exclusions;
- explain the significance of "insured" status to the availability of coverage under a standard CGL policy and differentiate between a *named insured*, an *automatic insured*, and an *additional insured* under the standard CGL policy;
- explain the insurance protections afforded to energy industry companies by use of a waiver of subrogation endorsement, additional insured endorsements, and by making the coverage provided to the additional insured "primary and noncontributory"; and
- explain the function of umbrella liability insurance, contrast the coverage available under a typical umbrella policy with that of a standard CGL policy, and illustrate the major ways in which an oil industry limitation endorsement alters the coverage of an umbrella policy.

Chapter 1
Liability Risks and Insurance Overview

Learning Objectives
In this chapter, you will learn how to… 1. Identify the parties involved in oil and gas exploration and recognize their legal and contractual relationships with one another. 2. Identify the major categories of insurable liability risk faced by energy industry companies. 3. Identify the types of protection that general liability insurance provides. 4. Recognize the types of losses addressed by each of the CGL policy's coverages. 5. Define various terms used in the CGL and the energy industry; accurately associate terms used in the CGL and in the energy industry with their appropriate meanings. 6. Identify the elements of a CGL policy and recognize what provisions are found in each of the elements. 7. Outline a process for determining whether a given insurance policy covers a particular loss.

General liability insurance provides protection against two types of financial loss arising out of a lawsuit against the company. First, it covers damages awarded to a third party because of injury or damage for which the insured is legally responsible, including loss of use of property claims. In addition, it covers the cost of defending the insured against the charges alleged in the suit, including attorney fees, investigation costs, and other legal expenses. Defense costs can amount to huge sums even when the insured is cleared of any legal liability for damages. Together, the indemnity (payment of damages on the insured's behalf) and defense (payment of legal expenses) obligations comprise the insurer's key contractual promises to the insured.

Liability loss exposures arise out of legal wrongs. The three broad classes of legal wrongs are crime, breach of contract, and tort, each being addressed by a different branch of the law. General liability insurance concerns itself with tort liability. Tort law protects the rights of individuals from civil wrongs and generally provides monetary remedies to tort victims. In some instances, a criminal act may give rise to civil as well as criminal liability, with monetary awards as remedies. For example, while fraud is punishable under criminal law, the individual victims may also be permitted to sue for monetary damages, such as restitution of losses and even non-economic damages such as punitive damages or emotional distress. Whether liabilities involving criminal activities such as negligent supervision are covered by general liability insurance often comes down to whether the insured had knowledge of the criminal actions and intent.

In addition to common law, contractual agreements also create legal duties, such as an agreement to perform in a certain manner, to complete a project in a specified length of time, to deliver a quality product, or to assume responsibility for liabilities that legally fall on another contracting party. Any violation or breach of a contractual agreement is a civil (as opposed to a criminal) wrong, with an award of monetary damages as a potential remedy. Many breach of contract claims are confined to allegations of financial or business loss that are not of a type that are covered under a general liability policy. For example, liability based on the failure to perform the contracted work is usually not insurable. Other contractual liabilities—including the assumption of the other party's legal liability to a third person or organization—are often covered.

Introduction: The Unique Nature of Oil and Gas Operations

It is important to understand the unique nature of oil and gas operations, since it affects the way general liability insurance responds to loss exposures. Therefore, we begin this course with a brief discussion of some significant features present in the energy industry that have an impact on risk allocation and coverage under general liability insurance. As an initial matter, oil and gas operations present the possibility of catastrophic loss, and the risk profile of the energy industry is measured by severity, not frequency. The British Petroleum (BP) oil spill provides a good example of the industry's risk profile. BP was the operator of the Deepwater Horizon rig and the contractor, Transocean, was drilling for oil at the Macondo exploratory well in the Gulf of Mexico. On April 10, 2010, high-pressure methane gas from the Macondo well expanded into the drilling riser and rose into the drilling rig, where it ignited and exploded, engulfing the drilling platform. The explosion resulted in 11 fatalities and 17 injuries to drilling crew members.

The Deepwater Horizon oil rig sank 36 hours after the explosion, and a sea-floor oil gusher (blowout) flowed for 87 days, resulting in the largest marine oil spill in the history of the petroleum industry. 205.8 million gallons of oil leaked from the Macondo well into the Gulf of Mexico. To put this in perspective, this figure represents about half of the amount of oil the U.S. imports each day. By comparison, 10.8 million gallons of oil spilled from the Exxon Valdez in 1989. It is estimated that 62,000 barrels of oil leaked each day when the wellhead first broke, a figure that is approximately equal to the amount of oil consumed daily in the state of Delaware. 665 miles of coastline were contaminated by oil. 16,000 total miles of coastline have been affected by the spill, including the coasts of Texas, Louisiana, Mississippi, Alabama, and Florida. Of Louisiana's 400 miles of coast, approximately 125 miles have been polluted by the oil spill. Over 8,000 animals, such as birds, turtles, marine mammals, fish, and crustaceans, many of which were endangered species, were reported dead just 6 months after the spill. These are sobering facts that illustrate the catastrophic loss that can result from oil and gas operations.

Oil and gas operations involve multiple employers, multiple employees, and expensive property, usually located at a common job site. For example, the process of drilling a well involves several parties such as the operator, the drilling contractor, the mud logging company, the well service contractor, as well as other consultants and contractors. These parties use contracts to define their obligations. Contracts are also used to allocate the high degree of risk associated with oil and gas operations. Mineral leases, leases for equipment, drilling contracts, master service agreements, joint operating agreements, surface use agreements, well site consulting agreements, work orders and credit agreements, and purchase and sale agreements contain indemnity provisions which require one of the parties (the indemnitor) to indemnify the other party (the indemnitee). These contracts also require insurance coverage to support the indemnity obligations. Consequently, oil and gas operations involve a high degree of contractual liability that is not always present in other industries.

Indemnity provisions are discussed in greater detail later in this course. Nevertheless, it is worth mentioning that risk allocation in oil and gas operations works differently than risk allocation in other industries. Indemnity provisions in many industries, such as construction, seek to allocate risk from an upstream party (e.g., the project owner) to a downstream party (e.g., the general contractor, who, in turn, allocates the risk downstream to its subcontractors). When bodily injury or property damage arises in oil and gas operations, it is often the result of a confluence of errors committed by multiple people, multiple companies, or both, and it is often factually or scientifically difficult to determine who was to blame and in what proportions. As a result, under certain oil and gas contracts, risk is typically allocated based on "ownership" of personnel and property, as opposed to fault. However, allocation of risk does not always follow ownership of property. In some cases, the operator contractually assumes liability for property that it does not own. For example, the downstream oil and gas contractor typically does not hold responsibility for well control. In most instances the operator (upstream) holds that responsibility unless it is excepted in the daywork or footage setting or in the turnkey setting, and then only when the turnkey rate is being used. So the operator is responsible for coordination of the control of well exposure even after well completion and production. Under some contracts, an operator or drilling contractor, may allocate risk to a downstream party such as a subcontractor. In sum, contractually assumed liabilities in energy industry contracts do not always follow the upstream to downstream pattern found in construction and other contracts.

Finally, insurance plays a key role in oil and gas risk allocation programs, not only to support a party's indemnity obligations, but also because of the high degree of risk inherent in oil and gas operations. Some of the most important insurance protections that general liability insurance provides to energy industry companies include waivers of subrogation, additional insured endorsements, and ensuring that coverage for additional insureds is “primary and noncontributory.” These protections are discussed in greater detail in this course. That is not to imply, however, that other portions of general liability insurance are immaterial to energy industry liability exposures. Although oil and gas operations have a high degree of risk, general liability insurance plays an important role in an energy industry company’s risk management program.

Energy Industry Liability Exposures

The insurance industry broadly categorizes general liability loss exposures into four groups. Premises and operations liability encompasses liability arising out of conditions in and around the insured’s premises as well as its current on and off premises business operations. Products and completed operations liability refers to just that—liability arising out of the insured’s products or its completed work. This contemporaneous grouping of exposures—those that are based on current activities and generally in close proximity to the insured and those that arise out of past activities and are remote in both time and distance from the insured—reflects the different risks and challenges these exposures present for insurers. Contractual liability involves the voluntary assumption of obligations that do not exist under common law, and independent contractor liability describes liability imposed upon the person who hires an independent contractor to perform work on its behalf. Energy industry professionals face significant liability exposures in each of these four categories.

Premises and Operations Risks

Premises and operational risks in the energy industry are significant and include fire, explosions, blowouts, pipe failure, cratering, sour gas releases, abnormally pressured formations, and environmental hazards such as oil spills, gas leaks, ruptures and discharges of toxic gasses. These are just a few of the liability exposures that energy industry companies face on every project they undertake and these exposures could result in injury or loss of life of employees and nonemployees. These also may cause severe damage to, or destruction of property, equipment, and natural resources, pollution or other environmental damage, as well as suspension of operations resulting in business interruption costs. When these damages can be attributed to an energy industry company’s negligence, or another source of legal liability, the energy industry company is responsible for damages that occur. (In most instances, injuries to employees do not present general liability exposures because of the exclusive remedy of workers compensation. Where exclusive remedy cannot be circumvented, the workers compensation and employers liability policy will apply, not the general liability policy.) In some cases, the energy industry company may be liable when someone else’s negligence was the cause of the loss—such as when it has contractually agreed to assume another party’s liability for such losses.

Products and Completed Operations Risks

Some energy industry companies may have product liability exposures, especially if they are part of the downstream process, such as oil refineries who convert crude oil into other products and then sell those products to customers or if a party fabricates materials for use in the project, but the completed operations exposure is by far the greater risk. For example, pipes constructed by a pipeline operator could fail several years after they were built, resulting in seepage of oil onto land adjacent to the pipes that takes place over several years. Similarly, a gas leak might occur without immediately being detected, resulting in property damage years later. A refinery’s operations might result in seepage of oil on to the refinery ground and adjacent land for several years before being detected. Hydraulic fracturing (fracking) might result in groundwater contamination over a period of years or might even result in natural resource damage by using up the surrounding groundwater supply. In other words, some completed operations exposures involve progressive damage that takes years to develop to the point of being noticed. These long-tail liabilities are difficult to estimate and much more difficult to investigate and determine the cause of the loss. Further, with respect to progressive injury or damage, issues often arise over when the actual injury or damage occurred.

Contractual Liabilities

Contractual relationships are at the heart of oil and gas exploration, production, and distribution activities because these activities are large in scale, expensive, complex, and involve numerous entities. As previously noted, the energy industry uses contracts as a way to designate responsibilities and allocate liabilities. For example, an operator is the party who has the legal right, either by ownership or by virtue of a mineral lease, a type of contract, to produce oil and gas from a particular well. Oil and gas exploration and production is usually not conducted by a single entity. Instead, joint ventures are formed to help mitigate the risks associated with exploration and production and to share the costs for exploration and production activities. The operator has responsibility for the day to day management ("working interest") of the drilling project whereas the other joint venturers own a "nonoperating working interest" in the mineral lease, which means they are responsible for a portion of the ongoing costs associated with the venture, but do not participate in the day to day management of the drilling project. Parties to a contract enter into a joint operating agreement (JOA), a type of contract that sets forth the duties and obligations of both the operator and nonoperating working interest owners.

Oil and gas wells are typically drilled by a drilling contractor, a company that owns the drilling rig and maintains employees to drill oil and gas wells. The oil operator and drilling contractor enter into a drilling contract, and depending on the terms of that contract, either the operator or the drilling contractor or both parties will enter into contracts with various other companies for services, supplies, and equipment needed to complete the drilling project. For example, an operator may hire a drilling fluids engineer to monitor drilling fluids to maintain hydrostatic pressure in the borehole. A mud logger may be hired to create a detailed record of a borehole by examining the cuttings of rock brought to the surface by the drilling mud. An illustration of some of the key players in oil and gas drilling operations is found in Exhibit 1.1, which outlines some of the main contractual relationships involved in the BP oil spill.

Exhibit 1.1 Contractual Relationships in Connection with the BP Oil Spill	
Company	**Role**
Transocean	Owner of the Deepwater Horizon drilling rig and the drilling contractor. Transocean leased the rig to BP. The lease agreement required Transocean to manage and operate the Deepwater Horizon on behalf of BP, including providing the drilling personnel.
BP	Operator of the Macondo oil well on behalf of its joint venture partners. Owner of a 65% interest in the Macondo mineral lease.
Anadarko E&P Company	A U.S. oil and gas exploration company that was a nonoperating working interest owner of the Macondo well. Anadarko E&P Company owned a 22.5% interest in the Macondo mineral lease.
Anadarko Petroleum Corporation	A U.S. oil and gas exploration company that was a nonoperating working interest owner of the Macondo well. Anadarko Petroleum Corporation owned a 2.5% interest in the Macondo mineral lease
MOEX Offshore 2007	A Japanese oil exploration firm that was a nonoperating working interest owner of the Macondo well. MOEX Offshore 2007 owned a 10% interest in the Macondo mineral lease.
Halliburton	Halliburton was BP's cement contractor at the Macondo well, and provided cement planning, products, and services at the site.
Cameron	A Texas-based manufacturer of oil and gas pressure control equipment. Cameron manufactured the Deepwater Horizon's blowout preventer.
MI-SWACO	A worldwide supplier of drilling supplies and services. MI-SWACO developed the mud program and provided drilling mud and personnel to operate the Deepwater Horizon rig's mud system.
Schlumberger	An oilfield service provider that provided well logging services for the Macondo well.
Sperry Drilling (Sperry-Sun)	A subsidiary of Halliburton that equipped the Deepwater Horizon with Sperry data sensors and Sperry mudloggers to monitor and evaluate well condition data.
Weatherford International	A Swiss-based multinational oilfield service and technology company that provided the casing, casing centralizers, and float conversion equipment used on the Deepwater Horizon.

Exhibit 1.1 demonstrates the prevalent nature of contracts in oil and gas operations. As expected, numerous contractual obligations arise under these contracts. For example, under a drilling contract, drilling contractors generally agree to perform the work in accordance with the specifications and industry standards, to perform the work in a workmanlike manner, and to complete the work by an agreed-upon date. Drilling contractors also agree to pay their suppliers and subcontractors (to avoid taxes and liens on the mineral property), and in some cases, to perform the contracted work for an agreed price. The liabilities that are created by these contractual obligations are considered the normal risks of doing business as a drilling contractor in the energy industry.

An additional type of contractual liability exposure involves the assumption of another party's legal liability for losses in connection with its work on the project. For example, under a drilling contract, certain risks such as bodily injury, damage to property, and consequential damages are allocated on a reciprocal basis regardless of fault. As previously noted, the operator may agree to be responsible for other risks, such as damage to the drilling contractor's tools, damage to the drilling contractor's rig, and/or downhole pollution. Furthermore, both operators and drilling contractors may require their subcontractors to "indemnify and hold harmless" the operator or drilling contractor for third-party liability they incur as a result of the subcontractor's work for them. The notion behind this risk transfer is that the party performing the work should bear responsibility for any injury or damage that is incurred by third parties in connection with that work. The key features of indemnity provisions in certain oil and gas exploration and production contracts are discussed in greater detail in Chapter 5 of this course.

Independent Contractor Liability

Operators, drilling contractors and other energy industry companies may hire subcontractors to perform all or part of the work for which they have contracted. Companies who do so face certain risks in connection with these arrangements. First, these hiring companies are also responsible to the party that originally hired them (i.e., the drilling contractor, operator, mineral lease owner, or property owner) for any damage to the property that is the result of a subcontractor's work. The basis of this liability is usually some form of direct negligence, such as negligent hiring or supervision of the subcontractor. Second, an operator, drilling contractor, or other company can be held liable for losses arising out of the acts of its subcontractors under the theory of vicarious liability or strict liability. Vicarious liability is liability that attaches even in the absence of direct negligence, due to a specific legal responsibility for the acts of another. That is, in certain circumstances, an operator, drilling contractor, or other company can be held liable for the negligence of its subcontractor merely because of the contractual relationship. Strict liability attaches without the need to show any negligence at all. The mere fact that a loss occurs renders the energy industry company liable. The circumstances under which contractors can be held strictly liable for a loss vary by state but commonly involve extra-hazardous operations such as blasting or use of hazardous materials.

Energy Industry Risks and the CGL Policy

Exhibit 1.2 outlines some of the energy industry's key general liability exposures and the CGL applicability to them. Energy industry companies have coverage for many of the liabilities they face in connection with both their ongoing and completed operations, including coverage for damage caused by pollution and to the work itself. While many contractual liabilities, such as failure to complete the work on time or as specified, are uninsurable business risks, energy industry companies have certain coverage for contractually assumed indemnification obligations. Likewise, companies have coverage for liabilities arising out of their use of subcontractors and independent contractors.

Exhibit 1.2 Energy Industry Exposures and CGL Coverage	
Company's Exposure	**The CGL Policy**
Damage to property being used during ongoing oil and gas operations.	Provides coverage with respect to the company's liability for damage to the property being used during oil and gas operations (sometimes referred to as "broad form property damage" coverage).
Contractual liability	Covers the insured's assumption of liability in an "insured contract," which includes tort liability assumed in a hold harmless or indemnity provision in a drilling contract, master service agreement, joint operating agreement, or other oil and gas contract.
Pollution liability	Covers certain above-ground and below-ground pollution incidents resulting from oil and gas operations.
Completed operations	Covers third-party bodily injury or property damage that occurs during the policy period in conjunction with completed operations, including damage to the completed project under some circumstances. Coverage may apply even if the work that produced the injury or damage was performed many years prior.
"Other" third-party bodily injury and property damage	Covers a broad array of claims for bodily injury or property damage sustained by third parties, including premises and operations liability.
Independent contractor liability	Responds to an operator, drilling contractor, or other energy industry company's liability arising out of its use of subcontractors.

Although the CGL policy never specifically grants coverage for "damage to property being used in oil and gas operations," "pollution liability," "contractual liability," or "independent contractor liability," it provides all these coverages—and then some—under its broad "Coverage A" insuring agreement. The exact scope of coverage for these sources of liability is sculpted in the policy exclusions. Pollution liability and contractual liability coverage receive particularly detailed attention in the CGL exclusions. In fact, what coverage exists for these exposures is defined in the exceptions to the exclusions.

CGL Policy Structure

General liability insurance is a highly standardized coverage. Both Insurance Services Office, Inc. (ISO), and the American Association of Insurance Services (AAIS) have standard general liability coverage forms. Of these, the ISO CGL form is the most widely used and is commonly viewed as the "standard" policy. The AAIS commercial liability policy corresponds closely to the ISO form, but it is not as widely used. Some insurers use their own nonstandard forms to provide general liability coverage, but most incorporate a significant amount of the CGL language. For the remainder of this course, references to the CGL policy imply the 2013 edition of the standard ISO CGL policy unless otherwise noted. References to the named insured will assume the insured entity is an energy industry company such as an oil operator, drilling contractor, well service contractor, or independent contractor.

The CGL policy is divided into four sections, which are summarized in Exhibit 1.3 and discussed further below. Section I is where the actual scope of coverage is defined. The remaining sections describe various other terms and conditions of the policy.

Exhibit 1.3 CGL Policy Structure	
Section I—Coverages	Contains three coverage parts that define scope of coverage for different types of covered damages
Section II—Who Is an Insured	Stipulates persons and entities covered by the policy
Section III—Limits of Insurance	Defines how each of the policy's seven limits of insurance apply
Section IV—Commercial General Liability Conditions	Outlines various obligations of the insured and the insurer

Section I

Section I contains three coverage parts based on the type of injury. Coverage A applies to liability for bodily injury and property damage, and Coverage B applies to personal and advertising injury liability. Both of these coverages are based on the insured's legal liability for the alleged damages. Coverage C provides a smaller amount of coverage for medical costs incurred by a third party without the need to show legal liability. The idea behind this coverage is that paying these costs up front may avoid a legal action for damages.

Each of the coverage parts contains an insuring agreement, which outlines the insurer's basic coverage obligations and a number of exclusions that eliminate coverage for certain types of claims. A "supplementary payments" section describes additional amounts the insurer will pay for certain costs under Coverages A and B.

Section II

Section II stipulates who, other than the named insured, is covered under the policy. Most CGL policies will include various categories of automatic insureds—that is, they do not have to be named on the policy to be covered by it. Various conditions or limitations may apply with respect to certain categories of insureds. For example, employees are insureds only to the extent their liability arises out of their work for the named insured. The categories of insureds and limitations on their insured status will be examined in more detail later in the course.

Section III

The standard CGL policy contains seven limits of insurance. Section III of the policy sets forth how the limits of insurance apply. Some of the limits stand alone, while others operate in conjunction with other policy limits. For example, the per occurrence limit is the most the policy will pay for all claims arising out of a specific accident or event, and the general aggregate is the most the policy will pay, in total, for all claims for the entire policy period. The general aggregate is usually some multiple of the per occurrence limit. The operation of these limits is discussed in more detail later in the course.

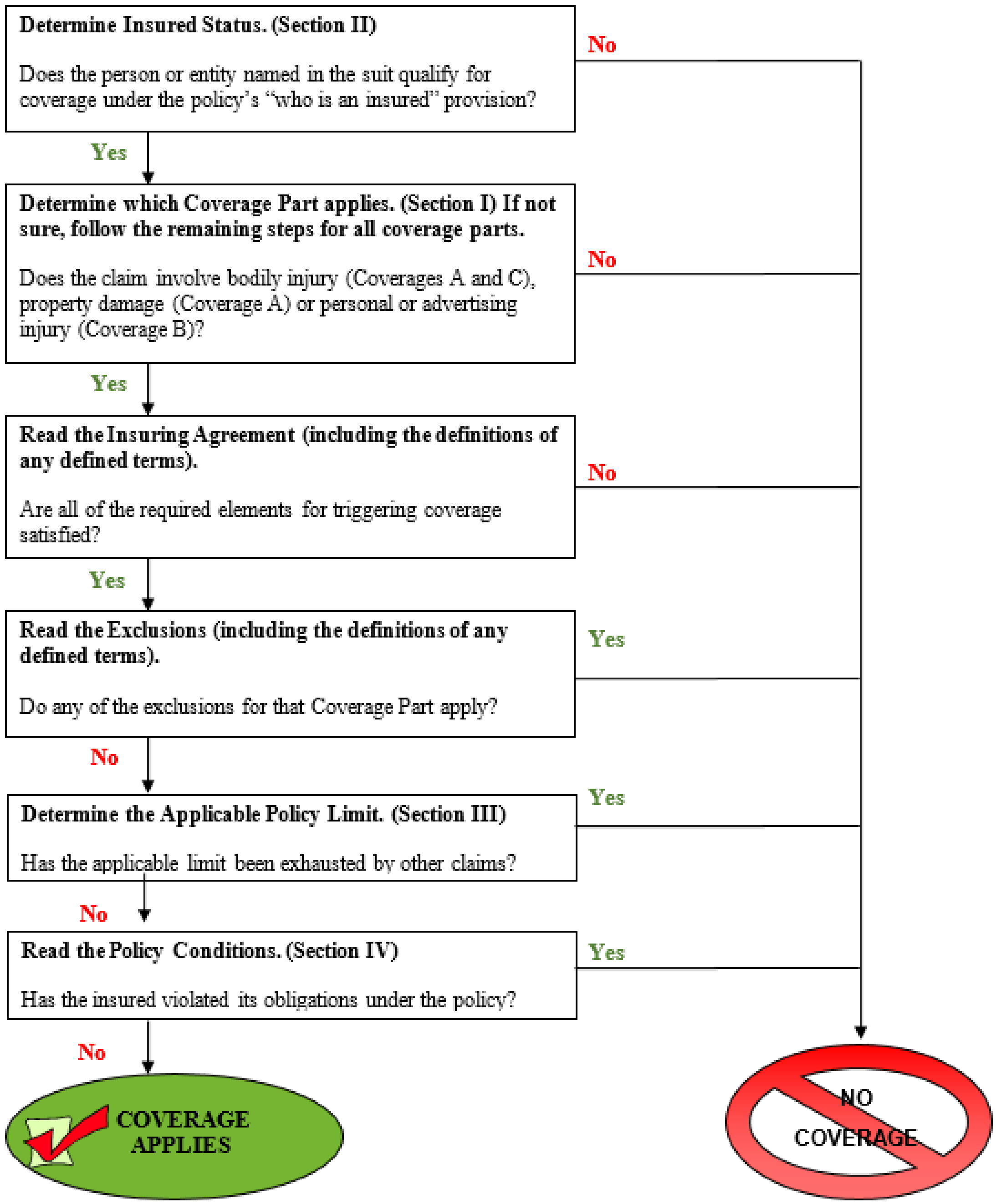
Section IV

Section IV of the CGL policy outlines various conditions of coverage. Some of these conditions place obligations on the insurer, and some impose obligations on the insured. For example, a cancellation provision stipulates an obligation on the insurer to provide a certain number of days' notice of its intent to cancel the policy so the named insured can take steps to arrange replacement coverage. Another provision requires the insured to provide timely notice of any legal action brought against the insured, as well as an event that is likely to result in a legal action. This notice provisionallows the insurer to conduct a proper investigation of the claim. Similarly, the "other insurance" provision stipulates how the policy will respond when there is another policy that also covers a claim. The standard CGL policy is designed to be primary—that is, it pays before any other applicable insurance—but some nonstandard CGL policies may apply on an excess basis. Policy conditions with specific implications for contractors are discussed in more detail later in the course.

Reading the Policy as a Whole

Making a determination of coverage for a particular claim or loss under the CGL policy requires a reading of all applicable policy provisions. Although one of the policy insuring agreements may indicate that a particular claim is within the scope of coverage, a number of other policy provisions might apply to remove coverage. For example, an exclusion may apply, the insured may have breached a policy condition, or the limit of insurance may have been exhausted by previous claims. Similarly, a claim may be precluded from coverage under one coverage part but not under another coverage part. If one stops reading too early, it is easy to come to incorrect conclusions about the policy's coverage for a given claim. Exhibit 1.4 illustrates the steps that are involved in evaluating the CGL policy's applicability to a given claim. Note that this process considers only the basic policy. Many CGL policies issued to operators, drilling contractors, well service contractors, and other energy industry companies contain endorsements. To the extent endorsements are attached that impact the scope of coverage, they must also be considered.

Exhibit 1.4
Steps for Determining Coverage



Chapter 2
CGL Coverage A Insuring Agreement

Learning Objectives
In this chapter, you should be able to… 1. recognize the elements that must exist in order for a loss to be covered by a CGL policy. 2. differentiate the two coverage triggers used in CGL insurance policies 3. determine how each type of trigger defines what policy will apply to a specific instance of injury or damage and 4. define (1) “bodily injury” and (2) “property damage.” 5. Describe the CGL’s coverage territory.

Coverage A provides coverage for “bodily injury” or “property damage” arising out of many different sources of liability, including premises and operations liability, products and completed operations liability, contractual liability, and independent contractor liability. Although there is no specific coverage part that grants coverage for each of these sources of liability, they all fall within the parameters of the CGL policy’s Coverage A insuring agreement. The insuring agreement (where coverage is granted) and the exclusions (where coverage is taken away) define the scope of coverage provided under each of the coverage parts.

The Coverage A insuring agreement sets the outer parameters within which coverage may apply with respect to causation, location, and timing. These key elements of coverage are listed in Exhibit 2.1 and discussed further below.

Exhibit 2.1 Elements of a Covered Loss Bodily Injury and Property Damage Liability (Coverage A)
• "Bodily Injury" or "property damage" occurs during the policy period. • "Bodily Injury" or "property damage" is caused by an "occurrence." • The "occurrence" takes place in the "coverage territory." • The insured is legally liable for the loss. • The insured was not aware of the "bodily injury" or "property damage," in whole or in part, prior to the policy period.

In addition to covered "bodily injury" or "property damage," the CGL will pay costs it incurs in defending or settling a claim. In the standard CGL policy, and most nonstandard policies, defense costs are payable outside the policy limit, which means they do not reduce the amount of insurance available to pay claims.

Coverage Trigger

Most businesses carry insurance continuously from year to year. Each time the policy is renewed, a fresh set of coverage limits will apply, and various changes may be made to the policy terms and provisions. For example, new exclusions may be added, policy definitions may be changed, new endorsements may be attached, and different deductibles may apply, among other possible variations. Determining the coverage available for a given claim, therefore, requires determining which policy applies to a given claim. The insurance industry uses what is called a coverage "trigger" to indicate the event that is required for the policy to respond to a claim. In this way, both the insurer and the insured can determine which policy's terms apply.

ISO publishes two versions of the CGL policy. The primary difference between the two forms is the event that triggers coverage for bodily injury or property damage (Coverage A). Under the occurrence form, coverage is triggered if the injury or damage occurs during the policy period. Under the claims-made form, it is the filing of a claim during the policy period that triggers coverage. The difference between these two coverage triggers is demonstrated in Exhibit 2.2. The practical impact of this difference is that under an occurrence-based policy, the insured is covered for injury or damage that occurred during the policy period even if that policy has been expired for years when the actual claim is filed. Claims-made coverage, however, applies only if there is a policy in force when the claim is made, and even then, it may place restrictions on coverage with respect to operations performed before a specified date. For this and other reasons, claims-made coverage is generally unpopular with insureds; therefore, most CGL policies are written with an occurrence trigger. Consequently, the remainder of this discussion assumes an occurrence trigger. The claims-made coverage trigger is prevalent in other lines of coverage, including professional liability, pollution liability, directors and officers liability, and employment practices liability.

Exhibit 2.2
Comparison of Occurrence and Claims-Made Coverage Triggers

An operator performs negligent work in 2011 that fails in 2012, resulting in significant damage to property. A claim is filed by the owner of the damaged property in 2013. Assuming all consecutive policies run from January 1 to December 31 and have the same type of coverage trigger, the following would be true:

Occurrence Trigger—2012 policy is triggered because the property damage occurred during its policy period.

Claims Made Trigger—2013 policy is triggered because the claim is filed during its policy period.

A key aspect of the standard CGL occurrence trigger is that coverage is triggered by the occurrence of covered injury or damage during the policy period. The date of the accident or event that produces the injury does not impact coverage, nor does the date the claim is filed. Many insurance professionals fail to recognize this distinction.

To illustrate, suppose a drilling contractor negligently installs a packer into a well in 2012. In December 2014, the packer fails causing the well to explode, injuring dozens of employees of an independent oilfield service contractor. Between March and September of 2015, numerous claims are filed against the drilling contractor for injuries sustained by these individuals. If the drilling contractor carried consecutive occurrence-based CGL policies from 2012 to 2015, each with an effective date of January 1 and an expiration date of December 31 of that same year, which policy could be triggered by this claim? The correct answer is the 2014 policy, because it was during 2014 that the injuries were sustained. Neither the 2012 policy, which was in effect when the work was performed, nor the 2015 policy, which was in effect when the claim is filed, is triggered for these losses.

Progressive Injury or Damage

At first glance, it may appear that determining the time at which bodily injury or property damage occurs is a simple task, but in the energy industry, it often is not. Sometimes injury or damage is the result of gradual exposure to a hazardous condition and is not immediately apparent. Silicosis is an example of a situation in which an injury may start at one point in time and progressively worsen until its effects are finally discovered. Did the injury occur when the person was exposed to silica, when the first signs of injury would have been visible (had they known to check for them), or when the person begins to feel the effects of the illness? Likewise, groundwater contamination from drilling operations will not be discovered on adjacent property until it is detected in the adjacent property's monitoring wells. Did the property damage occur when the onsite contamination occurred, when it was detected on the adjacent property, or over time as the condition worsened?

These distinctions are important, because the time at which the injury or damage occurred determines which CGL policy has been triggered by the claim. The answer could differ based on the jurisdiction in which the claim is filed. Because it is possible for policies to be triggered long after they expire, operators, drilling contractors, and other energy industry companies are wise to maintain files of their expired policies in an indexed storage format for as long as the company exists or is sold, at which time the policies should be passed down to the new owner. With the electronic storage resources available today, storage is less of a burden and less costly than previously. As long as the limits of coverage have not been exhausted, these policies may still prove valuable long into the future.

Known Loss Restrictions

A "known loss" provision limits recovery for progressive injury or damage that occurs over multiple policy periods. The standard CGL policy provides that it will not respond to claims for injury or damage of which the insured was already aware prior to the beginning of the policy period. A common misconception about the CGL known loss provision is that it removes all coverage for losses that occur but are not settled during the policy year. That is simply not true. The known loss provision is not triggered in policies in force when the insured first becomes aware of a claim or loss. It merely prevents coverage in any policy period after the insured first becomes aware of the injury or damage. Thus, the insured's knowledge is key with regards to the application of the known loss provision.

To illustrate the application of this known loss provision, assume an operator has a January 1 renewal date for its CGL insurance. On October 15, 2011, the operator receives notice of a claim. The claim is settled in July of 2012. While the 2012 policy will not respond to the claim because it was "known" by the insured prior to the policy effective date, the known loss provision of the 2011 policy does not apply at all, because the insured did not know of the claim at the beginning of the 2011 policy period. This policy, therefore, would respond to the claim, subject to the policy's other terms and provisions.

The standard CGL does not prevent the triggering of multiple prior policies as long as covered injury or damage occurred during each policy period (such as on a continuous injury or damage claim) and the insured was not aware of the injury or damage prior to the inception of that policy's coverage period. A few nonstandard policies take the known loss restriction a step further by adding a requirement that coverage is restricted to the policy where the insured *first became aware of the loss*. Under this approach, only one policy will be triggered by any given loss—the one that was in effect when the insured first became aware of the loss.

Completed Operations

The occurrence trigger sometimes makes completed operations coverage a confusing concept. If expired policies will pay for injuries arising out of past projects, why do companies need coverage for completed operations under their current policies? The answer is that, sometimes, injury or damage arising out of past projects does not occur until well into the future. Remember, it is not the time at which the event that caused the damage (e.g., the negligent act) took place that triggers the policy, but the time at which bodily injury or property damage occurs. Therefore, by covering injury or damage that occurs during the current policy period but is the result of work that has already been completed, the policy is providing coverage that would not exist under prior policies.

To illustrate, suppose a drilling rig's platform collapses under the weight of equipment in 2012, causing damage to the rig and its contents, and injuring five people. The cause of the collapse is determined to be due to defective construction. The rig (including the platform) was built during a time frame spanning May 2010 to June 2011. Which policy is triggered? If it has an occurrence trigger, the 2012 policy, which was in effect when the platform collapsed, is triggered. Neither the 2010 nor the 2011 policy is triggered because the damage did not occur during their policy periods. If the 2012 policy did not cover losses that are the result of completed projects, there would be no coverage for this loss.

Covered Damages

The Coverage A insuring agreement provides that coverage applies to liability for "bodily injury" or "property damage." The policy's definition of bodily injury includes sickness, disease, and death, as well as physical injury to a person. Mental injuries, such as mental anguish, emotional distress, and other disorders, are covered if the applicable jurisdiction recognizes these types of injuries as bodily injuries. (In most jurisdictions, these types of injuries are covered only if there is accompanying physical injury.)

Insurance professionals must distinguish between "bodily injury" and "personal injury." While attorneys frequently use the latter term to refer to physical injuries to a person (what the CGL policy refers to as "bodily injury"), insurance policies clearly distinguish the two. In the CGL policy, "personal injury" refers to a variety of offenses against a person *other than* a physical injury, such as invasion of privacy, slander, libel, trespass, and false imprisonment. Personal injury (along with advertising injury) is the subject of an entirely separate coverage part under the CGL (Coverage B), with its own insuring agreement and exclusions.

The policy's definition of "property damage" includes physical injury to property and the accompanying loss of use of that property, as well as loss of use of property that has not been physically damaged. Loss of use claims can include loss of revenues and even diminution of value. This is important coverage for energy industry companies where a company's negligence results in a damaged structure, such as a warehouse or storage tank, that lowers the market value of the property or if the property suffers a permanent loss in market value due to a company's negligently performed work. Nevertheless, the CGL policy will not respond to claims seeking purely monetary damages without any accompanying "property damage." This feature is discussed in greater detail in Chapter 3 of this course.

Coverage Territory

For coverage to apply to "bodily injury or "property damage" the occurrence must take place in the "covered territory." (Note that it is the event causing the bodily injury or property damage that must take place in the coverage territory and not the injury or damage itself.) The CGL policy's coverage territory categorically includes the United States, its territories and possessions, Puerto Rico, and Canada. Coverage is also available under certain conditions for occurrences that take place in other locations. For example, international waters and airspace are part of the coverage territory if the injury or damage occurs during transportation between the covered territories listed above. With respect to oil and gas operations, companies will want to make sure that the "covered territory" is proper in scope. To that end, companies who perform exploration or production activities in the Gulf of Mexico will want to be sure that the Gulf of Mexico is included as a "covered territory." Furthermore, companies who perform operations in new locations or in deeper international waters will want their policies endorsed to include those locations. Coverage applies worldwide with respect to injury or damage arising out of goods or products made or sold in covered territories or the activities of a person who resides in a covered territory but is temporarily away on business.

Chapter 3
CGL Coverage A Exclusions

Learning Objectives
In this chapter, you will learn how to… 1. Recognize the purpose of the CGL policy's exclusions. 2. Analyze the scope of the CGL contractual liability exclusion and explain how significant contractual liability coverage exists under the CGL policy despite the exclusion; 3. Recognize the liability and coverage implications of certain energy industry practices. 4. Analyze the scope of the CGL pollution exclusion and cite two examples of energy industry pollution liability claims that would be covered by the CGL policy despite the exclusion; 5. Identify ways to improve or supplement the coverage provided by a standard CGL policy to address certain needs. 6. Analyze the scope of other exclusions and recognize situations in which they would or would not preclude coverage. 7. Analyze the scope of the care, custody, and control exclusion, and identify examples of property damage claims that would not be covered because of this exclusion. Analyze the scope of the CGL electronic data exclusion and recognize the types of claims that would not be covered because of the exclusion.

Once the insuring agreement's conditions have been met, any damages meeting the definitions of "bodily injury" or "property damage" are covered, subject to the policy limit, unless an exclusion applies. Most of the CGL exclusions are designed to remove coverage for exposures that are not common to most insureds, that are customarily covered under other insurance policies, that underwriters are not willing to cover on a blanket basis, or that are considered uninsurable.

For example, the commercial auto policy covers liability arising out of the use of an automobile; therefore, that exposure is excluded under the CGL policy. Similarly, exposures that present a high risk of concentrated loss, such as war, that could result in a catastrophic loss for the insurer are considered largely uninsurable. Intentional losses or losses that are incurred with the intentional conduct of the insured are also uninsurable because they do not present a statistically predictable exposure. Some risks are excluded because they are viewed as merely a cost of doing business, such as the cost of redoing work that does not meet the required standard.

Many of the CGL exclusions are broad in scope, removing virtually all coverage for a certain category of injury or damage. However, exceptions to the exclusion are then used to sculpt a more precise application of the exclusion by stipulating certain types of injury or damage to which the exclusion will not apply. Insurance professionals sometimes make the mistake of believing that the exception actually "creates" coverage, when in reality, all it says is that in this specific instance, the exclusion does not apply; therefore, any coverage granted by the insuring agreement remains. This is an important distinction, and the misunderstanding of the way coverage is granted has generated a great deal of confusion and litigation.

To illustrate, the contractual liability exclusion contains an exception for liability assumed in an "insured contract" (see discussion below). This exception has led some to believe that as long as the contract is an insured contract, the policy will cover any type of liability assumed in that contract. This is not so. All the policy says is that the contractual liability exclusion will not operate with respect to liability assumed in an "insured contract." Because Coverage A only insures against "bodily injury" or "property damage," only contractually assumed liability for these types of damage are covered. So, in looking at the following exclusions, and the exceptions to the exclusions, keep in mind that in no instance is the coverage retained through an exception to an exclusion broader than the coverage granted in the insuring agreement.

Further, other exclusions may negate coverage for contractually assumed liabilities, even if they were assumed in an “insured contract.”

Exhibit 3.1 lists all 17 of the Coverage A exclusions. Some of these exclusions are routine and have no special importance to energy industry companies, but a number have profound implications for these companies. Each exclusion is described below, but the majority of our attention is given to those that impact energy industry companies most heavily.

Exhibit 3.1
Coverage A Exclusions

- Expected or Intended Injury
- Contractual Liability
- Liquor Liability
- Workers Compensation and Similar Laws
- Employers Liability
- Pollution
- Aircraft, Auto, or Watercraft
- Mobile Equipment
- War
- Damage to Property
- Damage to Your Product
- Damage to Your Work
- Damage to Impaired Property or Property Not Physically Injured
- Recall of Products, Work, or Impaired Property
- Personal and Advertising Injury
- Electronic Data
- Recording and Distribution of Material or Information in Violation of Law

Expected or Intended Injury or Damage

Insurance is designed to indemnify insureds for losses suffered fortuitously, not intentionally. For example, insurers do not pay for fire damage to a house that was set on fire by the insured or for damage to a car that was intentionally rolled over a cliff. Likewise, CGL insurance does not cover bodily injury or property damage that was expected or intended from the standpoint of the insured. Note that this exclusion removes coverage for injury or damage that was expected or intended as opposed to an act that was intended or expected.

Some insurers may argue that work performed in a negligent manner is intentional because the performance of the work was intentional. However, it is not the mere fact that an act was intentional that triggers this exclusion but that the resulting injury or damage was intended or reasonably expected to occur as a result of that act. For example, a drilling contractor that knowingly uses defective drill casings could reasonably expect the drill casings to fail and cause property damage. On the other hand, a drilling contractor that negligently uses the wrong type of drill casings, resulting in contamination of production zones, did not intentionally cause the damage merely because it intentionally used the casings.

The phrase "from the standpoint of <u>the</u> insured" preserves important coverage for an insured that did not expect or intend injury or damage even if another insured under the policy did. As will be discussed under Section II, multiple parties can be insureds under the same CGL policy. However, because the policy applies to each insured separately, one insured's intentional causing of a loss does not negate coverage for "innocent" insureds with respect to their liability for that loss. For example, an employer that is faulted for negligently supervising an employee that commits an intentional act, like an assault, would still be entitled to coverage because the employer did not act intentionally.

Contractual Liability Exclusion

Operators, drilling contractors, and other energy industry companies often assume substantial liabilities in indemnity, or "hold harmless," provisions in oil and gas exploration and production contracts. In many cases, the CGL will cover such liabilities. The insuring agreement states that the insurer will pay for injury or damage for which the insured is "legally responsible." It does not specify whether the legal responsibility arises out of common law or out of contractual obligations.

However, insurers certainly do not intend to cover all contractual risks insureds might assume. The CGL policy carves out coverage for certain contractual liabilities by including a broad contractual liability exclusion and then providing exceptions to the exclusion. These exceptions define the policy's contractual liability coverage.

Exclusion b. of the CGL eliminates coverage for bodily injury or property damage arising out of an assumption of liability in a contract. Two subsequent exceptions to the exclusion leave coverage in place with respect to liability (1) assumed in an "insured contract," as defined in the policy, and (2) liability "that the insured would have in the absence of the contract or agreement." These exceptions form the framework for contractual liability insurance coverage in the CGL policy.

While the meaning of "insured contract" is of obvious importance, note the other exception to the exclusion, which clarifies that coverage is available to the insured in a case where it would be liable even in the absence of a contract or agreement. This merely prevents the insurer from using the fact that the contract stipulates the energy industry company is responsible for damages caused by its own negligence (which it would be under common law even without the contract) to exclude coverage. For example, assume that Sanders Cleaning Services is retained by Carlton Oil and Gas, Inc., to perform industrial cleaning on parts of Carlton's refinery. The contract requires Sanders to hold harmless and indemnify Carlton for any property damage to the refinery arising from Sander's negligence in performing its operations. A fire erupts one evening, damaging several storage tanks at the refinery, and it is determined that the fire resulted from Sanders's negligence. Since Sanders is accountable under common law for its own torts, the CGL policy should respond on behalf of Sanders for its liability to repair the damaged storage tanks (unless another exclusion applies). The fact that Sanders had also contractually agreed to be responsible for its own negligence would not preclude coverage.

Definition of "Insured Contract"

Outside of liability the insured would have in the absence of a contract or agreement, the CGL policy specifies that only those liabilities assumed in an "insured contract," as the term is defined in the policy, are covered. For example, assume that the contract between Sanders and Carlton requires Sanders to indemnify and hold harmless Carlton for any damage to the refinery, regardless of the cause. The fire breaks out on storage tanks located in a different building of the refinery complex than the one on which Sanders is cleaning and can in no way be attributable to Sanders's negligence. Since Sanders would not be liable in the absence of the contract, any coverage for liability Sanders incurs for damage to the building because of this contractual agreement would have to come under the second part of the contractual liability provision, the exception for an "insured contract."

The CGL policy's definition of "insured contract" includes six distinctive categories of contracts that will qualify for the exception to the contractual liability exclusion. The first five parts of this definition grant "insured contract" status based on the type of contract. The last part addresses a type of provision that can appear in a broad array of business contracts. Fortunately, many of the agreements energy industry companies routinely enter into are "insured contracts," including indemnity agreements within drilling contracts, master service agreements, well site consulting agreements, mineral leases, equipment leases, joint operating agreements, rental agreements, and purchase and sale agreements. The types of contracts that meet the policy's definition of "insured contract," as well as exceptions to some categories of contracts, are summarized in Exhibit 3.2 and discussed in more detail below.

Exhibit 3.2 Categories of "Insured Contracts"	
Category	**Exceptions (Not an "Insured Contract")**
Lease of premises	That portion of the contract that indemnifies any person or organization for fire damage to the premises while rented to or temporarily occupied by the named insured with the owner's permission
Sidetrack agreement	None
Easement or license agreement	Contract executed in connection with construction or demolition operations on or within 50 feet of a railroad
An obligation under city ordinance to indemnify a municipality	Contract with a municipality for work
Elevator maintenance agreement	None
That part of any other contract or agreement pertaining to your business under which you assume the tort liability of another party to pay for third-party "bodily injury" or "property damage"	(1) An agreement to indemnify a railroad for injury or damage arising out of construction or demolition operations, within 50 feet of any railroad property, including any railroad bridge, trestle, tracks, road-beds, tunnel, underpass, or crossing (2) An agreement to indemnify an architect, engineer, or surveyor for injury or damage arising out of: (a) the preparation or approval (or failing to prepare or approve) of design-related documents; or (b) giving (or failing to give) directions or instructions (3) An agreement under which an insured architect, engineer, or surveyor assumes liability for an injury or damage arising out of: (a) its rendering (or failure to render) professional services and (b) its supervisory, inspection, architectural, or engineering activities

Lease of Premises

It is very common for leases to include a hold harmless clause requiring the lessee (the tenant) to hold the lessor (property owner) harmless for liability arising from the use of the premises. This portion of the definition would pertain to the energy industry company's leased premises, such as its offices and storage facilities, and not to the well or drilling site. An exception to this category of insured contracts is for damage to the premises caused by fire if the insured is liable solely on the basis of the contractual agreement, and not under tort law. (Another policy exclusion removes coverage for damage to property owned, rented, or occupied by the named insured for which the insured is liable. This exposure is best handled by purchasing first-party property insurance on the leased premises to protect the interests of both parties.)

Note that leases of property other than premises are not "insured contracts" under this part of the definition. However, indemnity agreements within leases involving other types of property, such as heavy oilfield equipment, may qualify under the last category of "insured contracts." The distinction is important because the latter category is more restrictive with respect to the types of liability that are covered. Specifically, the last category of contracts applies only to the assumption of another party's tort liability, whereas the lease of premises category contains no such restriction.

Sidetrack Agreements

Many insureds have spurs or sidetracks that connect their facilities to a main railroad line. As a condition within the sidetrack agreement, the railroad will normally require the firm to hold it harmless from losses arising out of the use of the sidetrack. Such sidetrack agreements are "insured contracts."

Easements

An easement is an interest that one party has in the land of another or a right of use over another party's property. An easement may be implied or it may be created by necessity or by prescription. An easement by prescription arises when one person uses another person's land for some period of time during which the owner of the property does not object to the use of the property. For example, in an oil and gas setting, an adjacent property owner may consent to allow the operator and drilling contractor to use its property to access the onshore mineral estate. A license is a right to come onto another party's property that arises from the consent of the owner and can be revoked at any time. With an easement or license agreement, it is generally the party enjoying the benefit of being on the property of another that assumes the liability of the property owner. Easement and license agreements are "insured contracts" unless they are in connection with construction or demolition operations on or within 50 feet of a railroad. Insurers will usually attach an endorsement that brings indemnification agreements executed in connection with operations on or near a railroad under the definition of "insured contract" if requested to do so.

Municipal Ordinance Obligations

Many municipalities have ordinances requiring indemnification from private citizens or organizations that erect any kind of obstruction or device that can cause bodily injury or property damage to members of the public, and these also qualify as "insured contracts." This indemnification requirement may simply result from an ordinance—it is not necessarily imposed by a specific contract between the municipality and the insured. However, if an insured performs work for the municipality, an ordinance-imposed indemnification in connection with that work is not included in this particular portion of the definition of "insured contract." Such indemnification is included as an "insured contract" under the last part of that definition (paragraph f.).

Elevator Maintenance Agreements

An agreement stipulating terms for maintaining or servicing elevators is an insured contract under part e. of the definition. Because of the similar purpose, operation, and use of the two, this definition would probably encompass escalator service agreements as well.

Indemnification Agreements

The last category of insured contracts, paragraph f., is where energy industry companies obtain coverage for liabilities assumed in drilling contracts, master service agreements, well site consulting agreements, mineral leases, equipment leases, joint operating agreements, rental agreements, work orders, and purchase and sale agreements, and similar contracts. For example, when an insured operator agrees to assume the *tort* liability of a drilling contractor, the drilling contractor's subcontractors, or an equipment lessor for bodily injury or property damage, the insured operator's policy will respond to that liability, subject to the policy's other exclusions and conditions.

To qualify, the contract must pertain to the named insured's business and it must be made before the "bodily injury" or "property damage" occurs. Thus, energy industry companies have no coverage if they agree to be responsible for a loss only after it has already occurred. While it might seem unlikely that any company would do such a thing, if not doing so means losing a valuable client, the company might consider the loss of future revenues to be more damaging than any amounts it has to pay for this loss. While energy industry companies are free to take on such liabilities, they cannot look to their insurance policies to pay the loss on their behalf because insurance covers fortuitous losses.

Notice that only the portion of the contract where the insured assumes the *tort* liability of another (e.g., the indemnity provision) is considered an "insured contract." This clarifies that, with respect to contracts that are "insured contracts" only under part f. of that definition, the contractual liability coverage of the CGL policy will not respond to a warranty of performance, breach of contract, or any other form of contractual obligation that is not based in tort law.

The contract does not have to be in writing, although that is certainly helpful in establishing the intent of the parties and energy industry custom usually involves written contracts. If an unsigned draft of the contract or even the existence of an implied or verbal agreement for indemnity can be established, the CGL policy will cover the company's indemnification obligation, provided that the company complies with all other coverage provisions.

No limitations are placed on the degree of contractually assumed liability that is covered. That is, the policy will respond to contractual liability arising from the indemnitee's sole negligence, joint negligence, or contributory negligence as long as the contract in which the liabilities are assumed is an "insured contract," the indemnity clause is valid and enforceable, and the liability is for bodily injury or property damage.

With respect to whether an indemnity clause is valid and enforceable, the applicable state oilfield anti-indemnity statute, if any, will largely determine the scope of coverage preserved for the contractual assumption of another party's tort liabilities. Furthermore, in certain states, a construction anti-indemnity statute may provide a second basis for determining the scope of coverage for contractual assumption of another party's tort liabilities. (Anti-indemnity statutes and their impact on the scope of contractual liability coverage in standard insurance policies are examined at length in a separate ERIS course, "Contractual Risk Transfer in the Energy Industry.")

Exceptions

Three exceptions specify types of indemnity provisions that are not insured contracts. The first of these is an agreement to indemnify a railroad for bodily injury or property damage arising from construction or demolition operations on or near railroad property. Such indemnification is commonly imposed on companies working on or near railroad property. Since they are specifically not included as insured contracts, no coverage would apply to these assumptions of liability.

The common method of insuring this exposure, and the method typically required by railroads, is for the company to purchase a railroad protective liability policy, under which the railroad is the named insured. However, the purchase of such a policy does not necessarily eliminate the company's contractual liability exposure under the agreement with the railroad for two reasons. First, a liability loss involving a train can easily exceed the policy limits of the railroad protective policy, and the railroad will undoubtedly seek indemnification for its loss in excess of its insurance protection. Second, railroad protective insurers usually maintain the right to pursue recovery from (i.e., to subrogate against) the company for amounts paid under the policy. If the company was negligent in causing the loss—and would be liable even in the absence of the contractual assumption—the company's CGL policy would cover the subrogation action. If, however, the action is based on the indemnity obligation in the contract, the CGL policy would not respond. This coverage limitation should be deleted from the CGL policies of companies that agree to indemnify railroads in connection with their work. A standard endorsement is available for this purpose.

The second and third exceptions to the definition of "insured contract" pertain to professional liability with respect to architects, engineers, or surveyors. No coverage is provided for a contractual assumption of professional liability if the insured, or the indemnitee of the insured, is an architect, engineer, or surveyor. Frequently, contractual agreements between these professionals and their clients will affirm the professional's responsibility for liability arising from his or her work. These exceptions prevent professional liability claims from being covered under the CGL's contractual liability insurance. A separate endorsement is often attached to the policy to preclude coverage for direct claims involving professional liability. (See the discussion of professional liability exclusion endorsements later in this course.) While, in general, it is not legally permissible to contractually transfer the professional liability of an architect or engineer to another party, these types of transfers do sometimes appear in design contracts. This exception makes it clear that such contractually assumed liabilities are excluded.

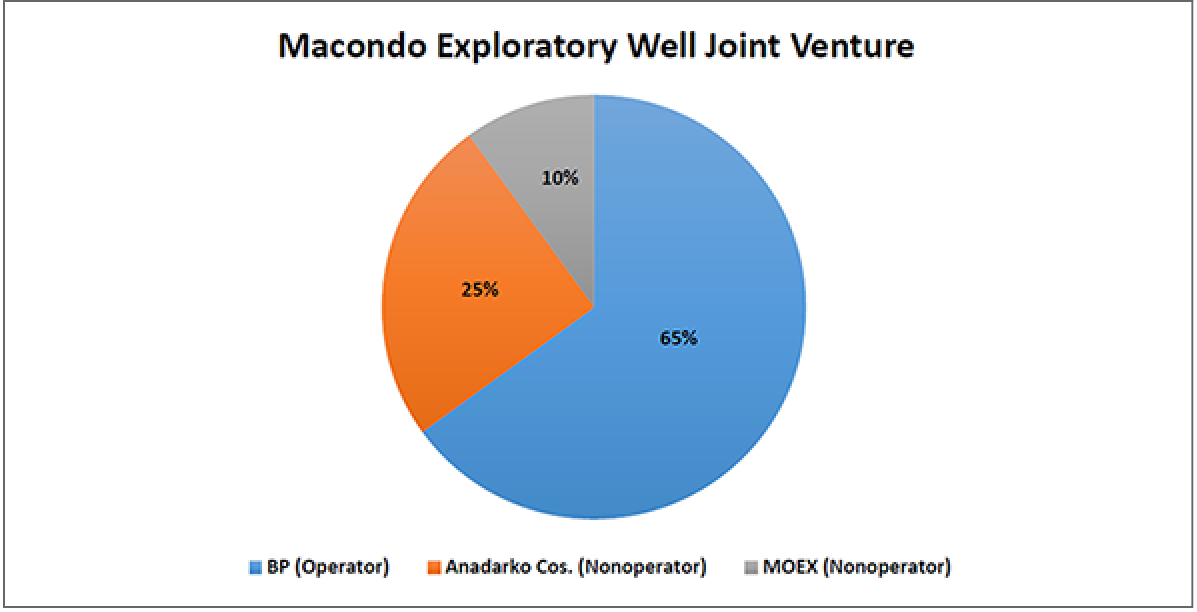
The exception for the assumption of professional liabilities is frequently misunderstood to be a total exclusion of liabilities assumed in a contract with a design professional. While energy industry companies must be extremely careful not to accept transfers of professional services liability, other forms of liability that are transferred from a professional services firm to the energy industry company may be covered. For example, liability incurred by the professional services company arising out of ordinary (not professional) negligence would be covered if the company has assumed responsibility for these liabilities in an enforceable hold harmless agreement. It is only the assumption of professional liability that is excluded. For example, the operator contracts with an engineer to have the engineer supervise and report on the progress of independent contractors at drilling site, and the operator agrees to assume the engineer's liability for injury or damage sustained to the drilling contractor and the drilling contractor's group (the operator and drilling contractor's groups are explained in greater detail in Chapter 5 of this course) as a result of the engineer's supervision. The drilling contractor's employee is injured when he negligently removes a cement head, and the engineer negligently failed to supervise the removal. This type of contractually assumed liability would be covered because the supervision, or failure to supervise, removal of the cement head did not require professional engineering expertise or other professional expertise.

There is one other important exception that can arise in connection with indemnity provisions in oil and gas contracts. Indemnity provisions in these contracts often transfer responsibility for risk without regard to fault. For example, under "sound location" provisions in drilling contracts, the operator is asked to assume liability for the rig even in the absence of the operator's fault or tort liability. Therefore, under sound location provisions, when the operator agrees to accept liability for the driller's own equipment, even if it is damaged by the sole fault of the driller, an argument exists that the operator is not thereby taking on the "tort liability of another" since the driller cannot have "tort liability" for damaging its own equipment. If the driller's rig is damaged by the driller as opposed to the operator, an insurer may argue that there is no coverage for contractual liability for damage to the driller's property where that liability is assumed without regard to fault. The insurer could argue that, because the driller has no "tort liability" for damage to its own property and because there is coverage only for the operator's assumption of tort liability, there is no contractual liability coverage for the promise to indemnify the driller for loss to its own equipment due to its own fault. One possible solution is to broaden coverage by removing the word "tort," thereby eliminating the "tort liability" requirement from the definition of "insured contract." However, this approach is not foolproof and does not solve the problem of a party's direct liability in the absence of fault.

Exceptions for Non-Operators as Named Insureds

As previously noted, joint ventures are commonly formed in connection with oil and gas exploration and production activities. Parties to a joint venture enter into a joint operating agreement (JOA), a contract that serves several purposes, including identifying the property interests of the parties in the applicable mineral lease. In a JOA, one of the co-owner of the mineral lease (typically the co-owner with the largest working interest in the mineral lease or the most operating expertise) is designated operator. The operator has responsibility for the actual operation of the well or mine. The other co-owners are designated "nonoperators." Nonoperators are investors in the venture who are responsible for a portion of the ongoing costs associated with the venture, and receive profits from successful wells, but do not participate in or have any responsibility for the actual operation of the well or mine. An example of an operating group's interest in a mineral lease might be helpful. Exhibit 3.3 illustrates the operating group for the Macondo exploratory well.

Exhibit 3.3
Operating Group for the Macondo Exploratory Well



The JOA also sets forth the method for sharing expenses and for the allocation of liability with respect to the oil and gas exploration and production operations. JOAs usually contain an exculpatory provision eliminating an operator's liability, absent the operator's gross negligence or willful misconduct. Liability under a JOA is several, meaning each party is responsible for its share of claim costs, absent the operator's gross negligence or willful misconduct. Furthermore, the JOA typically requires the operator to purchase insurance, including CGL, for the benefit of the joint venture and the parties to the JOA, and the nonoperators are usually named as additional insureds under the operator's insurance policies.

However, CGL coverage is not always required by the JOA, and, therefore, nonoperators need to have their own insurance, either primary (if there is no CGL coverage under the JOA) or excess of the coverage provided by the JOA. Nonoperators are not always named in suits against the Operator. This creates a potential problem for the non-operators because coverage under their own CGL policy may not be triggered. Most CGL policies do not address the exposure that exists when a nonoperator is a named insured but is not named in the lawsuit against the operator. A few insurers have modified the contractual liability exclusion to address this situation. The modified language creates an exception to the contractual liability exclusion which preserves coverage for the liability of the operator or any co-owners to pay damages if the named insured assumed such liability as operating expenses under a JOA for any well, oil lease, or gas lease the named insured owns but does not operate.

Consider the following example.

- The operator owns a 50% working interest in the mineral lease.
- Nonoperator A and Nonoperator B each own 25% working interests in the mineral lease.
- Operator, Nonoperator A, and Nonoperator B are parties to a JOA with an exculpatory clause but the JOA does not require Operator to purchase insurance for the benefit of the joint venture and the parties to the JOA.
- Nonoperator A's CGL policy contains the modified version of the contractual liability exclusion, but Nonoperator B's CGL policy contains the standard contractual liability exclusion.

The Operator hires a contractor to perform fracking operations but the operations fail and the well must be plugged and abandoned. One of the contractor's employee's is injured during the operations. The employee sues the Operator, alleging that the Operator's ordinary (not gross) negligence caused his injuries. Nonoperator A and Nonoperator B are not named as defendants to the lawsuit but are liable for their share of any judgment or settlement because the Operator's conduct did not amount to gross negligence or willful misconduct. The Operator reaches a settlement with the employee and invoices Nonoperator A and Nonoperator B for their share of the damages paid. Both Nonoperator A and Nonoperator B seek coverage for the claim under their CGL policies. Nonoperator B's insurer denies the claim. However, Nonoperator A's policy will respond to the liability it assumed to pay damages under the JOA, subject to the policy's other exclusions and conditions, because the modified language of the contractual liability exclusion expressly preserves coverage for this liability.

The example discussed above illustrates how nonoperators might have exposure under their own CGL policies. Nonoperators should consider modifying the contractual liability exclusion in their own CGL policies to preserve coverage for contractually assumed liability to pay operating expenses under a JOA for any well, oil lease, or gas lease they own but do not operate.

Liquor Liability Exclusion

The liquor liability exclusion precludes coverage for bodily injury or property damage for which any insured may be held liable relating to the furnishing of alcoholic beverages. However, the exclusion applies only if the named insured is in the business of manufacturing, distributing, selling, serving, or furnishing alcoholic beverages. Consequently, it has virtually no impact on energy industry companies. In the event an energy industry company is sued for injury or damage associated with its providing of alcohol at company-sponsored parties or events, there would be coverage for the claim under the CGL policy. (This exposure is often referred to as "host liquor liability.")

Workers Compensation and Similar Laws Exclusion

Exclusion d. of the CGL policy precludes coverage for any obligation the insured may have under workers compensation, disability benefits, and unemployment compensation laws. These coverages are provided under separate policies designed specifically to handle these exposures. The exclusion in the CGL policy, therefore, avoids a potential overlap in coverage.

Employers Liability Exclusion

The employers liability exclusion removes coverage for any claim arising out of bodily injury to an employee of the insured if the injury is sustained as a result of that employment. Injuries to workers are normally covered by workers compensation insurance, but even if they fall outside the workers compensation statute, they are not covered by the CGL policy. Claims brought by an injured employee's family members for loss of consortium, companionship, etc., as a consequence of an employee's bodily injury, are also excluded. All of these types of claims are covered under the employers liability coverage section of the workers compensation insurance policy that most employers are required by law to carry.

The only exception to the employers liability exclusion is liability that the insured company assumes under an "insured contract." This exception preserves coverage under the CGL policy for third-party-over actions, in which a company's employee sues a third party (e.g., the operator's drilling fluids contractor's sues the operator) for injuries sustained while working on the project. The operator then looks to the drilling fluids contractor for a defense and indemnification of damages, in accordance with a hold harmless agreement in the contract with the drilling fluids contractor. The "insured contract" exception to the employers liability exclusion preserves coverage for third-party-over claims. The policy's definition of the term "employee" does not include temporary workers, such as seasonal workers, a substitute for a permanent employee who is on leave, and other short-term workers. As a result, temporary workers are not prevented from bringing a claim against the insured for injuries sustained in connection with their work for the insured. The CGL policy will respond to such claims.

Pollution Exclusion

CGL coverage for energy risks will almost always be modified by pollution exclusions different from the "absolute" exclusion found in the basic policy.

The pollution exclusion omits coverage for damages arising out of the "discharge, dispersal, seepage, migration, release or escape of pollutants." This wording is designed to encompass virtually any means by which pollutants enter or are spread through the environment—ground, water, or air. The term "pollutants" is defined in the exclusion as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste."

The current standard CGL pollution exclusion is commonly known as the "absolute" pollution exclusion that removes liability coverage with respect to most pollution events that occur in the course of an insured's business operations. This name, however, is a misnomer, as the five subparts of the exclusion, in which its application is qualified, actually leave some coverage intact. The coverage energy industry companies retain through exceptions to the pollution exclusion is summarized in Exhibit 3.4.

Exhibit 3.4
Covered Pollution Exposures

- "Bodily injury" sustained in a building owned or operated by the insured that is caused by smoke, fumes, vapor, or soot from equipment used to heat, cool, or dehumidify the building; or from a water heater
- Non-remedial operations on non-owned premises, if you are a contractor and if neither the contractor nor its subcontractors brought the contaminants onto the site
- Accidental discharge of fuels, lubricants, or other operating fluids if you are a contractor and the contractor brings to the site that are essential to the operation of "mobile equipment"
- Release of fumes or vapors from materials brought to the site by the insured in connection with the work
- Injury or damage arising out of products of the insured or completed operations (unless remedial in nature)
- Heat, smoke, or fumes from a "hostile fire" (unless related to remedial operations)

Premises Exposures

With one exception, the CGL provides no coverage for any pollution that is confined to or that originates from the insured's own premises, including any location that is currently or was ever owned or occupied by or rented or loaned to the insured or any other insured. The only exception to this portion of the exclusion is for "bodily injury" sustained in a building and caused by smoke, fumes, vapor, or soot from equipment used to heat the building. This exception preserves coverage for bodily injury arising out of accidents such as the escape of carbon monoxide from a defective furnace.

Operations Exposures—Handling of Pollutants

Where the insured's primary function at any other site is to clean up, monitor, contain, treat, or test for pollutants, the exclusion will also apply—likewise for liability arising out of the use of any site for storage, disposal, processing, or treatment of waste and liability arising out the transportation of wastes by or for an insured. This is significant for energy industry companies who perform environmental remediation services or provide hazardous waste transportation services. Energy industry companies who perform environmental remediation services or who provide hazardous waste transportation services should consider purchasing pollution legal liability, contractor's pollution liability insurance, or other specialty environmental insurance. Pollution legal liability and contractor's pollution liability insurance are briefly discussed in greater detail later in this chapter.

Operations Exposures—Other

With respect to operations other than the type described above, the CGL pollution exclusion only applies to operations on which the insured (or its contractors or subcontractors) "are performing" operations. The present tense implies that the exclusion does not apply to (thus, coverage does exist for) completed operations. In fact, nothing in the CGL pollution exclusion directly addresses the completed operations hazard, and those exclusions that do apply to completed operations are by virtue of a broad exclusion that does not use the "are performing operations" language. Therefore, a broad scope of coverage is available for bodily injury or property damage caused by pollution at a site on which the insured is no longer performing work.

With respect to ongoing operations, the pollution exclusion only applies if the pollutants were brought onto the job site by the insured or the insured's contractor or its subcontractors. For example, if the operator's well service contractor accidentally ruptures an underground pipe that leaks contaminants into the soil, air, or waterways, the exclusion will not apply. There are even a few exceptions to the exclusion for contaminants that are brought to the site by the insured or the insured's contractor or its subcontractors. Most notably, a release of fuel, lubricants, and other potential "pollutants" that are needed for the operation of the insured's equipment is not excluded if they accidentally spill or escape from the equipment they are intended to help function. That is, if a fuel tank on a bulldozer is punctured by a forklift and fuel leaks out, the exclusion would not apply. However, if the insured brings a fuel tank to the site for refueling purposes, and the tank is ruptured, the exclusion would apply.

Other coverage that is left intact by the pollution exclusion includes liability for damages caused by heat, smoke, or fumes from a "hostile fire." (A "hostile" fire is generally defined as a fire that is outside its intended scope or boundaries.) In other words, contamination of the air caused by smoke from an unintended fire at the construction site would not be an excluded "pollution" incident; on the other hand, contamination by smoke from the controlled burning of scrap, or from fires kindled in metal drums to provide warmth to workers on a drilling rig, would be "pollution," and any resulting liability would be excluded.

Waste and Waste Sites Exclusions

Some CGL policies issued to insureds in the oil and gas industry contain additional exclusions which may apply to pollution liability. For example, a CGL policy may also contain a "waste site" exclusion under which the policy does not apply to any injury, damage, expense, cost, "loss"," liability, or legal obligation arising out of or in any way related to any actual or alleged discharge, dispersal, seepage, migration, release, or escape of "pollutants" at, from, or related to any "waste site." The definition of "waste site" could vary by insurer but generally includes any premises, site, or location not owned, occupied by, or rented or loaned to any insured which is or was at any time licensed or subject to licensing or reporting requirements by a regulatory authority for the recycling, reconditioning, reclamation, storage, disposal, processing or treatment of waste, including any materials that were discarded or have been removed as part of any environmental remediation effort. The "waste site" exclusion can have significant implications for energy industry companies that own or dispose into salt water disposal wells or if the company owns or operates salt water pipelines or if the company reuses produced water since the salt water disposal wells, salt water pipelines, and wells holding produced water could be considered waste sites. Consequently, it is important for companies in the energy industry to amend the definition of "waste site" so that it does not include salt water disposal wells, salt water pipelines, and any containers that hold produced water. The exclusion itself should also be amended to address the unloading or loading of pollutants at a salt water disposal facility.

As previously noted, the CGL policy's definition of "pollutants" includes "waste." Some CGL policies do not define the term "waste" and other CGL policies contain a definition that is extremely broad. For example, a policy might define waste as materials to be recycled, reconditioned, or reclaimed. This definition of "waste" is problematic because oil and gas operations typically use or produce substances that qualify as "waste." For example, produced water that is reused in fracking operations would qualify as "waste." It is important for energy industry companies to amend the definition of waste so that it excepts substances produced by the insured's wells, substances injected into the insured's wells, and glycol used in the insured's oil and gas operations.

Pollution Liabilities-Additional Considerations

CGL policy coverage forms can differ from insurer to insurer. This means that certain pollution liabilities might be excluded from coverage under certain CGL policies. For example, some CGL forms cover pollution cleanup costs but require legal liability for such costs. Other CGL forms cover first party cleanup costs that are voluntarily incurred and do not require legal liability. Additionally, some CGL forms may exclude coverage for punitive or exemplary damages arising from pollution liabilities. In other words, to the extent that coverage exists for pollution claims, the policy may only cover compensatory damages.

Other CGL policies may exclude coverage for damages and costs associated with an out of control well, including harm caused by seepage and pollution and costs for remedial clean-up measures. If the CGL policy has language excluding coverage for control of well expenses, energy industry companies should consider purchasing an Operator's Extra Expense/Control of Well (OEE/COW) insurance policy. An OEE/COW policy provides coverage for costs that energy companies incur when regaining control of a well. Coverage under an OEE/COW policy may include redrilling expenses and damages paid to third parties for harm caused by seepage and pollution and costs for remedial clean-up measures. An OEE/COW insurance policy might also provide coverage for liability for damage to third-party equipment under the operator's care, custody or control and removal of wreckage or debris.

Finally, oil and gas operations routinely require companies to be named as additional insureds. If standard blanket additional insured endorsements are used, the additional insured will not receive the benefit of pollution coverage under the CGL policy. Consequently, blanket additional insured endorsements will need to be modified to address pollution coverage for the additional insured.

Seeking coverage for pollution liabilities under the limited coverage provided under the CGL policy is not a realistic risk transfer technique, especially for gradual, long-term pollution events. Certain endorsements discussed in greater detail later in this course add limited coverage for pollution events, but these endorsements are not sufficient to manage the types of pollution or environmental events that can occur from oil and gas operations. Therefore, energy industry companies should consider purchasing pollution legal liability, contractor’s pollution liability insurance, or other specialty environmental insurance.

The use of pollution legal liability, contractor’s pollution liability, and other specialty environmental insurance policies is warranted for a few reasons. First, coverage for pollution events arising from oil and gas operations under the CGL policy is limited. Second, under many oil and gas contracts, one party contractually assumes liability for pollution liabilities, but most pollution forms do not provide pollution coverage that is contractually assumed. One way to get around this problem is to have contractual liability for pollution liabilities endorsed on to the policy. Third, coverage for pollution liability under the CGL policy might not get triggered if the injury or damage was not caused by an accident or an event. Fourth, pollution exclusions in CGL policies issued to energy industry companies often contain a time element during which pollution must be discovered by the insured and reported to the insurer. The time element can be problematic when the claim involves gradual, long-term pollution. Fifth, if the pollution event is “expected or intended,” coverage under the CGL policy would not exist. Finally, most CGL policies do not cover medical monitoring costs. These costs can arise for energy industry companies, especially those companies involved in fracking operations. Many lawsuits involving fracking include demands for medical monitoring for claimants whose drinking water is contaminated, and the insurer might take the position that absent actual bodily injury to claimants, no coverage for medical monitoring exists.

Pollution legal liability policies typically cover both first party and third party clean-up costs as well as third party bodily injury and property damage claims. Furthermore, pollution legal liability policies generally apply to both gradual and sudden and accidental pollution events. Pollution legal liability policies often have broader coverage triggers than a CGL policy and coverage typically exists for certain expenses not covered by CGL policies, such as medical monitoring costs, natural resource damage, diminished value of third party property, emergency response, evacuation and crisis management expenses, and direct business income loss (when caused by a pollution event). Finally, pollution legal liability and specialty environmental policies typically sit “excess and difference in conditions” to underlying policies including the CGL and umbrella policy. This feature eliminates any difficulties in making “other insurance” clauses work seamlessly.

Contractor’s pollution liability insurance covers pollution incidents arising out of the insured’s job site operations. For example, contractor’s pollution liability insurance may be appropriate for a contractor who is hired to install equipment at the job site. Contractor’s pollution liability insurance provides coverage for first party and third party cleanup costs, third party bodily injury and property damage, defense costs, emergency response costs, and transportation and disposal of waste or materials from the job site. Finally, contractor’s pollution liability insurance can be incorporated into an insured’s pollution legal liability policy if, in addition to performing services, the insured also owns wells, pipelines, or other fixed job site assets.

Aircraft, Auto, or Watercraft Exclusion

This exclusion precludes coverage for injury or damage arising out of the ownership, maintenance, or use of aircraft, auto, or watercraft. Liability arising out of the loading or unloading of an automobile is also excluded. These exposures are more appropriately covered under policies specifically designed to insure them.

Note that the exclusion applies only to aircraft, autos, or watercraft that are owned by, operated by, rented to, or loaned to the insured. The exclusion, therefore, does not eliminate coverage with respect to autos owned and operated by someone other than an insured, such as a subcontractor. This preserves coverage for the insured contractor's derivative liability arising out of its use of independent contractors.

Five exceptions to the exclusion preserve coverage for certain additional exposures, summarized in Exhibit 3.5. Of these, the exceptions for contractually assumed liabilities and operation of specified types of attached equipment are of most importance for energy industry companies.

Exhibit 3.5
Covered Auto, Aircraft, and Watercraft Exposures

- Watercraft while ashore on the named insured's premises
- Nonowned watercraft less than 26 feet in length that is not being used to carry persons or property for a fee
- Third-party bodily injury or property damage arising out of valet parking services the insured provides for automobiles of customers, guests, or other visitors. Physical damage to the automobiles themselves is excluded by the care, custody, and control portion of the "damage to property" exclusion.
- Liability assumed under an "insured contract" for the ownership, maintenance, or use of aircraft or watercraft
- Liability arising out of the operation of specified types of equipment that is permanently attached to an auto

Contractual Liability—Aircraft or Watercraft

Recall that the CGL policy covers a variety of contractually assumed liabilities. However, that coverage is subject to the rest of the policy's terms and conditions. Therefore, if liability arising out of the use of an auto, aircraft, or watercraft is excluded, that applies to contractually assumed liabilities for such damages as well. However, an exception to the aircraft, auto, and watercraft exclusion preserves coverage for liabilities arising out of the use of an aircraft or watercraft only (not use of an auto) that are assumed under an "insured contract." (The commercial auto policy provides similar coverage for contractual liabilities arising out of the use of an auto.)

An example may be helpful in demonstrating a company's potential exposure to aircraft and watercraft liability and how the CGL policy responds to these liabilities. Assume a drilling contractor hires the owner of a helicopter to airlift a drill from the roof of the drill manufacturer's warehouse to a drilling rig. The helicopter owner agrees in the contract for services to hold harmless, defend, and indemnify the drilling contractor and manufacturer from liability arising from its operation of the helicopter in lifting the drill from the roof of the manufacturer's building to the drilling rig. In the course of the moving operation, the helicopter drops the drill , causing damage to an adjacent building and several vehicles parked nearby. The helicopter owner's CGL policy will not respond to claims made directly against him due to the aircraft exclusion. A special aircraft liability policy is needed to cover that exposure. However, the helicopter owner's CGL will respond to his obligation to indemnify the contractor and manufacturer for any claims made against them for such damages due to the exception to the "aircraft, autos and watercraft" exclusion for contractually assumed liabilities.

Mobile Equipment vs. Autos

Many energy industry companies face a number of liability exposures arising out of the ownership and use of mobile equipment, such as bulldozers, cranes, and backhoes. Mobile equipment exposures include transportation and operation of the equipment. Liability arising out of the operational use of many types of mobile equipment is covered by the CGL due to an exception to the "auto" exclusion. (Liability arising out of the transportation of such equipment is largely excluded. See the discussion of the mobile equipment exclusion below.)

The CGL policy's distinction between "auto" and "mobile equipment" is important . While liability for the use or ownership of automobiles is excluded, liability arising out of the ownership or use of mobile equipment is covered. Unfortunately, the distinction between mobile equipment and autos is complicated, and some losses may fall into the gray area where it is not clear whether the loss involves "mobile equipment" or an "auto."

The CGL policy defines "auto" broadly as "a land motor vehicle, trailer or semitrailer designed for travel on public roads, including any attached machinery or equipment." This definition (and thus the auto exclusion) is broad enough to include many types of equipment energy industry companies use in their operations if it were not for a specific statement that "mobile equipment" will not be considered an "auto." (The CGL and commercial auto policies use the same definition of "mobile equipment," which allows their coverages to dovetail precisely.) The definition of "mobile equipment" thus determines where coverage does and does not exist with respect to such equipment.

The CGL policy defines "mobile equipment" to include items that have some features of an auto, such as wheels and an engine, but that are not typically used in the capacity of an automobile. Tractors, forklifts, cranes, and graders are just a few examples of "mobile equipment." These items are used more like tools and machinery, and the risks they impose are more in line with machinery and tools than with those presented by automobiles. Therefore, they are more appropriately insured under the general liability policy than under the auto policy.

Mobile equipment includes items that are incapable of operation on public roads (e.g., heavy construction cranes), items that are designed for use off public roads but can nevertheless be driven on public roads (tractors, bulldozers), and items that would ordinarily be considered "autos" except that they are used exclusively in off-road activities (e.g., a crane that is used exclusively on a drilling contractor's rig). This blend of features and uses results in blended auto and mobile equipment exposures. For example, a truck registered and used on public roads presents an auto-type exposure when it is traveling on public roads. However, if that truck has permanently attached equipment, it presents more of an operations exposure (general liability) when the vehicle is stationary and the equipment is in use.

To keep coverage for each of these exposures in the most suitable place, coverage is split between the auto policy and the CGL policy based on how the vehicle/equipment is being used at the time of the loss. By an exception to the auto exclusion, coverage applies to the operation of certain types of permanently mounted equipment, which means the operations exposure is covered under the CGL even if the unit as a whole is classified as an auto. For example, if a pickup with a permanently attached welding apparatus is involved in an automobile accident, the insured's automobile policy will respond, and this loss is excluded under the CGL policy (due to the "auto" exclusion). If, on the other hand, negligent use of the welding equipment results in a fire, the insured's CGL policy will respond due to the mobile equipment exception to the auto exclusion. Avoiding coverage disputes over how the policy should respond to these types of losses is a good reason to place an energy industry company's automobile and general liability coverages with the same insurer whenever feasible.

Mobile Equipment Exclusion

Although the CGL policy provides coverage with respect to "mobile equipment," an exclusion does apply with respect to the transportation of such equipment. When mobile equipment is being transported by truck or other vehicle, the liability risks associated with the equipment are highly similar to the risks associated with using an automobile; therefore, coverage is provided under the auto policy rather than the CGL policy. The mobile equipment exclusion prevents the argument that a given accident involving an auto carrying mobile equipment actually arose out of the mobile equipment and should therefore be covered.

Specifically, the mobile equipment exclusion of the CGL policy removes coverage for liability arising out of the transportation of mobile equipment while being transported by an auto "owned, operated by, rented or loaned to" the insured. Transportation of mobile equipment by a hired mover or independent subcontractor, however, is not excluded as long as the vehicle transporting the equipment is not owned, operated, rented, or loaned to the insured. This preserves the insured company's coverage for when it is sued based on the actions of its independent contractors.

The exclusion also eliminates coverage under the policy while covered equipment is being used in a racing, speed, or demolition contest, or stunting activities. No exceptions apply to this portion of the exclusion.

War Exclusion

While prior versions of the CGL excluded only contractual liabilities arising out of war activities, the current version of the exclusion is nearly absolute in its application. The war exclusion in the current standard CGL policy precludes coverage for bodily injury or property damage arising out of the following three categories of war risks.

- War itself, including undeclared war and civil war
- Other warlike action undertaken by a military force
- Insurrection, rebellion, revolution, and usurped power, including governmental action to counter any of these

Damage to Property Exclusion

Recall that the primary purpose of the CGL Coverage A is to provide coverage for third-party bodily injury and property damage. That is, the policy intends to cover the insured company's liability for damages suffered by others as a result of the insured's negligence. Understandably, therefore, the policy does not cover damage to the insured's own property. Nor does it cover damage to certain other types of property where the risks are more representative of first-party property than third-party property, such as premises that the energy industry company rents or leases. A close look at the "damage to property" exclusion will reveal some problems that show why first-party property insurance is the only way to obtain comprehensive coverage for certain categories of property.

The "damage to property" exclusion removes coverage for six categories of property, which are listed in Exhibit 3.6. Each of these categories is discussed briefly below.

Exhibit 3.6
Excluded Property Categories—"Damage to Property" Exclusion

- Property the insured owns, rents, or occupies
- Premises the insured sells, gives away, or abandons (aka "alienated property")
- Borrowed property
- Personal property in the insured's care, custody, or control
- "That particular part" of real property on which the insured (or any contractors or subcontractors) is performing operations if the damage arises out of those operations
- "That particular part" of any property that must be restored, repaired, or replaced because the insured's work (including work performed by a contractor or subcontractor) was incorrectly performed on it

Property Owned/Rented/Occupied by the Insured

The first category of property addressed under the "damage to property" exclusion is property owned, rented, or occupied by the insured. These types of property are more appropriately covered through first-party insurance policies (e.g., a building and personal property policy).

Alienated Premises

Also excluded is property damage that arises out of any part of premises that are sold, given away, or abandoned by the insured. The intent of this exclusion, which is commonly referred to as the "alienated premises" exclusion, is to remove coverage for the costs of correcting any known defects in the premises prior to selling it. (Note that this part of the exclusion applies only to property damage; bodily injury arising from such premises and property damage to property other than the actual premises are not addressed in the exclusion.)

By exception, this exclusion does not apply if the premises in question are the named insured's work and were never occupied, rented, or held for rental by the named insured.

Borrowed Property

The damage to property exclusion precludes coverage for damage to property loaned to the energy industry company. This part of the exclusion would eliminate coverage for damage to tools or equipment the company borrows from another party. Coverage for borrowed property can often be arranged under a separate contractors equipment insurance policy for the oil and gas industry or rigs and equipment insurance policy.

Personal Property

Damage to personal property in the care, custody, or control of any insured is also excluded. The keys to interpreting this exclusion are defining what constitutes personal property and what constitutes "care, custody or control" of that property. Personal property is not defined in the policy, so it takes on its normal legal meaning, which is any property other than real property. Real property, by definition, includes land, buildings, and certain items permanently attached to such property.

The more problematic element of this exclusion is what constitutes being in an insured's "care, custody or control." Recall that risk under most oil and gas contracts is usually transferred to one party regardless of fault, and, in some instances, the contracts contain carve-outs which require one party to take direct responsibility and release the other party from certain risks. For example, under a drilling contract, the operator takes direct responsibility for damage to the drilling rig and damage to downhole tools due to unsound location. Assume that roustabouts damage an amine unit while installing it for an operator. Damage to the amine unit would not be covered because it was in the care, custody, or control of the operator. Similarly, damage to the drilling rig caused by the operator's well service contractor would not be covered if the drilling rig was in the operator's care, custody, and control at the time such damage took place. Given the unique way risk is allocated under oil and gas contracts, the CGL and umbrella policies cannot always be relied upon to provide coverage for large property exposures. Consequently, operators should consider purchasing specialty insurance such as rigs and equipment coverage or OEE/COW insurance for such exposures.

Property on Which the Insured or its Contractor Is Working

The fifth type of excluded damage to property applies only to operations being performed on *real* property. (As noted above, real property includes land, buildings, and certain items permanently attached to such property.) If the insured's operations result in damage to real property, there is no coverage for damage to "that particular part" of the property on which the operations were being performed at the time of the loss. (The requirement that the operations are in progress at the time the loss occurs renders this portion of the exclusion inapplicable to completed operations losses.)

The phrase "that particular part" is intended to define precisely what is covered (i.e., resulting damage to other property) and what is not covered (i.e., the faulty work or the item being worked on at the time of the loss).

Faulty Workmanship

The sixth and last category under the "damage to property" exclusion is frequently referred to as a "faulty workmanship" exclusion. Under this part of the exclusion, coverage is eliminated for property damage to "that particular part" of property that must be repaired or replaced because the insured's work was "incorrectly performed" on it. (Unlike in the previous section of the exclusion, this portion of the exclusion is not limited to damage to *real* property.) The purpose of this exclusion is to eliminate coverage for the insured's bad work. Most insurers would argue that to cover poor workmanship would be a disincentive for insureds to be diligent in the quality of their work. By specific exception, the exclusion does not apply to losses that are included in the "products and completed operations hazard," which limits its application to damage arising out of ongoing operations. (Coverage for damage to completed work is the subject of a separate exclusion, which is discussed below.)

Damage to "Your Product" Exclusion

The damage to "your product" exclusion eliminates coverage for property damage to the named insured's product arising out of that product or any portion of it. This exclusion is intended to apply only to manufacturers and other entities that produce "products" rather than service companies such as operators and drilling contractors. The damage to "your work" exclusion, which applies to completed operations, is of much greater significance to operators, drilling contractors, and well service contractors.

Damage to "Your Work" Exclusion

While several CGL exclusions pertain to completed operations losses, the "damage to your work" exclusion is by far the most important in defining the scope of completed operations coverage. This exclusion specifically states that it applies only to liability arising out of the "products-completed operations hazard," which limits its application to completed work. The "damage to property" exclusion, discussed above, addresses coverage for damage to work in progress.

The purpose of the "damage to your work" exclusion is to prevent the CGL policy from functioning as a warranty of the insured's work. It provides that Coverage A does not apply to damage to "'your work' arising out of it or any part of it and included in the 'products-completed operations hazard.'" A casual reading of this language may appear to render completed operations coverage virtually worthless, at least with respect to damage to the work itself. Nothing could be further from the truth. Significant completed operations coverage is retained in the exception to the exclusion. Specifically, the exclusion does not apply if the damaged work or the work out of which the damage arises was performed by a subcontractor. Coverage is thus preserved for damage *to* a subcontractor's work and damage *caused by* a subcontractor's work.

The only property damage to completed work that is not covered, therefore, is damage to the insured company's own work that is the result of that work. For this reason, the exclusion is frequently referred to as the “workmanship” exclusion.

“Impaired Property” Exclusion

The purpose for including the “impaired property” exclusion in the CGL policy was to address “passive defects” due to the presence of defective products or defective work. A passive defect is one that has not yet failed but that presents an increased risk of failure in the future. For example, a defective blade by one manufacturer is incorporated into another manufacturer’s wind turbine. The defect does not directly (“actively”) damage the property, but its incorporation renders the property less useful or valuable, or makes it necessary to undertake extensive, and potentially destructive alteration of the property in order to repair or replace the defective product. Specifically, the exclusion eliminates coverage for claims alleging loss of use arising out of the mere incorporation of a defective component into another piece of property or defective work into a product or into a building or structure. The exclusion goes on to stipulate that such physical injury—even though it constitutes "property damage"—is not covered if it meets the conditions set up by the "impaired property" definition.

The CGL policy uses a two-prong test to determine if property is “impaired property.” First, there must be tangible property *other than* “your product” or “your work” that cannot be used or is less useful because “your product” or “your work” is incorporated into the property. Second, the property can be restored to use by the repair or replacement of “your product” or “your work.” When both of these conditions are met, the property is deemed “impaired property” and thus excluded under the CGL policy.

"Impaired property" can be created not only by the incorporation of the insured's defective product into other property, but also by the failure of the insured to fulfill a contract. The most obvious application of this part of the exclusion involves losses when an insured manufacturer supplies defective components to another manufacturer. The defect may be discovered before incorporation of the insured's product has taken place yet still result in loss to the other manufacturer, who is left with an inventory of partially completed products that lack one necessary component. If replacement components cannot be easily acquired—or cannot be acquired at all—the other manufacturer incurs loss of use of its inventory because of the insured manufacturer's failure to deliver components in fulfillment of its contract. If the items of the other manufacturer's inventory can be restored to use (i.e., if they can be assembled and marketed as intended) given the insured's delivery of nondefective components, then the inventory represents impaired property. If fulfillment of the insured's contractual obligation would not restore the inventory to use—if, for instance, a critical time factor governed the manufacturing process and that time had passed—then the inventory is not impaired property.

This application of the exclusion is consistent with the notion that the CGL policy is not intended to cover the cost of repairing or replacing the faulty product or the faulty work. By exception to the exclusion, coverage is retained for loss of use that is the result of sudden and accidental physical injury to “your product” or “your work” after it has been put to its intended use, which preserves coverage for damages that are caused by the actual failure of the defective work, as opposed to the mere risk of failure.

“Your Product” and Breach of Contract

While our discussion of the impaired property exclusion has centered on the issue of damage arising out of “your work,” it is worthwhile to make a few general observations on the other parts of the exclusion. First, materials and supplies that are furnished by the insured company in connection with their work are included in the policy’s definition of “your work.” Thus, the incorporation of bad piping into an oil pipeline project falls under the “your work” aspect of the exclusion, as opposed to “your product.” Most energy companies, therefore, will not be impacted by the “your product” portion of the exclusion.

A second part of the exclusion eliminates coverage for “delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.” This exclusion negates coverage for loss of use claims arising out of the insured’s failure to meet its deadlines, among other things. For example, a drilling contractor agrees to rig up and start drilling a well by a specific date and fails to do so. The operator loses the mineral lease because of the drilling contractor’s delay and sues the drilling contractor, alleging the drilling contractor’s failure to drill the well by a specific date constituted a breach of contract. The drilling contractor’s CGL policy would not cover this claim.

Recall of Products, Work, or Impaired Property

This clause, commonly known as the "sistership" or "products recall" exclusion, precludes coverage for damages incurred if the named insured's "product, work, or property is withdrawn or recalled from the market or from use" because of a "known or suspected defect, deficiency, inadequacy or dangerous condition in it." Its origin derives from the aircraft industry where a major accident with one type of plane would prompt the recall of every other plane of that make (its "sisterships").

Personal and Advertising Injury

The personal and advertising injury exclusion removes coverage for bodily injury that arises out of "personal and advertising injury." Coverage for personal and advertising injury is the subject of the CGL policy's Coverage B. To avoid duplication, coverage for any consequential damages arising out of a bodily injury is excluded under Coverage A.

Electronic Data

The electronic data exclusion eliminates coverage for damages arising out of the "loss of, loss of use of, damage to, corruption of, inability to access, or inability to manipulate electronic data." This exclusion, added to the policy in December 2004, is somewhat redundant to the policy's provision that "electronic data is not tangible property," which disqualifies it for coverage by removing it from the definition of "property damage." However, this exclusion can result in serious consequences for energy industry companies. Cyber exposures have become common in the energy industry and these exposures can affect energy industry control systems as opposed to business applications or email. In fact, at least four United States oil companies have been infected by the Stuxnet virus. The virus is used to take control of a particular model of Programmable Logic Controller (PLC) manufactured by Siemens. The virus subsequently sets up communications with a remote server computer that can be used to take control of the PLC system or to steal proprietary corporate data. For example, the Stuxnet virus could infect an oil pipeline's PLC, ultimately shutting down the pipeline or could infect an offshore drilling rig, ultimately leading to an oil spill. In 2010, the virus targeted uranium enrichment centrifuges used by Iran in its nuclear enrichment facilities, was able to reconfigure the centrifuge drive controllers, and caused the equipment to slowly self-destruct.

The energy industry is vulnerable to more than just the Stuxnet virus. Oil and gas companies in the U.S. are the frequent targets of cyber-attacks by hackers who are looking to access trade secrets, such as strategic plans, bids for new drilling projects, geological data, and information about private negotiations with foreign officials. To put this in perspective, from approximately 2008 to 2011, many U.S. oil and gas firms were invaded by the "Night Dragon," a series of cyber intrusions by hackers located in China with the purpose of stealing highly confidential and proprietary information about oil and gas field operations, financial transactions, and bidding data. Moreover, the energy industry's increasing reliance on digital technology has resulted in process control automation systems that contain vast amounts of highly sensitive information that are vulnerable to cyber threats. Finally, new federal and state legislation related to cyber-risk disclosures and privacy breaches have resulted in increased cyber liability exposures for energy industry companies.

Since the electronic data exclusion establishes that electronic data is not tangible property, an energy industry company's CGL policy will not respond to third-party loss exposures associated with a cyber-attack. Many insurance companies now offer policies specifically designed to provide coverage for both first-party and third-party cyber risks. Consequently, operators, drilling contractors and other energy industry companies should evaluate whether their existing insurance programs adequately cover cyber security-related risks, and whether to purchase a specialized insurance policy to cover cyber risks.

Chapter 4
CGL Coverages B and C

For energy industry companies, Coverage A, discussed in detail in Chapters 2 and 3, is by far the most important coverage of the CGL policy. Chapter 4 deals more briefly with the CGL's other two main coverages:

- Coverage B of the CGL expands the policy's scope of coverage to include "personal and advertising injury" liability; these terms are described further in this chapter.
- Coverage C reimburses the medical expenses incurred by members of the general public who are injured on the insured company's premises or because of the firm's operations. Because benefits under this coverage are paid regardless of the insured's legal liability, it is not truly a liability coverage.

Learning Objectives
In this chapter, you will learn how to… 1. Differentiate "bodily injury" from "personal injury" and explain where coverage for each may be found in a standard CGL policy. 2. Determine whether or how Coverage B of the CGL would respond to various types of claims. 3. Identify the criteria that must be met for a medical payments loss to be covered and determine whether they have been met in a given situation. 4. Recognize why medical expense coverage is provided on a no-fault basis.

Coverage B—Personal and Advertising Injury

Coverage B of the CGL expands the policy's scope of coverage to include "personal and advertising injury" liability. The policy's definition of "personal and advertising injury" cites a number of different types of offenses that may produce covered damages. The key offenses that trigger coverage for personal and advertising injury are outlined in Exhibit 4.1.

Exhibit 4.1 Personal and Advertising Injury
• False arrest, detention, or imprisonment • Malicious prosecution • Wrongful eviction • Wrongful entry • Invasion of privacy • Libel or slander of a person, organization, product, or service • Advertising infringement • Copyright infringement in advertisements • Consequential "bodily injury" arising out of any of the above offenses

The offenses listed in Exhibit 4.1 are given their normal legal meaning. For example, *Black's Law Dictionary* (5th ed.) defines malicious prosecution as one "begun in malice without probable cause to believe the charges can be sustained." Likewise, libel is defined as "a method of defamation expressed by print, writing, pictures, or signs."

Although many attorneys tend to use the term "personal injury" to include "bodily injury," the CGL policy makes a clear distinction between the two. Although both types of injury are covered, they are separate sections of the policy, with different insuring agreements, different exclusions, different limits of insurance, and other variations in coverage. Note that bodily injury that occurs as a consequence of "personal and advertising injury" is covered under Coverage B rather than under Coverage A, which is where the policy's primary coverage for bodily injury is found. This is consistent with Coverage A's exclusion for such damages.

Advertising infringements include the inappropriate use of another's copyright, logo, slogan, etc., in the insured's advertisements, as well as misappropriation of another's advertising ideas. It does not cover other forms of copyright infringement, such as the use of copyrighted design documents without the copyright holder's permission. Internet publishing and advertising is covered the same as in more traditional media. For example, the definition of "advertisement" includes "material placed on the Internet or on similar electronic means of communication." As a result, operators, drilling contractors, and other energy industry companies have coverage for liability arising out of activities such as the posting of ad banners on a website.

Key elements of personal and advertising injury coverage are discussed below.

Insuring Agreement

The Coverage B insuring agreement makes promises similar to those found in the Coverage A insuring agreement. That is, it sets forth the insurer's promise to pay sums that the insured becomes legally obligated to pay as damages because of personal and advertising injury that is covered by the policy. It also states the insurer's obligation to defend the insured. Other key elements required to trigger coverage are outlined in Exhibit 4.2.

Exhibit 4.2 Elements of a Covered Loss—Personal and Advertising Injury Liability (Coverage B)
• Covered "personal and advertising injury" • Insured has a legal obligation to pay damages to a third party • Damages were caused by an offense arising out of the insured's business • The offense took place in the "coverage territory" during the "policy period"

One key difference in the Coverage A and Coverage B insuring agreements is the event that triggers coverage. While Coverage A is triggered by an "occurrence," the events that trigger Coverage B are referred to as offenses. The concept of an "occurrence" is inappropriate to Coverage B, since the CGL policy defines an occurrence as an "accident." The actions of an insured that might give rise to a personal and advertising injury claim are very seldom accidental. For example, the events that give rise to a claim based on libel, slander, copyright infringement, invasion of privacy, etc., are generally intentional acts. Even though the injury itself may not be intended by the insured, there would be coverage problems in providing personal and advertising injury on an "occurrence" basis. For this reason, the term "offense" is used in lieu of "occurrence" to designate the event out of which a personal and advertising injury claim arises.

Exclusions

Coverage B contains 16 exclusions, which are listed in Exhibit 4.3. Many of these exclusions pertain to offenses that were committed with knowledge of the fact that they violate the rights of another. Criminal acts committed at the direction of the insured are likewise excluded. The two key exclusions with specific application to the energy industry are the contractual liability exclusion and the pollution exclusion.

Exhibit 4.3
Coverage B Exclusions

- Knowing Violation of Rights of Another
- Material Published with Knowledge of Falsity
- Material Published Prior to Policy Period
- Criminal Acts
- Contractual Liability
- Breach of Contract
- Quality or Performance of Goods—Failure To Conform to Statements
- Wrong Description of Prices
- Infringement of Copyright, Patent, Trademark, or Trade Secret
- Insureds in Media and Internet-Type Businesses
- Electronic Chatrooms or Bulletin Boards
- Unauthorized Use of Another's Name or Product
- Pollution
- Pollution-Related Costs
- War
- Recording and Distribution of Material or Information in Violation of Law

Intentional Injuries

Coverage B does not require that the act that produces the injury be an unintentional act. On the contrary, as noted previously, the requirement that there be an offense, as opposed to an accident, is based on the notion that many of the actions that produce personal and advertising injuries will be intentional acts. However, if the person who commits the act does so with an understanding that it will almost certainly produce an injury, the CGL policy will not respond. Thus, it is the intentionality of the injury, rather than the act that produces the injury, that triggers the exclusion. Two of the Coverage B exclusions fall into the category of "intentional injury"—knowing violation of another's rights and publishing materials the insured knows to be false.

Publishing Activities

Several of the Coverage B exclusions are designed to remove coverage with respect to a variety of publishing risks. With the exception of the insured's own advertisements, liability arising out of publishing activities is largely excluded. An even broader exclusion for such offenses applies to insureds whose primary business is as a publisher, broadcaster, advertiser, or telecaster. Specialty coverages are available to insure these exposures, which constitute professional liability exposures for such businesses.

Various attempts have been made to obtain coverage for the misappropriation of intellectual property by arguing that advertising something that someone else legally owns the rights to constitutes "advertising injury." For example, if a drilling contractor uses data or techniques that are the proprietary property of a competitor, the mere advertisement of the use of such techniques does not constitute advertising injury. Only when the advertisement itself constitutes an infringement of another's copyright, slogan, etc., will Coverage B respond.

Personal and advertising injury is unique in that it can arise out of a single act that is or has been repeated many times. Print or broadcast advertisements, for example, may run in various media dozens or hundreds of times over a period of months or even years. The exclusion for materials first published prior to the policy period eliminates coverage for injury that arises out of material that is first published before the policy took effect, even if the particular publication giving rise to the claim occurs during the policy period.

Internet-Related Exclusions

The ownership, hosting, or supervision of Internet chat rooms and bulletin boards (websites where participants may post messages and opinions on a variety of topics) presents a significant risk of libel, slander, and invasion of privacy claims. Rather than factor this increased risk into basic CGL rates, when a large majority of insureds do not need the coverage, the risk is simply excluded.

Attempts to misdirect Internet users to a website by creating domain names and Web addresses that are similar to names associated with more well-known or more reputable companies could result in claims of copyright infringement or trade dress, or even criminal charges.

Criminal Acts

The exclusion for liability arising out of a criminal act applies only to the insured that committed the criminal act. Coverage is preserved with respect to the vicarious liability of an innocent insured. The exclusion does not require that the criminal act be willful, intentional, or malicious to be excluded.

Contractual Liability

As with Coverage A, contractually assumed liabilities are excluded, but unlike Coverage A, there is no exception for liabilities assumed in "insured contracts." Consequently, the energy industry company has no coverage for contractually assumed liability for personal injuries. Given the proclivity of many attorneys to use the term "personal injury" instead of "bodily injury" in indemnity clauses, energy industry companies may be assuming liabilities for which they have no coverage. One solution to this problem is to convince the drafters of the contract to use the term "bodily injury" instead of "personal injury" in the indemnity provision. In that way, the company's liability is matched to its insurance coverage. Deleting the Coverage B contractual liability exclusion is an alternative method of avoiding this uninsured exposure if the underwriter will agree to this modification.

Breach of Contract

With one exception, this exclusion removes coverage for personal and advertising injury that arises from a breach of contract in the insured's advertisement. (Claims for breach of contract with respect to activities other than advertising do not trigger coverage; therefore, the exclusion would not even come into play.) The exception applies where contractual obligations and advertising injury exposures could potentially overlap, such as where a dispute arises over express or implied contractual rights to use another's idea. When a breach of contract claim is brought against the insured in these circumstances, the exclusion does not interfere with coverage.

Failure To Meet Performance and Price Guarantees

Personal and advertising injury coverage is not intended to function as a guarantee of either quality or price. Energy industry companies have no coverage for claims that they failed to deliver the promised quality of product or service. Likewise, errors in cost estimates or other types of price differentials are not covered damages.

Pollution

Under prior versions of the CGL policy, a number of pollution liability claims that were clearly excluded under Coverage A were successfully pursued under Coverage B on the basis that the spread of pollutants onto another's property constituted trespass or wrongful entry onto another's premises. To avoid this type of claim, which clearly misconstrues the coverage intent, a pollution exclusion was incorporated into Coverage B. The exclusionary language is essentially absolute in effect.

Pollution claims alleging trespass and wrongful entry onto another's premises are more common than you might think. For example, the owners of a mineral estate ("estate owners") enter into a mineral lease with an operator, and the operator commences oil and gas operations on a mineral estate known as A-24. During onshore oil drilling, the operator develops an excess wastewater problem on an adjacent mineral lease it owns (A-16), hindering production of the operator's oil and gas on that property. The operator ultimately determines that the best solution to the problem would be to inject the wastewater into A-24 under the mineral lease. This action contaminates the A-24 estate owners' property. The estate owners sue the operator, alleging that the operator committed a trespass by discharging the excess wastewater on to their property and the contamination caused by the trespass interfered and damaged the wells in the estate owners' property. If a court concludes that the injection of excess wastewater spread pollutants onto the A-24 estate owners' property and constituted a trespass, the Coverage B pollution exclusion would bar coverage for the claim. Similarly, a group of oil and gas operators construct and operate pits, wells, sumps, pipelines, flow lines, tank batteries, well heads, and injection wells as part of their drilling operations. Operation of these items results in spillage or disposal of toxic oilfield wastes, causing pollution damage on property that is adjacent to the mineral lease. The landowners sue the operators, alleging that the disposal of toxic oilfield wastes on their property was, among other things, a trespass. If a court concludes the spillage or disposal of toxic oilfield wastes was a trespass, the pollution exclusion would bar coverage for the oil and gas operators' claim.

Also excluded under coverage B are the costs of complying with any request, demand, or order to ascertain the extent of contamination, if any, or to remediate pollutants, by the government or otherwise. Likewise, governmental claims for damages for amounts spent for these types of activities are excluded. However, depending on the jurisdiction, coverage for these claims may be found under Coverge A.

War

Personal and advertising injury coverage is subject to a broad war exclusion identical to the one that applies to Coverage A. Injury, however caused, arising directly or indirectly out of war, warlike action by a military force, and other forms of insurrection is excluded.

Recording and Distribution of Material or Information in Violation of Law

This exclusion removes coverage for injury arising out of the violation of various federal and state laws aimed at regulating so-called junk faxes and e-mails. For example, the Telephone Consumer Protection Act of 1991 prohibits sending unsolicited advertisements to a fax machine, and similar restrictions were imposed on the use of e-mail for marketing purposes by the Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003. It would also reach injury arising out of violation of the Fair Credit Reporting Act and similar laws affecting the electronic gathering and recording of personal information about consumers.

Coverage C—Medical Payments

Coverage C reimburses medical expenses incurred by members of the general public who are injured on the insured company's premises, or because of the firm's operations. This coverage pays without regard to legal liability. If, for example, a customer is injured in the lobby of the operator's business office, the CGL insurer will pay for reasonable medical expenses incurred regardless of whether the contractor is legally liable for the injury. For coverage to apply, injuries must be reported within 1 year of the accident.

The rationale for this "no fault" coverage is that injured parties may be less inclined to sue if their immediate medical expenses are taken care of. Because the objective of this coverage is to reduce claims under Coverage A, injuries that would not trigger coverage for "bodily injury" under Coverage A are not compensable under Coverage C. For example, if the injury was the result of an intentional act, no coverage would be available under Coverage A; consequently, no coverage is available under Coverage C, either.

Exclusions

Medical payments coverage is intended to respond to injuries sustained by the general public, including the contractor's customers. Insureds (including employees of the insured) are not eligible to collect under this coverage. Also exempt from coverage are independent contractors (and their employees), tenants, anyone for whom workers compensation benefits are available (such as a supplier's delivery person), and persons injured while engaged in athletic activities. Injuries arising out of the company's completed operations are also excluded.

Chapter 5
CGL Supplementary Payments (Coverages A and B)

Learning Objectives
In this chapter, you will learn how to… 1. Identify the types of "supplementary payment" an insurer is obligated to make under the standard CGL policy 2. Identify the types of indemnity provisions used in oil and gas contracts 3. Recognize how indemnity provisions affect the indemnification and defense of indemnitees under the standard CGL policy.

The supplementary payments section of the CGL policy addresses expenses associated with investigating and defending against liability claims alleging covered bodily injury, property damage, personal injury, or advertising injury. Supplementary payments are paid outside the policy limit and therefore do not reduce the amount of coverage available to pay covered damages.

The categories of supplementary payments are summarized in Exhibit 5.1. The inclusion of defense costs, which can run into the hundreds of thousands of dollars, as supplementary payments represents a significant benefit to energy industry companies, as it does to all insureds. Almost equally important to energy industry companies, however, is how the policy handles the defense of its indemnitees. Operators, drilling contractors, well service contractors, and other energy industry companies are liable for these costs whether or not they have insurance to cover them.

Exhibit 5.1
Supplementary Payments

- Investigation and defense costs
- Bond costs
- Up to $250 for bail bonds required as a result of an accident or violation involving the use of a vehicle to which Coverage A applies, such as mobile equipment
- Cost of bonds to release attachments that have been made on the insured's assets. The insurer's maximum obligation for such bond costs is the cost of a bond with a value equal to the policy limit
- Expenses incurred by the insured at the insurer's request as part of its investigation or defense of the claim, including up to $250 a day for loss of earnings
- Costs and fees assessed against the insured in the suit, such as court costs
- Prejudgment interest awarded against the insured
- Postjudgment interest that accrues between the award date and the payment of damages
- If stated conditions are met, costs incurred in defending the insured's indemnitee

Defense of Indemnitees

Indemnity, or hold harmless, agreements are contractual provisions under which one party (e.g., the operator) agrees to be responsible for certain liabilities for which another party (e.g., the drilling contractor) would otherwise be legally responsible. The party that agrees to take on another's liabilities is known as the "indemnitor," and the party that is shifting its liabilities is called the "indemnitee." (The term "indemnify" means "to make compensation to an entity, person, or insured for incurred injury, loss, or damage.")

Indemnity provisions are standard in energy industry contracts (between the operator and the drilling contractor) as well as most subcontracts (between the operator or drilling contractor and their respective contractors or subcontractors.) Indemnity provisions in master service agreements, joint operating agreements, surface use agreements, well site consulting agreements, work orders and credit agreements, and purchase and sale agreements transfer risk differently than in other types of contracts (such as construction contracts between a contractor and a project owner).

The topic of indemnity and contractual risk transfer in energy industry contracts is covered in greater detail in a separate course. However, it is important to have a working knowledge of indemnity provisions in oil and gas contracts because the type of indemnity provisions used in these contracts can have an impact on the coverage available under the CGL policy.

In the energy industry, contractual indemnity clauses are often reciprocal in nature. These reciprocal provisions are known as "knock for knock" indemnity. Under this scheme, indemnification is based on "ownership" of property and personnel (which often includes each party's respective contractors and subcontractors) as opposed to allocating risk based on fault. The simplest way to summarize a knock for knock indemnity provision is, "You take care of your people and property, and I'll take care of my people and property." However, a knock for knock indemnity scheme requires a more precise definition of each party's indemnity obligation regarding "your people" and "my people" and who each party actually has to indemnify. Because of this, three models of reciprocal indemnity agreements have evolved.

Under a narrow form of reciprocal indemnity, each party accepts responsibility for loss to its people and property. This form of reciprocal indemnity only covers claims for injury or property damage to the parties (e.g., the operator or the drilling contractor) and their direct employees without regard to fault. In other words, the protection extends solely to the indemnitee; the indemnitee's contractors and subcontractors do not receive the benefit of the indemnity. For example, the operator indemnifies the drilling contractor for claims arising from harm to the operator's property or personnel but not operator's contractors or subcontractors. In exchange, the drilling contractor indemnifies the operator for claims arising from harm to the drilling contractor's property or personnel but not its contractors or subcontractors.

Under a broad form of reciprocal indemnity, each party accepts responsibility for loss to its own people and property and for the people and property of its contractors and subcontractors. For example, a drilling contract with a broad reciprocal indemnity clause would require the operator to indemnify the drilling contractor, and the drilling contractor's subcontractors and sub-subcontractors, from claims arising out of injury, illness, death, loss or damage to property of the operator's property or own employees and its own contractors' and subcontractors' employees and property. Correspondingly, the drilling contractor would be required to indemnify the operator, and the operator's contractors and subcontractors, from claims arising out of injury, illness, death, loss or damage to property of the drilling contractor's property and its own employees and its own contractors' and subcontractors' employees and property. Under this form of reciprocal indemnity, the parties may make the protections more or less broad. For example, some broad reciprocal indemnity provisions include "joint venturers," "customers," "clients," "invitees," or others.

Finally, a modified form of reciprocal indemnity exists which is a hybrid of the narrow and broad models. In one version of modified reciprocal indemnity, one party accepts responsibility only for loss to its own people and property and extends that protection to the indemnitee as well as its contractors and subcontractors. The other party, however, indemnifies a broad group of indemnitees for loss to the indemnitor's own people and property, as well as the people and property of its contractors and subcontractors.

In order for the reciprocal indemnity scheme to work, oil and gas contracts often contain "pass-through" indemnity provisions, under which the indemnitor is required to assume the indemnitee's own indemnification obligations to other parties (such as the indemnitee's contractors or subcontractors). In other words, the contract includes a mechanism for ensuring that a party like an operator is entitled to indemnity protection from its contractors, such as an equipment service contractor, that can be passed through to the drilling contractors or other contractors who are entitled to indemnity. A common way that "pass-through" indemnity provisions are created is to define the categories of entities and individuals to whom indemnity protections flow under the applicable contract. This often happens by broadening the universe of indemnitees to include the contracting parties' affiliates, partners, owners, agents, contractors, and subcontractors. These entities and individuals are often defined as the "Operator Group" and the "Contractor Group." By defining these groups, the parties effectively create pass-through protection for those indemnitees. Exhibit 5.2 illustrates how indemnity flows under a pass-through protection.

There are certain exceptions to the reciprocal indemnity scheme discussed above that have a significant impact on risk allocation. These exceptions typically apply to "all claims arising out of" a particular event or circumstance.

Furthermore, the knock for knock indemnity approach does not address claims for injuries or damages to true third parties, i.e., nonparties to the contract and other entities that are not included within the breadth of the indemnity. This may include governmental agents, neighboring land owners, passersby, and even trespassers. For the most part, both drilling contractors and operators expect that responsibility for claims by true third parties will remain "at law." Some drilling contractors, however, seek to shift responsibility for all third-party claims to the operator regardless of fault, arguing that the operator's return on the drilling operation justifies this shift of responsibility. Operators, on the other hand, typically oppose that type of broad shift because, as relates to claims by third parties due to the drilling contractor's fault, the operator has no control over either the drilling contractor's methods or the tort victim and thus may not be able to insure the risk. However, for work that does not involve exploration and production (e.g., work that does not involve a common multiemployer work site), use of ownership-based risk allocation is generally not appropriate. When one employer (e.g., a contractor) controls the entire work site and all personnel at that site, the difficultly of allocating fault lessens and the benefits of allocating risk without regard to fault are greatly reduced. For example, ownership-based risk allocation is usually not appropriate in construction contracts since the general contractor usually has complete control of the job site. Under that scenario, risk is transferred "downstream," with the project owners at the top of the construction chain, followed by the general contractor, and various tiers of subcontractors. As previously noted, the topic of indemnity and contractual risk transfer in energy industry contracts, including "pass through" indemnity provisions and certain carve-outs to knock for knock indemnity, will be covered in greater detail in a separate course.

Louisiana, Texas, New Mexico, and Wyoming have oil field anti-indemnity acts that invalidate, based on public policy grounds, indemnity provisions that exculpate parties from damages or losses caused by the indemnified party's own fault. Additionally, most states place some limits, either by statute or through the courts, on the scope of allowable indemnity. Most commonly, they forbid or severely restrict the transfer of liability for one's sole negligence in construction contracts and motor carrier transportation contracts. Some states prohibit any transfer of liability for one's own negligence, such as when the parties are jointly liable for the loss.

As discussed previously with regard to contractual liability coverage, the CGL policy covers liabilities assumed in an indemnity provision. However, whether insurers are required to provide a defense to the insured contractor's indemnitee has been a subject of debate. The prevalent practice among general liability insurers is to provide a defense for their insureds' indemnitees in conjunction with the defense provided to the insured. In most cases, the same cause of action will involve a claim against the insured company and its indemnitee, which makes mounting a defense for both parties not only practicable but also prudent. Since the CGL insurer will probably be responsible for any damages awarded against the indemnitee (because of the insured's contractual obligation to pay those damages), most insurers provide the indemnitee with a defense simply as a way of protecting their own interests.

The current edition of the CGL policy provides that if certain conditions are met, a duty to defend an indemnitee is created, and defense costs are payable as supplementary payments outside the policy limit. These conditions are summarized in Exhibit 5.2. However, if any of the conditions is not met, there is no duty to defend, and the indemnitee's defense costs are payable under the contractual liability coverage as damages. (Both of these scenarios assume the contract in which liability for these amounts was assumed is an "insured contract.")

Exhibit 5.2
Requirements for Triggering a Duty To Defend Indemnitees

- The insured operator, drilling contractor, well service contractor, independent contractor, or company has specifically agreed in an "insured contract" to assume the liability on which the suit is based, including the indemnitee's defense costs.
- The liability assumed in the hold harmless agreement must be of a kind covered by the policy. In other words, if the damages would not be payable as a direct claim against the insured, they are also not covered as a contractual liability.
- The insured operator, drilling contractor, well service contractor, independent contractor, or company and the indemnitee are both named in the suit.
- There is no apparent conflict of interests between the insured indemnitor and its indemnitee.
- The request for a defense is made by both the insured and the indemnitee, and both parties agree to have the same counsel provide a defense.
- The indemnitee agrees to cooperate with the insurer in defending the suit (just as the insured agrees to do in the policy's basic conditions) and to provide records and documents related to the suit.
- The indemnitee must agree to notify any other insurer whose policy may be triggered by this claim and to cooperate in coordinating such other coverage.

Clearly, it is to both parties' advantage (the indemnitee's as well as the insured indemnitor's) for defense costs to be payable as supplementary payments as it avoids the erosion of limits available to pay claims. Unfortunately, a couple of the conditions for qualifying for coverage under the supplementary payments provision are problematic for energy industry companies.

First, the duty to defend arises only when the insured and the indemnitee are both named in the suit. A number of circumstances can give rise to a suit against the indemnitee (e.g., operator) in which the insured (e.g. drilling contractor) itself is not a defendant. By far, the most common such circumstance is a third-party-over action, in which a suit is brought against the indemnitee by an employee of the insured indemnitor. In that instance, the injured employee collects workers compensation benefits and is barred from pursuing further action against the indemnitor/employer. The employee can, however, file a suit against the indemnitee alleging some form of negligence, such as failure to warn of known dangers. If that happens, the indemnitee will normally look to the indemnitor for a defense (as well as coverage for damages) in conjunction with the hold harmless provision in the oil and gas contract.

This scenario is played out frequently on oil and gas projects in a way that is different from other industries. For example, an operator hires a casing company to perform work on a well. The casing company's employee is injured, collects workers compensation benefits from the casing company and sues the operator and the drilling contractor. The operator sought indemnity from the casing company for its percentage of fault for the employee's injuries pursuant to its contract with the casing company. The operator also has an indemnity agreement with the drilling company which required the operator to pay the drilling company's percentage of fault for the employee's injuries. Consequently, the operator sought indemnity from the casing company for the contractual liability owed to the drilling contractor. If the applicable contracts contained "pass-through" indemnity provisions, the casing company would be responsible for indemnifying the operator for the contractual liability owed to the drilling contractor. If the applicable contracts did not contain "pass-through" indemnity provisions, the operator would owe indemnity to the drilling contractor for the casing company's employee's injuries but would not have the ability to rely on the indemnity from the casing company to satisfy that obligation.

Therefore, failing to include a pass-through indemnity provision in even one contract between an operator and its contractors could create a significant uninsured exposure. Consequently, energy industry professionals often broaden the group of indemnitees to include the contracting parties' affiliates, partners, owners, agents, contractors, and subcontractors (e.g., Operator Group and Contractor Group). Parties also address "pass through" liability by removing the word "tort" from the definition of "Insured Contract," thereby eliminating the "tort" liability requirement from the definition. Using the example discussed above, because the casing company is not also named in the suit against the operator and drilling contractor (nor can it be), the duty to defend is not triggered under the CGL policy. Coverage in this case would revert to defense costs being covered as damages (as opposed to outside of policy limits) as provided by the differing contractual treatment of defense costs as an exception to the Supplementary Payments provision for Coverage A. If the defense costs plus any damages that are eventually awarded against the indemnitee exceed the available policy limit, the casing company is left holding the bag for the remainder. (The casing company's obligation to indemnify remains even if there is no insurance to cover the obligation.) In this event, the loss would need to be handled by excess or umbrella limits available to the insured, which may involve another insurer.

A second problem is the duty imposed on the indemnitee to notify its own insurer of the suit and to cooperate in coordinating coverage with that other insurer. In other words, the casing company's CGL insurer clearly contemplates some form of contribution toward the indemnitee's defense costs from the indemnitee's own CGL insurer. Indemnitees require indemnification provisions precisely because they do not want their own policies to have to respond to claims arising out of indemnitors' actions or operations. Yet that is what the CGL policy requires to trigger a duty to defend under the supplementary payments section of the policy. Timely notice and response from all potentially affected insurers, both primary and excess, is most important.

As it is written, the CGL approach to providing coverage for defense of an indemnitee falls far short of ideal. As a matter of practice, most insurers have heretofore provided energy industry companies' indemnitees with a defense. Since the insurer is obligated for any damages awarded, its own interests are best served in this manner. However, additional insured status is a much more reliable method of guaranteeing access to a defense under an indemnitor's liability policy. Additional insured status is discussed in greater detail later in this course.

Chapter 6
CGL: Who Is an Insured (Section II)

In addition to the person or entity listed on the policy as the named insured, the CGL policy automatically provides coverage for various other persons or entities. While it would not be beneficial to grant insured status to just anyone, where certain legal or contractual relationships exist, it makes sense to do so. The "Who Is an Insured" section stipulates who automatically qualifies for insured status under the CGL policy.

Learning Objectives
In this chapter, the student will learn how to… 1. Determine whether a given party has insured status, and is therefore covered, in a given situation. 2. Differentiate between the rights of a named insured, an automatic insured, and an additional insured under the standard CGL policy.

Exhibit 6.1 summarizes the CGL's "who is a insured" provision. In most instances, an individual's or organization's status as an insured is limited to liability that results directly from the described relationship with the named insured energy industry company.

Exhibit 6.1
Automatic Insureds

In addition to the named insured, the following persons or entities are automatically provided insured status under the CGL policy. Limitations may apply as to the extent of coverage certain insureds are afforded.

If the named insured is…	**An individual who is the sole proprietor of a business**	**A partnership joint venture or limited liability company**	**Any other type of organization (e.g., a corporation)**	**A trust**
		Members or partners	Stockholders	
	Spouse of the named insured	Spouses of insured members or partners		
		Managers of a limited liability company	Directors and executive officers	
	Volunteer workers	Volunteer workers	Volunteer workers	
	Employees	Employees	Employees	
	Real estate manager	Real estate manager	Real estate manager	
	Legal representative*	Legal representative*	Legal representative*	Trustee
	Newly acquired organizations**	Newly acquired organizations**	Newly acquired organizations**	

** In the event of the insured's death.*
*** Automatic coverage for 90 days,* ***unless*** *the newly acquired organization is a partnership, joint venture, or limited liability company.*

The application of various policy provisions is directly influenced by the policy's use of references to the various insureds. Numerous CGL policy provisions refer to the named insured (by definition, the terms "you" and "your" refer to the named insured), and others use the terms "an insured" or "the insured." These distinctions can be crucial in defining coverage. For example, an exclusion that applies to property in "your" care, custody, or control will not apply to an additional insured because "your" is defined in the policy to refer only to the named insured. If that same exclusion applied to property in "the insured's" care, custody, or control, it would apply equally to claims against the named insured for property in its control and claims against an additional insured for property in its control. A third possibility is that an exclusion might apply to property in "an insured's" care, custody, or control. In that instance, it would not matter who the claim is against or which insured had control of the property—the exclusion is categorical rather than situational in that instance.

Family and Business Relationships

A variety of familial or business relationships may earn individuals insured status. Generally speaking, these individuals are provided insured status due to certain legal obligations imposed on them as a result of the relationship. For example, a spouse can be held responsible for the liabilities of the other spouse. Similarly, members of a partnership are jointly and severally liable for the obligations of the other partners.

As respects a partnership or a joint venture, the entity itself is an insured as well as any partner or member of the entity and their spouses. However, individuals are only covered for their liability in a partnership or joint venture that is listed as the named insured. No person or entity is covered for liability arising out of their involvement in a current or past partnership, joint venture, or limited liability company (LLC) that is not listed as a named insured in the declarations.

When the named insured is an organization other than a partnership or joint venture (i.e., corporation, association, etc.), the entity itself, as well as any executive officers, directors, or stockholders are insureds. Those individuals having coverage under this provision are insured only with respect to their duties as officers or directors. Stockholders are insureds to the extent they may be held liable as stockholders.

Employees

The named insured's employees and volunteer workers are insureds under the CGL policy for liability arising out of their employment activities. The policy's definition of "employee" includes leased workers but does not extend to temporary workers. Providing coverage for employees as well as for the corporate entity has several potential benefits. First, it may assist in attracting and retaining quality employees. Second, it increases the likelihood of employee cooperation in defending a claim that names both the individual employee and the corporation. However, several restrictions are placed on the scope of coverage employees and volunteers receive. (The limitations described below apply to volunteers as well as employees.)

First, employees have no coverage with respect to injuries sustained by the named insured, its partners or members, or another employee or volunteer. (This exclusion does not apply to suits against executive officers.) The exclusion also removes coverage for claims filed by others as a result of an injury to another employee or volunteer, such as a spouse or child of the injured worker. The primary purpose of this "fellow employee" exclusion, as it is commonly called, is to avoid creating a "loophole" that allows employees to circumvent the exclusive remedy doctrine in the workers compensation law by suing a coworker who caused or contributed to the injury.

Second, employees have no coverage with respect to any professional liability arising out of providing or failing to provide professional healthcare services. For example, if an operator employs a registered nurse to run a first aid treatment center at drilling sites, that nurse is not covered under the contractor's CGL policy for the provision of medical treatment. This exclusion only applies to the medical professionals—the insured operator is covered for its liability arising from these medical services.

Finally, employees are not insureds with respect to property damage to the property that is owned, occupied, used by, rented to, or in the care, custody, or control of the named insured, the partners or members who own the company, or other employees.

While there is logic and equity behind these limitations, they can also create problems. As the effectiveness of the "exclusive remedy" aspect of workers compensation has been eroded over time, lawsuits against fellow employees have become more common, particularly with regard to safety and security personnel and mid-level supervisory employees such as foremen. Most employees will have no coverage for such suits if it is not provided by the employer. Even if the suit is ultimately unsuccessful, the employee may incur substantial uninsured legal expense. For this reason, some energy industry companies attempt to modify the co-employee injury limitation to preserve insured status for certain employees with respect to fellow-employee suits. See the discussion of "injury to fellow employee" endorsements later in this course.

Legal Representatives

The CGL policy provides insured status to two categories of legal representatives. First, in the event of the named insured's death, both temporary custodians and legal representatives of the deceased become insureds with respect to their liabilities and duties in those capacities. Second, any person or organization acting as the named insured's real estate manager is an insured.

Newly Acquired Organizations

Organizations formed or acquired by the named insured during the policy period automatically have 90 days of coverage under the CGL policy. This coverage is intended to provide for the incidental exposure when a newly acquired or newly formed organization may be without insurance protection for a short period of time. It is not intended to pick up liability for losses that already existed prior to the acquisition. To reinforce this intention, injury or damage that occurred before the acquisition or formation of the organization is specifically excluded from this coverage extension. This exclusion eliminates the possibility of acquiring coverage for liability that has already been incurred simply by being acquired by another organization that has CGL coverage. To further emphasize this intent, the policy provides that the automatic coverage extension does not apply if the acquired organization had similar insurance that would apply to the loss, regardless of whether the limits of liability of those policies are adequate.

The automatic coverage applies only if the named insured owns at least a majority interest in the company, and the new entity is not a partnership, joint venture, or LLC. (Coverage is available to partnerships, joint ventures, and LLCs only if they are listed on the policy as named insureds. This condition can pose significant coverage problems, especially in large organizations where some joint ventures might not be reported to the insurance agent or risk manager.) Beyond 90 days, the new firm must be specifically added to the policy to avoid an interruption in coverage.

Additional Insureds

It is common among parties to sophisticated oil and gas contracts to assess the risks associated with their contractual activities and allocate those risks through a combination of indemnification provisions and insurance requirements. With respect to insurance requirements, oil and gas contracts may require one party, such as the operator, to add other parties (i.e., the drilling contractor and its affiliated companies) to their liability policies as "additional insureds" when one party has agreed to indemnify another.

Additional insured status provides the indemnified party with several benefits. First, it allows the indemnitee to place the indemnitor's CGL policy in front of the indemnitee's own policy, and, as a result, protects the indemnitee's CGL policy limits. Second, an additional insured is a direct party to the insurance contract whereas an indemnitee is not a direct party to the insurance contract. Consequently, additional insureds have the rights of an insured, including the right to a defense and, in certain cases, indemnity from the insurer, and the right to file a claim directly against the policy. Further, defense costs constitute supplementary payments that are outside the policy limit, which may not be the case when filing a claim for indemnity under the policy's contractual liability coverage. (See the "Defense of Indemnitees" discussion above.) Moreover, additional insured status significantly augments the total amount of coverage available for a particular loss or series of losses. Finally, sometimes indemnity obligations are not valid due to oilfield anti-indemnity acts but insurance required under the contract is still valid. For example, Louisiana courts have created a judicial exception to the Louisiana Oilfield Anti-Indemnity Act, which, if applicable, does not invalidate the additional insured protection. In order for the exception to be applicable, all material costs of extending additional insured protection must be paid by the indemnitee. Texas courts have also created a judicial exception to the Texas Oilfield Anti-Indemnity Act, which allows insurance protection under policies that do not directly support an invalid indemnity agreement.

Additional insureds are added by endorsement on either a scheduled basis or a blanket basis. Under a scheduled approach, only those persons or entities that are listed by name on the endorsement are additional insureds. Under an automatic or "blanket" endorsement, additional insureds are added by virtue of meeting the parameters for such status specified in the endorsement, such as "anyone who requires such status in a contract with you."

The scope of coverage provided to an additional insured is dictated by the terms of the endorsement, as well as the rest of the policy provisions. However, the unique risk allocation system in oil and gas contracts has an impact on the appropriate scope of coverage for additional insureds. The appropriate scope of coverage for oil and gas additional insureds is discussed in greater detail in Chapter 8 of this course.

There are standard endorsements for adding nonoperating working interest owners, contractors, and other designated persons or organizations as additional insureds. Furthermore, there is a nonstandard endorsement for adding owners of gas and oil lease working interests as additional insureds. The exposures that these endorsements cover are discussed in greater detail in Chapter 8 of this course.

Chapter 7
CGL Limits of Insurance (Section III) and Policy Conditions (Section IV)

Policy limits in the CGL are somewhat complex. After examining the way in which the CGL deals with policy limits, which appear in Section III of the CGL, this chapter provides an overview of the policy conditions that appear in Section IV. This course emphasizes the provisions most directly relevant to energy industry companies.

Learning Objective
In this chapter, you will learn how to… 1. recognize the relationships among the CGL's various types of policy limits in the CGL, and identify the types of loss to which each limit applies. 2. Identify the function of each CGL policy condition and recognize the potential consequences of an insured's failure to comply with a policy condition 3. recognize how the CGL's other insurance condition affects the way in which more than one policy that provides coverage will respond to a loss.

Limits of Insurance

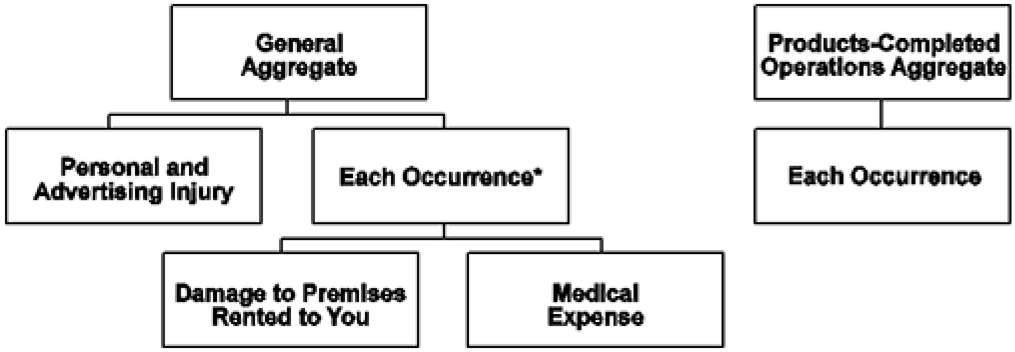
The CGL policy contains six different limits of insurance, summarized in Exhibit 7.1. The aggregate policy limits apply separately to each consecutive year the policy is in force. Thus, with each renewal, the insured company has a fresh set of limits with respect to claims that occur during that policy period. Remember, however, that claims filed during the current policy period may actually be payable under previous policies if the actual "bodily injury" or "property damage" is deemed to have occurred during their coverage periods. With respect to "personal and advertising injury," the policy triggered is the one that was in force when the offense was committed. Thus, the limit of coverage that is actually available will be the stated policy limit of the triggered policy, unless any claims that have already been paid under that policy have eroded the general aggregate limit.

Several of these limits are actually sublimits that also reduce the amount payable under another limit. For example, losses arising out of the same "occurrence" are subject to a collective maximum and reduce the aggregate amount of coverage remaining for claims arising out of other occurrences. If other claims have eroded the general aggregate limit or products and completed operations aggregate limit, the insurer is liable for a maximum of the difference between the applicable aggregate limit and the amount already paid under that limit. Likewise, losses paid under Coverage C—medical payments—are subject to a maximum amount per person, but these payments also reduce the amount left in the per occurrence limit for other claims arising out of the same occurrence.

Exhibit 7.1 CGL Limits of Liability	
General Aggregate	The most the policy will pay for all bodily injury, property damage (other than that involving the products-completed operations hazard), personal and advertising injury, and medical payments claims
Products-Completed Operations Aggregate	The most the policy will pay for all bodily injury and property damage claims included in the "products-completed operations hazard"
Personal and Advertising Injury	Provides for a per person (or per organization) limit of liability for claims involving covered personal and advertising injury. These payments are also subject to the general aggregate limit.
Each Occurrence	Establishes a maximum the insurer will pay for all bodily injury, property damage, or medical payments arising out of any one occurrence
Damage to Premises Rented to You	Establishes a limit, subject to the each occurrence limit, for damage arising out of any one fire. This coverage will typically have a $50,000 limit. Increases beyond $50,000 would have to be negotiated with the insurer
Medical Expense	Applicable to Coverage C, this is the most the policy will pay to any to one person for first aid and covered medical expenses resulting from any one accident

The separate products-completed operations limit allows insureds to choose an amount of products and completed operations coverage based on their perceived exposure. The general aggregate and products and completed operations aggregate can be different amounts, but unless otherwise stated, the same per occurrence limit applies to both coverages. The application of the CGL policy limits is illustrated in Exhibit 7.2.

Exhibit 7.2
Illustration of the Limits of Liability Provision



** For the purpose of clarity in this example, the "each occurrence" limit is shown separately for products-completed operations and premises-operations. While the general policy aggregate and the products-completed operations aggregate can be different in amount, the policy is arranged so that the each occurrence limit will usually be the same amount for both coverages.*

Products-Completed Operations Hazard

Completed operations coverage is a very important component of an energy industry company's insurance program. While coverage for certain completed operations is automatically provided under Coverage A, it is distinguished from the other types of bodily injury and property damage liability, primarily premises and operations losses. Losses that fall under the completed operations hazard are subject to different treatment in the application of certain exclusions as well as different policy limits. (A standard endorsement is available for the purpose of removing completed operations coverage for oil, gas, and other mineral products completed operations. Companies should avoid such an exclusion if at all possible, as it represents a substantial loss of coverage.)

The "products-completed operations hazard" definition merely stipulates when a project shifts from being an operation in progress to being a completed operation. Once a project meets the definition of a completed operation, coverage is governed by the appropriate completed operations provisions, including the products and completed operations aggregate limit.

To simplify, the key elements of a "completed operations" hazard are summarized in Exhibit 7.3. Three exceptions apply to this rule. In most instances, liability arising out of the transportation and delivery of property (e.g., construction materials, mobile equipment) is not a completed operations loss, nor is liability arising out of abandoned or unused equipment or materials. Certain companies' operations are of a type that are, by the rules of the rating guide definition, subject to the general aggregate limit rather than the products and completed operations limit.

Exhibit 7.3
Elements of a Completed Operations Hazard

- "Bodily injury" or "property damage" that occurs anywhere other than on the company's own premises
- "Bodily injury" or "property damage" that arises out of "your product" or "your work" (which includes work performed on your behalf by a subcontractor)
- "Your work" on the project has been completed or abandoned.

With respect to the last criterion in Exhibit 7.3, work is considered completed when any *one* of the following conditions is met.

- All operations called for in the contract have been completed.
- All operations at the site of the operations have been completed.
- The portion of the project out of which the loss arose has been put to its intended use.

If a single contract encompasses several projects at different sites, the completion of all work at any one of these sites will cause losses at that particular site to come under the completed operations hazard. If all or part of a project is put to its intended use, that portion of the project will be considered a completed operation, even if the other two tests have not been satisfied. For example, if a drilling rig has two platforms —one in the course of construction and the other completed and already in use—the platform in use would be considered a "completed operation" and any losses arising out of that work would fall under the "products-completed operations hazard." An exception to the "intended use" test applies when the use of the work is by another contractor or subcontractor working on the same project. For example, building systems such as heating, lighting, and elevators may be put to their "intended use" by contractors' employees still at work in the building. As long as some work remains to be done by the heating, electrical, or elevator contractor, the use of completed portions of those contractors' work by other contractors will not bring the products-completed operations hazard into play.

Work that is complete except for any correction, repair, replacement, service, or maintenance is considered "complete."

Policy Conditions

Section IV of the ISO CGL coverage form contains the CGL conditions. While some of the CGL conditions represent true "conditions" of coverage (actions that, if not performed, void the contractual obligations of the parties), many policy conditions merely stipulate various terms of the agreement. It is a miscellaneous group of contract provisions that define specific rights and duties of both the insured and the insurer or give more detailed explanations of how the policy's coverage or limits will apply.

Some of the policy conditions apply exclusively to the named insured, and others apply to all insureds, including those that automatically qualify for insured status under the policy's "Who Is an Insured" provision and those that have additional insured status by means of an endorsement. For example, the policy requires the *named insured* to provide timely notice of any claim or any event that is likely to give rise to a claim, including claims against other insureds. However, *all insureds* are required to cooperate in the investigation and defense of any claim against them.

The CGL policy contains a number of conditions. This course examines the four that have the greatest implications for energy industry companies.

Duties in the Event of Occurrence, Claim, or Suit

The CGL insurer is obligated to provide a defense of covered claims, as well as to pay damages awarded against the insured. Providing a defense requires investigating the facts of the claim. With the passage of time, evidence is lost, witnesses become unavailable or less reliable because they recall less, and claimants may become less willing to negotiate a settlement. For this reason, insurers require prompt notice of any claim or suit filed against the insured, as well as any occurrence or offense that could potentially give rise to a claim.

Further, insureds must cooperate in the investigation and defense of any claim, including supplying copies of all legal papers as well as any needed documents and records of the insured. Failure to comply with these conditions may be grounds for denial of the claim.

While the obligation to cooperate in the investigation and defense of a claim applies to all insureds, the requirement to provide notice of a claim applies only to the named insured. That is, the named insured is solely responsible for informing the insurer that a claim, or an event that is likely to lead to a claim, has occurred, regardless of which insured may actually be named in the suit. It is not necessary to have all of the facts to report an occurrence, but an attempt should be made to comply with the notice requirements (i.e., provide a summary of the events, the involved parties, witnesses, etc.) to the extent possible. However, it is better to provide notice with incomplete facts than to delay notice altogether to the point that coverage may be jeopardized.

What Is “Prompt” Notice?

The notice provision requires the insured to give notice “as soon as practicable” of a claim, suit, occurrence, or offense. This wording leaves room for interpretation about what is a reasonable amount of time for giving notice. When courts have been asked to make such a determination, they typically give consideration to the following circumstances, among others: (1) the length of the delay in giving notice, (2) the reasons for the delay, and (3) the probable effect of the delay on the insurer.

There are no hard and fast rules that clarify these issues precisely for all circumstances, and those that can be established will vary by state as caselaw establishes different standards in different jurisdictions. For example, some courts have held that a belief that there were no damages or that no claims would be filed (perhaps on the assurance of the injured party) is a valid reason for not reporting an occurrence, while others have not found it to be a justifiable reason for delay. Courts have also varied as to whether the insurer’s ability to conduct a thorough investigation and defense of the claim must be prejudiced by late reporting to void coverage for breaching this condition.

Insureds are sometimes tempted to delay the reporting of an incident that has not yet produced a claim because of a fear that it will negatively affect their insurance premiums. This is a risky strategy in light of the fact that it could jeopardize the contractor’s coverage for any claim that eventually materializes.

The Question of “Knowledge”

Some energy industry companies, such as operators and drilling contractors, face a daunting challenge with respect to their reporting obligations. First of all, the named insured company may not be present on the drilling site at all times. For example, an operator may rely on well service contractors, subcontractors, or independent consultants to perform certain tasks. Similarly, a drilling contractor may contract with subcontractors to complete performance of project–related services. If the operator or drilling contractor is not informed of the incident (perhaps because it was not considered significant, or perhaps in an attempt to cover up a mistake), it cannot feasibly provide notice to the insurer. Even if the operator or drilling contractor has a full-time presence on each and every drilling site, there may be hundreds of subcontractors performing work at the site, and the site itself may be spread over a large area. It is virtually impossible for the operator or drilling contractor to be fully aware of everything that transpires at such a site.

Operators and drilling contractors should negotiate a clarification of these issues with the insurer and put it in writing. Ideally, the agreed upon terms will be attached to the policy as an endorsement. (This is the only way to ensure the agreed upon conditions will be legally enforceable.) A common approach is to agree that the named insured will be deemed to have “knowledge” of a claim, occurrence, or offense when a person with at least a certain level of authority becomes aware of it, such as an executive officer. See the discussion of “modified notice of occurrence” endorsements later in this course.

Other Insurance Provision

The “other insurance” provision spells out how the insurer’s obligation to pay claims and provide a defense are impacted when the insured has other insurance that is also triggered by a claim. For example, it is possible to have some overlap in coverage between an operator or drilling contractor’s general liability policy and its professional liability policy. More often, an additional insured will have coverage under both the policy on which it is an additional insured and its own general liability policy.

The standard CGL policy provides that coverage applies on a primary basis except in a few specified situations, which are discussed in more detail below. As primary coverage, the insurer’s obligation to provide a defense is triggered immediately. (The duty to defend may not be immediate when a self-insured retention (SIR) applies. SIRs are discussed in more detail below.)

CGL as Excess

The standard CGL policy provides that it is primary over other valid and collectible insurance, except under specified circumstances, which are summarized in Exhibit 7.4. Those circumstances all involve the existence of other, more specific insurance covering the loss. When first-party coverages available to the insured such as fire and builders risk insurance also cover a loss that would be covered by the CGL, the first-party coverages apply as primary. Also, if a loss involves aircraft, autos, or watercraft and coverage is available under both the CGL and the specific policies designed to cover such vehicles, the CGL is excess. Coverage is also excess over any other "primary" policy—another party's CGL policy, for example—to which the named insured has been added as an insured.

Exhibit 7.4
Conditions for CGL Policy as Excess

- With respect to damage to “your work,” separate property insurance is available.
- With respect to damage to premises rented to or temporarily occupied by you, separate fire insurance, or separate liability insurance purchased to specifically to cover your liability as a tenant for damage to the premises, is available.
- With respect to liability arising out of the maintenance or use of aircraft, “autos,” or watercraft, other insurance is available to respond to the claim.
- The other insurance available to you also states it is primary and is available as a result of your status under that policy as an additional insured

There are a few ways that the above-referenced conditions might come into play for energy industry companies. For example, assume that a frack fleet is damaged by explosion due to the negligence of the fracking company’s subcontractor while loading diesel fuel. Assume that the operator contractually assumed direct liability for damage to the frack fleet (regardless of fault). Under that scenario, the operator’s CGL policy might not cover physical damage or loss of use of the fleet. A claim involving damage to the fleet might trigger coverage under both the operator’s general liability policy and the operator’s commercial auto policy. When a situation such as this arises, it is the intent of the CGL policy to provide the insured with excess protection over that of the more specific primary policy.

Another condition that causes the policy to be excess is that the other insurance available to you is under a primary policy on which you have additional insured status. When operators and drilling contractors are required to provide additional insured status (or when they require such status from each other or their subcontractors), that requirement typically states that the coverage provided to the additional insured will be “primary and noncontributory.” This means that the policy will respond to a claim against the additional insured on a primary basis without requiring the additional insured’s own general liability policy to contribute to the payment of any claims, which is consistent with the parties’ intent. The CGL policy’s other insurance language causes the policy on which the party is an additional insured to be primary and the policy on which the party is a named insured (“you”) to be excess. When both policies have standard language, this provides a clear order of payment. Nonstandard policies may not include the clarifying language with respect to coverage available to you as an additional insured. Energy industry companies should check the wording of their CGL policy other insurance provision, and if it is not there, they should request this type of modification. Because it reduces the insurer’s exposure, there should be no resistance to the change.

Ensuring your own policy will not interfere with the intended order of payment as outlined above is important but not sufficient. To ensure the additional insured coverage works as intended, the contract should require that the additional insured coverage will be “primary and noncontributory.” ISO introduced a primary and noncontributory endorsement (CG 20 01) in 2013 that enables CGL insureds to evidence compliance with this contract requirement. This endorsement states—reiterates, really—that the coverage provided to the additional insured is on a primary basis. However, it further states that the insurer will not seek contribution from any other insurance under which the additional insured is a named insured—in other words, it will not seek to force the additional insured’s own CGL insurer to contribute to the settlement or payment of a covered claim. This limitation would not prevent the insurer from seeking contribution from another policy under which its additional insured may also have additional insured status. Since one of the major insurance protections that is commonly required by indemnified parties in oil and gas contracts is being named as an additional insured, it is very important to remember to match the “primary and noncontributory” insurance protection to the indemnity obligation, meaning that Endorsement CG 20 01 should be extended to all of the indemnified parties, such as the Operator Group or the Contractor Group. In sum, endorsement CG 20 01 is a crucial component of risk allocation in oil and gas contracts and energy industry companies should make sure to include this endorsement when necessary.

Conflicting Provisions

Sometimes, the other insurance provisions of the policies that are triggered conflict with each other. For example, both policies may state that they are primary, or both policies may state that they are excess, with respect to a given claim. When both policies provide primary coverage, the policy provides a formula for sharing the loss. In some cases, the insurers will contribute equal amounts. If one of the policy's limits is reached, the remaining insurer(s) will continue to pay until its limit has also been exhausted or the claim is resolved. In other cases, the insurers will contribute based on their applicable policy limits. The insurer with the higher applicable limit will pay a proportionately higher share of the loss. Under this approach, unless one or both of the insurers' applicable policy limits have been eroded by other claims, the insurers' policy limits will be reached at the same time.

The more troubling situation is when both policies state they are excess with respect to a given claim. This situation is not as common in CGL policies as with some other types of policies, primarily because the standard CGL policy states that it is primary in most cases. Conflicting "other insurance" provisions between two CGL policies generally arise when at least one of the policies is written on a nonstandard policy form (a form developed specifically for use by an individual insurer). If, for example, you are an additional insured on a nonstandard policy that states it is excess over any other available insurance, there will be a conflict between your coverage as an additional insured and your own standard CGL coverage, which also states that it is excess with respect to any policy on which you have coverage as an additional insured. This type of situation often results in a standoff between insurers with respect to which policy must pay first.

An approach used by some insurers on nonstandard policy forms is to stipulate that the coverage provided to an additional insured is excess coverage unless primary (or primary and noncontributory) coverage is required in the underlying contract—in this case, the construction contract. While it is unlikely that a contract will require additional insured status that is excess, it is possible for the contract to be silent on this matter, which may result in a coverage dispute. Operators and drilling contractors should include clear language in their contracts and subcontracts that the coverage provided to them as additional insureds is to be primary and noncontributory.

The standard CGL policy provides that when it is excess, the insurer has no duty to defend any claim that another insurer has a duty to defend. However, it further provides that if no other insurer provides a defense, the insurer will do so. This at least guarantees access to a defense. (The insurers are left to sort out how the defense costs will be allocated.)

Impact of an Indemnity Agreement

With respect to oil and gas contracts, some courts have resolved "other insurance" conflicts between the named insured's and additional insured's CGL policies in light of the indemnity agreement between the parties. In such cases, the courts interpret a request for additional insured status on the presumption that such requests are for coverage that will pay first, before the additional insured's own policy. The reasoning behind this presumption is that the additional insured could alternatively enforce its indemnity agreement with the named insured, in which case the additional insured's own policy would not be called upon to contribute.

Separation of Insureds Provision

In most instances, the CGL policy applies to each covered entity as if the other insureds did not exist. For example, suppose an employee of the named insured files a claim against an additional insured for an injury sustained as a result of the additional insured's negligence. The employers liability exclusion would not apply in that case because the claimant is not an employee of the additional insured. The fact that the claimant is an employee of the named insured is irrelevant with regard to the claim against the additional insured.

The separation of insureds provision also protects insureds from the acts of other insureds. For example, if one insured (an employee) intentionally causes a loss that results in a claim against another insured (the named insured contractor), the intentional loss exclusion will not prevent the claim against the innocent party (the contractor). Likewise, if one insured refuses to cooperate in the investigation of a claim, other insureds named in that suit will not be denied coverage based on the actions of the uncooperative insured.

Subrogation Provision

Insurance companies routinely pay claims on behalf of their insureds that someone other than the insured is legally responsible to pay. For example, if an electrician's shoddy work causes a fire in a building, the owner's property insurer will pay the cost of repairing the fire damage. When such a payment is made, however, the insurer receives the insured's legal right to pursue recovery from the responsible party. This action is commonly known as subrogation.

The CGL policy's "Transfer of Recovery Rights Against Others to Us" provision (commonly referred to as the "subrogation" provision) stipulates that when the insurer makes payment under the policy, it is entitled to the insured's rights of recovery against any party that is responsible for the damages paid by the insurer. Without some type of exception, this provision would cause a problem when the responsible party is someone the insured has promised to hold harmless from any loss. For example, an operator agrees to indemnify a drilling contractor and hold it harmless for damages arising out of its work and the work of its Operator Group at the drilling site. A visitor to the drilling rig is injured while the operator's equipment service contractor was performing operations and files a suit against both the operator and the drilling contractor. The operator's insurer pays the claim but then attempts to recover a portion of the amount paid from the drilling contractor on the grounds that the drilling contractor was partially responsible for the loss. This violates the intended transfer of risk between the operator and the drilling contractor.

Fortunately, the policy contains a provision for this type of contractual agreement. Specifically, it requires the insured to protect the insurer's right to recover from responsible parties and to "do nothing *after* loss" to impair those rights. By inference, the insured does have the right to waive its rights of recovery and thus the insurer's ability to subrogate based on those rights, *before* a loss occurs. Courts have largely upheld this interpretation of the provision.

There is no requirement that the wavier be in writing, although that is useful in establishing that a waiver did in fact exist before the loss occurred. (The burden of proof in this instance is on the insured.) Nor is the insured required to notify the insurer that it has waived subrogation rights against another party. However, operators and drilling contractors are sometimes required to provide proof that the insurer's subrogation rights against the other contracting party have been waived. A standard endorsement is available for this purpose. Some insurers may want to charge an extra premium for attaching this endorsement on the grounds that they are giving up a right they would otherwise have. If the policy includes the "do nothing after a loss" language described above, and the operator and drilling contractor has already waived its rights of recovery against that party in the oil or gas contract, the insurer's argument is incorrect, and no extra premium is warranted.

Chapter 8
CGL Endorsements

The standard CGL policy is designed to provide some core coverages that are commonly needed by a cross section of industries. Tailoring the policy to meet industry-specific needs of energy industry companies commonly requires a variety of modifications to the policy. Chapter 8 examines many of the endorsements commonly used to modify the CGL policies of companies in the energy industry.

Learning Objectives

In this chapter, you will learn how to…

1. recognize the circumstances under which it may become necessary or desirable to attach an endorsement to a CGL policy and recognize the ways in which endorsements can alter a policy's coverage
2. assess the characteristics of the oil and gas industry that create a need or desire for endorsements that modify the CGL policy, and recognize the desirable and undesirable effects of these endorsements.

Some endorsements are inexpensive and easy to obtain, while others are available only at significant cost, if at all. Some expand the company's scope of coverage, and some narrow the scope of coverage. Others change how the policy operates, such as how the limits apply, who is insured under the policy, or other policy conditions.

Standard endorsements are available for accomplishing a variety of policy modifications, but in many cases, nonstandard endorsements are required. Individual insurers typically have their own endorsements they routinely use for certain purposes. (Insurers use their own endorsements either because there is no standard endorsement or because they want to modify the language of the standard endorsement.) Sometimes, the insurer and insured will draft an endorsement—from scratch or by modifying an existing endorsement—to accomplish a specific objective on a given policy. These negotiated endorsements are known as "manuscript" endorsements.

Endorsements That Expand Coverage

Some endorsements expand the scope of coverage by deleting exclusions, modifying how various coverage provisions will apply, changing policy definitions, etc. The following endorsements are commonly needed by operators, drilling contractors, other contractors, and consultants to avoid gaps between their CGL coverage and their risk exposures.

Underground Resources and Equipment Coverage

The underground resources and equipment coverage endorsement (CG 22 62) is an endorsement that is frequently attached to CGL policies issued to companies in the energy industry. The endorsement is intended to apply to a large range of oil and gas operations, unless coverage for such exposures is provided through the use of the Underground Resources and Equipment exclusion endorsement (CG 22 57). CG 22 62 makes three components of the CGL "damage to property" exclusion inapplicable to property damage claims that fall within the endorsement's scope, thereby broadening the CGL policy's definition of "property damage" to include loss of underground resources. To that end, the endorsement states that the "damage to property" exclusion does not apply to:

- Damage to real property in the insured's care, custody, or control.
- Damage to real property on which the insured or any contractors or subcontractors working directly or indirectly on the insured's behalf are performing operations if the "property damage" arises out of those operations.
- Damage to property that must be restored, repaired or replaced because the insured's work was incorrectly performed on it.

The endorsement defines "underground resources and equipment hazard" as "property damage" to the following:

- Oil, gas, water or other mineral substances which have not been reduced to physical possession above the surface of the earth or above the surface of any body of water.
- Any well, hole, formation, strata or area in or through which exploration for or production of any substance is carried on;

- Any casing, pipe, bit, tool, pump or other drilling or well servicing machinery or equipment located beneath the surface of the earth in any such well or hole or beneath the surface of any body of water.

Operators should make sure that the underground resources and equipment coverage endorsement is attached to their policies. However, the extension of coverage under the endorsement is not absolute. In fact, the endorsement modifies Coverage A to add two additional exclusions which pertain to claims or suits by co-owners of a mineral lease. First, the CGL policy does not apply to any costs or expenses incurred by the insured or at the insured's request or at the request of any "co-owner of the working interest" in connection with bringing a well under control. The endorsement defines "co-owner of the working interest" as any person or organization that is the insured's co-owner, joint venturer, or mining partner in mineral properties who participates in the operating expense of such properties or has the right to participate in the control, development, or operation of such properties. In other words, the insured's costs associated with bringing a well under control are excluded from coverage. Furthermore, the CGL policy does not apply to damages claimed by any "co-owner of the working interest." These exclusions dovetail with an additional condition imposed by the endorsement on the insured which requires the insured, at the insured's own cost and expense, "promptly and diligently" take whatever steps are necessary or legally required to bring a well under control. Operators and drilling contractors need to be aware of the interplay of this endorsement with the rest of the CGL policy. This is especially true with respect to underground pollution losses. If the Underground Resources and Equipment Coverage endorsement does not amend the pollution coverage afforded under the CGL policy, and there is a pollution element to an underground loss, a situation could arise where the pollution portion of the policy or the underground resources and equipment coverage portion of the policy could both come into to play. Operators and drilling contractors should not assume that the Underground Resources and Equipment Coverage endorsement will result in coverage for underground pollution losses.

Since the underground resources and equipment coverage endorsement modifies the CGL policy to exclude coverage for control of well activities, operators should consider purchasing an OEE/COW insurance policy.

Time Element Pollution Exclusion

The time element pollution exclusion endorsement has become prevalent in CGL policies issued to the energy industry. This endorsement adds back a very narrow coverage grant for liability arising from the release of pollutants, provided that the pollution event begins during the policy period, is discovered within the time specified in the endorsement, and is reported to the insurer within the time specified in the endorsement. In other words, coverage for the release of pollutants may exist if the pollution event is discovered and reported to the insurer within a specific period of time. The wording for this coverage grant differs from insurer to insurer. However, most time element pollution exclusion endorsements are written on an occurrence basis and typically require the release of pollutants to be detected by the insured within a set time period (generally 30 days) of the commencement of the release, and reported to the insurer within a set time period (generally 60 or 90 days) of the commencement of the release. The time frame during which the release of pollution must be detected and reported varies from insurer to insurer, a fact that should be noted by energy industry companies. Some endorsements require the insured to discover the pollution event within 7 days of its commencement and report it to the insurer within 21 days of its commencement. If the time period of discovering and reporting the release of pollution is too limited in duration, meaningful coverage for pollution liability exposures will not exist under the time element pollution exclusion endorsement.

Additionally, certain time element pollution exclusion endorsements require the release of pollutants to be "sudden and accidental," whereas others merely require that the bodily injury or property damage arising from the release of pollutants commences during the policy period.

It is important to remember that endorsement's timeframe starts when the pollution event commences, not when the insured discovers the pollution event. Although the time element pollution exclusion provides some coverage for pollution liability exposures, the risk of undiscovered release, seepage, or contamination of pollutants at onshore and offshore drilling sites is significant. Therefore, energy industry companies should consider purchasing pollution legal liability, contractor's pollution liability insurance, or other specialty environmental insurance.

Designated Pollutants Coverage

As discussed previously, the Coverage A "pollution" exclusion does not apply to a release of pollutants at a non-owned site if the insured did not bring the pollutants to the site. (Other conditions also apply, but they are not relevant to this discussion.) For energy industry companies whose primary business involves the use of chemicals and other substances that could be harmful to persons or property, such as ethylene glycol in drilling mud or boric acid in fracking fluids, this exception does little in the way of restoring coverage for the company's off-site operations.

The pollution exclusion—limited exception for designated pollutant(s) endorsement CG 04 30 provides that with respect to a pollutant specifically listed in the endorsement's schedule, the insured will have coverage for an accidental release of such substances on the insured's own premises as well as at sites where the insured is conducting operations. However, the endorsement contains one exclusion of its own. Its exception to the pollution exclusion does not apply to any scheduled pollutant while that pollutant is being transported or stored for others, or while it is being transported, handled, stored, treated, disposed of, or processed as waste. Therefore, oilfield service contractors who haul waste to and from job sites could not use endorsement CG 04 30 to arrange basic liability for the "pollutants" specifically involved in business operations. However, other companies whose operations require them to bring chemicals and other hazardous substances onto a site, or that store drums of fuel and lubricants on their premises for use with equipment and machinery, can obtain coverage for an accidental release of such substances by attaching this endorsement.

Limited Exception for Short-Term Pollution Event

Two endorsements provide broadened coverage of pollution losses by adding exceptions to the CGL pollution exclusion.

The pollution exclusion-named peril limited exception for a short-term pollution event endorsement (CG 04 28) provides broadened coverage of pollution losses by adding exceptions to the Coverage A pollution exclusion for "short-term pollution events" that are caused by a "named peril." The endorsement deletes the pollution exclusion in its entirety and replaces it with a new version of the exclusion that contains the "named peril" and "short term pollution event" provisions. These provisions affect the sections of the pollution exclusion pertaining to on-premises pollution events and to pollutants brought to an off-premises job site by the insured. When CG 04 28 is used, those sections of the pollution exclusion do not apply if: (1) the escape or release of pollutants is a "short-term pollution event" and (2) the escape or release is attributable to one of the enumerated "named perils."

The term "short term pollution event" is defined in the endorsement as an escape, release, discharge, or dispersal of pollutants that begins during the policy period; ends completely at an identified time no later than 48 hours after it begins; must be reported to the insurer as soon as practicable, but in no case more than 14 days after it ends; and must not originate from an underground storage tank. An intermittent (i.e., noncontinuous) escape of the same pollutants from the same source will be considered a single pollution event and must meet the 48-hour requirement in its entirety to qualify for the exception.

The term "named perils" is also defined by the endorsement to mean lightning, windstorm, or earthquake; explosion, implosion, collapse, puncture, bursting, rupture, collision, or overturn of a tank, vessel, piece of machinery or equipment, or similar apparatus or device, including attached pipes, pumps, or valves; or vandalism or malicious mischief by someone other than an insured. The explosion, rupture, or collision peril does not apply with respect to "autos"; that peril is covered by standard auto liability insurance. Nor does it apply if the explosion, collapse, rupture, etc., is caused by deterioration or wear and tear.

The causation requirement under this endorsement is not restrictive. To be covered, the pollution event must be one that would not have occurred "but for" the named peril. Therefore, the named peril does not need to be the sole or proximate cause of the pollution event; it only needs to be a necessary link in the chain of events causing the escape or release. Consider the following scenario. A system of storage tanks for the insured's product, a hazardous chemical used in fracking operations, is regulated by an electronic monitoring device that prevents the accidental overflow of the chemical from the open tanks. Lightning strikes the insured's facility, disabling the electronic monitor and allowing the chemical in one of the tanks to spill out for a period of several hours (but fewer than 48) before the insured becomes aware of the spill and ends it. Lightning did not directly cause this pollution event, but the lightning was a necessary causative link. The overflow would not have occurred but for the lightning. Therefore, it meets the endorsement's definition of a short-term pollution event from a named peril.

The modified exclusion incorporates exceptions also found in the basic CGL pollution exclusion: fumes from building heating equipment and water heaters; releases at or from an additional insured project owner's premises; hostile fire; fumes from materials used in connection with the insured's off-premises operations; and accidental release of operating fluids from mobile equipment.

A second endorsement, the pollution exclusion—limited exception for a short term pollution event, (CG 04 29) provides the same limited exception for short term pollution events but without the requirement that the pollution event be caused by a named peril. In other words, "short term pollution events" may be covered regardless of the circumstances that give rise to those events. However, this endorsement adds two stipulations to the definition of "short-term pollution event." First, the defined term does not include a "repeat or resumption" within 12 months of a previous pollution event involving the same pollutants and the same source. Second, the defined term does not include heat, smoke, or fumes from a hostile fire. Coverage in connection with pollutants of this kind comes by way of the separate provision regarding hostile fire, which is contained in the basic CGL pollution exclusion.

Although both short-term pollution event endorsements provide some coverage for pollution liability exposures, most pollution events associated with oil and gas operations would not end within 48 hours after they begin. Moreover, the 14 day reporting requirement is stringent. Consequently, the coverage afforded under these endorsements is minimal, at best. Energy industry companies would be advised purchasing pollution legal liability insurance, contractor's pollution liability insurance, or other specialty environmental insurance.

Endorsements That Constrict Coverage

Some endorsements constrict the scope of coverage by adding new exclusions, modifying how various coverage provisions will apply, changing policy definitions, etc. Certain exclusionary endorsements are routinely attached to contractors' policies (or certain types of contractors' policies) to restrict coverage for certain types of claims. Some exclusionary endorsements are less commonly used, but the very fact that they exist is something contractors should be alerted to watch for their use. The following discussion covers some endorsements in each of these categories.

Generally, insurers use a variety of endorsements to remove coverage for risks they are not willing to insure. Sometimes insurers' unwillingness to cover certain risks is based on a general underwriting philosophy, and other times it is based on specific characteristics of the insured contractor.

Designated Professional Services Exclusion

The standard CGL policy does not include a professional liability exclusion, but one is almost always added to energy industry companies' policies by endorsement. Because the standards of care and damages sought are often very different for professional liability losses, most insurers will carve these claims out of the CGL policy and require energy firms needing this coverage to purchase separate professional liability insurance. A standard endorsement is available for excluding professional liability on energy companies' policies. This endorsement is a virtually total exclusion for bodily injury and property damage arising out of an energy industry company's design services. The Designated Professional Services exclusion endorsement (CG 21 16) is used by insurance companies when underwriters detect exposures under the CGL policy that should be excluded and for which no special professional liability exclusion is available. The endorsement contains a schedule for listing a description of the professional services to which the exclusion applies. For example, if an operator hires an oil and gas consultant to create a drilling plan for an oil well and to consult and assist in the drilling of the well, an endorsement to the consultant's CGL might specify that the exclusion applies to "Oil and Gas Consultant Operations." Suppose that the contract between the operator and the oil and gas consultant states that the consultant is responsible for ensuring that the drill pipe does not fail under the drilling conditions, and also requires the consultant to indemnify the operator for any claims, losses, damages, or expenses arising from providing or failing to provide professional services. A blowout of the well subsequently occurs after the consultant fails to instruct the mud logger to check for metal shavings in the drilling fluid. The operator sues the consultant seeking damages associated with the blowout. Under that scenario, the designated professional services exclusion would bar coverage for the consultant under the consultant's CGL policy.

The Designated Professional Services exclusion is significant given that energy industry contracts, including contracts for professional services, typically contain indemnity provisions in which risk is allocated to one party to the contract. To the extent that the consultant does not have separate professional liability insurance, the designated professional services exclusion would result in an unanticipated exposure under the CGL policy. The risk allocation system in most drilling contracts further complicates matters. Remember that most drilling contracts have broad, reciprocal indemnity clauses and include a pass-through provision where a party such as the operator is required to indemnify the drilling contractor for the consultant's negligence if the operator's group includes a consultant providing professional services. Consequently, operators should resist the attachment of professional services exclusions to their CGL policies as it represents a significant reduction in coverage.

Finally, it is important to note that coverage for professional services would not exist under the exception to the contractual liability exclusion. That exclusion carves out coverage for "liability that the insured would have in the absence of the contract or agreement" and "liability assumed in an 'insured contract.'" The first exception to the contractual liability exclusion would not apply if the consultant incurs liability because it breached its contract with the operator. Damages for breach of contract would not be covered by the CGL policy. The second exception to the contractual liability is just as problematic since the definition of "insured contract" specifically requires assumption of another's "tort" liability. To the extent a consultant agrees to assume the tort liability of the operator, the CGL policy will respond to that liability, provided no other exclusions or conditions apply. However, assumption of another party's contractual liabilities will not be covered. Additionally, coverage under the exceptions to the contractual liability exclusion does not apply to direct claims made by the indemnitee (e.g., the operator) against the indemnitor (e.g., the insured contractor), such as the example discussed above where the consultant was contractually obligated to ensure the drill pipe did not fail. In sum, coverage for professional services liability may not be covered under the CGL policy.

Because of the gaps in the CGL policy's professional liability coverage, energy industry companies with any professional liability exposure should consider the purchase of oil and gas professional liability insurance. Several niche markets exist for this coverage.

Underground Resources and Equipment Exclusion

Many CGL policies issued to operators, drilling contractors, well service consultants, and other energy industry contractors or consultants contain an underground resources and equipment exclusion endorsement (CG 22 57) that excludes liability for property damage included within the underground resources and equipment hazard. The definition of "underground resources and equipment hazard" is identical to that contained in the Underground Resources and Equipment Coverage endorsement (CG 22 62) discussed above.

The endorsement is intended to apply to a large range of oil and gas operations, unless coverage for such exposures is provided through the use of the Underground Resources and Equipment Coverage endorsement (CG 22 62). For example, an oil well servicer may be hired by an operator to service a well and the contract may require the oil well servicer to indemnify the operator. While servicing the well, a cable breaks and the sinker bar gets caught in the hole. The operator brings a claim against the oil well servicer for the cost of cleaning up the hole. The oil well servicer seeks coverage for this claim under its CGL policy. The cable and sinker bar would likely qualify as "any casing, pipe, bit, tool, pump, or other drilling or well servicing machinery or equipment located beneath the surface of the earth in any such well or hole" portion of the definition of "underground resources and equipment hazard." Consequently, coverage for the oil well servicer's claim would be barred if the oil well servicer's CGL policy contained the underground resources and equipment exclusion.

As another example, an operator hires a contractor to perform the final step of "swabbing" the well. When the swab was lowered into the well, the swab and swab line were lost down the tubing because the line was not attached to the drilling rig's spool. The contractor was able to retrieve the swab and swab line but damaged the well during the retrieval process. The damage to the well would not be covered under the contractor's CGL if the policy was endorsed with the underground resources and equipment exclusion.

Energy industry companies with any underground resources and equipment exposures should resist the attachment of an underground resources and equipment exclusion endorsement and should consider having the CGL policy endorsed to provide coverage for underground resources and equipment exposures.

Oil or Gas Producing Operations Exclusion

The oil or gas producing operations exclusion endorsement (CG 22 73) modifies the CGL's pollution exclusion because the pollution exclusion does not reach certain off-premises exposures of contractors when the work contracted for does not involve pollution remediation and the pollutants in question were not brought on site by the contractor. This endorsement bars coverage for "bodily injury" or "property damage" arising out of pollution incidents "at or from any premises, site or location on which any insured or any contractors or subcontractors working directly or indirectly on any insured's behalf are performing operations." This endorsement has the effect of removing coverage for pollution incidents at any location where an insured or a contractor or subcontractor of an insured is performing operations, and, as a result, the pollution exposure to operators, drilling contractors, well service contractors, and other contractors is significant. Parties engaged in operation of oil and gas drilling equipment must typically accept this endorsement as part of their CGL policies. Consequently, energy industry professionals who are involved with the operation of oil and gas drilling equipment should consider the purchase of pollution liability insurance.

Saline Substances Contamination Exclusion

The saline substances contamination exclusion (CG 22 47) is designed to exclude property damage within the "saline substance contamination hazard." The endorsement defines this hazard as "property damage" to oil, gas, water, or other mineral substances caused directly or indirectly by a saline substance, as well as damage to any other property caused by a saline substance. The endorsement does not define "saline substance"; however, saline substances may include drilling "mud" or fluid, saltwater pumped into a well to stimulate oil recovery, or saltwater used during the fracking process. For example, the saline substances contamination exclusion could bar coverage for expenses incurred by an operator to clean up a fresh-water aquifer if the aquifer is damaged by a release of saltwater into the aquifer during the fracking process.

The saline substances contamination exclusion applies to oil and gas lease operations. Its use is mandatory for the two classifications listed in the endorsement schedule: 98150 and 98151, oil or gas lease operators—natural gas.

Failure to Supply Exclusion

The failure to supply exclusion endorsement (CG 22 50) is typically attached to CGL policies insuring several classifications, including fuel oil or biofuel dealers or distributors, gas dealers or distributors, and gas companies. When this endorsement is attached to a CGL policy, no coverage is intended for claim or suit involving bodily injury or property damage arising out of the failure of any insured to adequately supply any gas, oil, water, electricity, steam, or biofuel. However, this exclusion does not apply if the failure to supply results from the sudden and accidental injury to tangible property owned or used by any insured to procure, produce, process, or transmit the element in question.

The exception is significant for oil and gas dealers or distributors. For example, suppose that a natural gas supplier's natural gas transmission line is connected to a distributor's main transmission line, and the distributor's main transmission line is connected to the service lines of 50,000 customers. The supplier's mechanical equipment used to transmit the natural gas ruptures without warning, resulting in an infiltration of air in the supplier's transmission line and the distributor's main transmission line. Due to the equipment failure, the distributor suffers a complete loss of use of its transmission line because the air infiltration caused a dangerous condition which required the distributor to cease using the transmission line. The distributor is required to take action to restore the line to use, including flushing the line, and the service lines of its 50,000 customers, over a period of several days. The distributor subsequently seeks to recover the expenses it incurred from the supplier. The supplier's GCL policy contains the failure to supply exclusion endorsement, but the exclusion might not bar coverage for the claim to the extent that the interruption in the gas supply to the distributor and its customers resulted from a sudden and accidental injury to the supplier's transmission equipment.

Sunset Provisions

Some insurance policies issued to energy industry companies are endorsed with a "sunset" provision. A sunset provision imposes a time limit for reporting claims under the policy. These provisions essentially modify the CGL's "occurrence" coverage by introducing a date limitation by which claims must be reported. Under a traditional occurrence form, there is no time limitation on when a claim can be reported. Under a policy with a sunset provision, the insured must report the claim within the applicable time period specified in the provision (typically ranging from two to five years after the expiration of the policy period). If the insured fails to report the claim or suit to the insurer within the time period specified in the sunset provision, the policy will not provide coverage for the claim or suit.

This endorsement is frequently encountered in CGL policies issued to construction companies, but it is now common to include it in CGL policies issued to energy industry companies. The inclusion of such an endorsement can leave the insured with significant uninsured exposures, especially with respect to pollution or other long-tail claims. The following example illustrates the effect such a provision can have on an energy company. A drilling contractor hires an equipment contractor to install new crude oil storage tanks on an onshore drilling rig. The equipment contractor completes installation of the storage tanks in May, 2009. At the time the work was completed, the equipment contractor was insured under a CGL policy with a policy period of September 1, 2008 to September 1, 2009. The CGL has a sunset clause requiring the contractor to report all claims or suits to the insurer within three years after the expiration of the policy (e.g., September 1, 2012). The equipment contractor negligently installed the storage tanks and crude oil starts being gradually released into the soil and groundwater in June 2009. However, the pollution is not detected by the drilling operator until October 1, 2012. On October 2, 2012, the drilling contractor seeks indemnity from the equipment contractor. The equipment contractor reports the claim to its insurer that same day, but the insurer denies coverage for the claim because the equipment contractor did not report the claim within the three-year time period stated in the sunset clause. Therefore, the equipment contractor must satisfy its indemnity obligation to the drilling contractor using its own money.

Many occurrences involving oil and gas operations may not be visible until years later, especially pollution events that are gradual in nature. Consequently, energy industry companies should resist the attachment of a sunset provision endorsement to their CGL policies as it represents a significant reduction in coverage.

X, C, U Exclusion

The "X, C, U" exclusion removes coverage for property damage liability when the cause of loss is one of the three designated hazards—explosion (X), collapse (C), and underground property damage (U). These hazards may be excluded individually or in any combination by indicating on the endorsement which of the three hazards is to be excluded. The scope of the exclusion for each hazard is limited to property damage arising out of specified causes of loss. For example, collapse caused by certain types of operations may be excluded while collapse caused by other operations is not excluded. Under no circumstances does the exclusion apply to liability for bodily injury.

The X, C, U hazards exclusion applies only to property damage arising out of: (1) operations in progress and (2) operations performed by the insured. Therefore, the exclusionary endorsements do not affect coverage as it applies to the products-completed operations hazard or to the independent contractor exposure.

There are two standard X, C, U endorsements, which are identical except with regard to the projects to which they apply. The exclusion—explosion, collapse and underground property damage hazard (specified operations) endorsement (CG 21 42) applies the exclusion only to those operations (e.g., projects) that are scheduled in the endorsement. The other endorsement—exclusion—explosion, collapse and underground property damage hazard (specified operations excepted) (CG 21 43)—takes the opposite approach, making it applicable to all of the insured's operations *except* those that are scheduled in the endorsement.

The explosion exclusion removes coverage for property damage arising from blasting operations or other explosions. The collapse exclusion removes coverage for structural property damage caused by the excavation and demolition activities specifically listed in the endorsement. The underground property damage exclusion removes coverage for property damage to specifically listed types of property (e.g., wires, pipes, tunnels, and sewers) caused by mechanical digging, pile driving, excavating, or similar equipment.

The X, C, U exposures represent significant third-party property damage exposures. While fairly substantial premium reductions may apply when the exclusion is added to the CGL policy, it is usually advisable to have coverage for these exposures. If an exclusion is attached, it is important to understand which approach is used—exclusion of scheduled operations only or a blanket exclusion with scheduled exceptions.

Total Pollution Exclusion

Despite its "absolute pollution exclusion" (as it is commonly referred to), the standard CGL policy retains some important pollution coverage with respect to insureds' off-premises operations. First, insureds have coverage for third-party bodily injury or property damage arising out of non-remedial operations (operations for purposes other than cleaning up pollutants) on property not owned, rented, or occupied by the insured. Second, because the exclusion only applies to property on which you (the named insured operator, drilling contractor, or other energy industry company) "are performing" operations, it does not reach injury or damage that arises out of the insured's completed work. And third, insureds have coverage for injury or damage caused by smoke or fumes from a "hostile fire" (one that has escaped its intended boundaries) and emissions from equipment used to heat or cool the contractor's premises.

Insurers can remove all coverage for pollution damages from the CGL by attaching the standard total pollution exclusion endorsement to the policy. Three versions of this endorsement exist. The broadest of the three—CG 21 49—is virtually total, with no exceptions. A second version—CG 21 55—includes a hostile fire exception, and a third version—CG 21 65—makes exceptions for both a hostile fire and an escape of fumes or other emissions from equipment used to heat, cool, or dehumidify the insured's own building premises, or from a water heater. All three versions take away coverage that the standard CGL pollution exclusion left in place. The latter two versions retain coverage for two categories of substances that are not intended to be excluded "pollutants" under the basic CGL policy. The standard CGL pollution exclusion also affords coverage for these substances.

Energy industry companies whose operations entail direct involvement with pollutants—hazardous waste contractors; contractors working on an oil rig, in an oil refinery, or oil refinery construction; installers of underground storage tanks, etc.—are most likely to have a total pollution exclusion added to their policies, but some insurers automatically attach it to all insureds' policies. Energy industry companies whose operations entail direct involvement with pollutants should resist the attachment of a total pollution exclusion, but if one cannot be avoided, they should attempt to obtain the hostile fire and heating/cooling equipment exceptions.

Contractually Assumed Liabilities

The standard CGL policy does not include any limitation on the insured's contractual liability coverage with respect to the indemnitee's negligence. That is, although many states forbid the transfer of certain types of liability in oil and gas contracts, the CGL policy does not differentiate. Rather, the policy will cover whatever the law allows. As long as the loss falls within the indemnity clause and the indemnity clause is valid and enforceable, coverage applies whether the claim is based on the insured's negligence, joint negligence of the insured and the indemnitee, or even the sole negligence of the indemnitee.

However, the amendment of insured contract definition endorsement—CG 24 26—adds an additional condition to the portion of the definition of "insured contract" (those that qualify for coverage of contractually assumed liabilities) that applies to indemnity agreements, which is where energy industry companies obtain coverage for tort liabilities assumed in contracts, equipment leases, and such. Under this revised definition, the injury or damage that is the basis of the claim must be "caused in whole or in part" by the named insured or those acting on its behalf. This change effectively eliminates coverage for the insured's assumption of liability arising out of the other party's (indemnitee's) sole negligence. Where the transfer of liability for one's sole negligence is allowed, this restriction could result in a coverage gap for some companies. Furthermore, the indemnitee should be concerned if this endorsement is attached to the CGL policy because insurance is the most common means to make sure an indemnitor is able to meet its contractual indemnity obligations. An indemnitor may have a contractual obligation to indemnify the indemnitee but may not have the insurance to fund such an obligation. Under that scenario, the indemnitee would be relying on the indemnitor's solvency to honor its indemnity obligations. Operators and contractors entering into drilling contracts should be aware of the amended definition of "insured contract" under CG 24 26 and should take steps to mitigate the endorsement's effects.

One good approach that operators and drilling contractors can take is to obtain a specific contractual liability endorsement (or, at a minimum, a specialized oil and gas insurance form) that is crystal clear that whatever liability that party traditionally undertakes in a drilling contract is covered under the contractual liability provision. The contractual liability endorsement should provide broad and unambiguous coverage for the contractual obligations that the party typically assumes in a drilling contract, such as the operator's potential liability for damage to the rig, certain pollution liabilities, down-hole tools, etc. Therefore, instead of relying on the basic language provided in an ISO form, with its potential pitfalls, the most prudent step to take is to seek a manuscript endorsement that squarely covers such typical liabilities attached to the CGL policy. Whether an insurer will provide such a manuscript contractual liability endorsement will vary, depending on such things as account size and insurance market conditions.

Oil Industry Limitation Endorsement

CGL policies issued to oil and gas companies specifically exclude liability for drilling-related damages using an endorsement called an "oil industry limitation endorsement." There is no "standard form" endorsement, and the wording can differ from policy to policy. The endorsement clarifies the type of drilling-related damages that are not covered under the policy. For example, the endorsement might exclude coverage for:

- Loss of hole, reservoir, formation, or strata, and any in-hole equipment, including fishing costs;
- Loss or damage to, or loss of use of property directly or indirectly resulting from subsidence caused by subsurface operations of the insured;
- Removal of wreck or debris;
- Removal of or loss to subsurface oil, gas or any other substance, or to the property of others;
- Property damage to drilling rigs, drilling or production platforms, workover rigs, servicing rigs, drilling tools, pipes, supplies, collars, machinery, and equipment leased by or rented to, or in the care, custody or control of any insured;
- Damages claimed by any co-owner of the working interest;
- Any professional services performed by or on behalf of the insured, including but not limited to the preparation or approval of maps, plans, opinions, report surveys, designs, or specifications, and any supervisory, inspection, or engineering services; and
- Pollution liability.

The endorsement typically excludes coverage for damages that are deemed to be first-party in nature. This makes some sense because CGL policies were not designed to respond to first party losses. However, the risk allocation system present in oil and gas contracts does not always follow ownership. Under certain circumstances, the operator takes direct responsibility for damage to the drilling contractor's property (third-party property). Damage to that property may not be covered under the operator's first-party property policy. For example, the operator could be contractually liable for removing the drilling contractor's wreck or debris. The oil industry limitation endorsement would remove coverage for this loss from the operator's CGL policy and the operator's first party property policy or the OEE/COW insurance policy might not cover this specific type of third-party property damage.

Endorsements That Change the Policy Conditions

A variety of endorsements are used to modify policy conditions, such as how the limits apply, who is insured under the policy, or other "non-coverage" provisions. While these endorsements do not broaden the scope of coverage as outlined in Section I of the policy, they can provide significant extra benefits under the policy. Some of the more commonly needed changes of this type are discussed below.

Designated Location(s) General Aggregate Limit

Operators typically have a single CGL policy covering liability in connection with all of their wells. To ensure that the CGL's aggregate limits are not used up for a claim in connection with a well in which the non-operating working interest owners have no interest, some safeguard is required. This is typically accomplished by attaching a designated location(s) general aggregate limit endorsement (CG 25 04) to the CGL policy. This endorsement structures the method of assigning separate general aggregate limits to individual insured locations. Endorsement CG 25 04 provides for a schedule of "designated locations," to each of which a separate "designated location general aggregate limit" applies. Another policy general aggregate limit applies to losses not associated exclusively with a scheduled location.

Unintentional Failure To Disclose Hazards

When applying for coverage, insureds are required to provide a detailed account of their operations. Insurers rely on the accuracy of this information in determining whether to offer coverage and, if so, at what price. Intentional failure to give the insurer information it needs for these purposes may jeopardize coverage if the failure amounts to a material misrepresentation.

However, sometimes the failure to disclose is unintentional, as opposed to an attempt at fraud. For example, the person filling out the application may be unaware of the insured's involvement in certain types of operations. An unintentional failure to disclose hazards endorsement ensures that coverage is provided for operations that existed at the inception date of the policy but were unintentionally not reported to the insurer. There is no standard endorsement of this type, but many insurers have their own nonstandard endorsement that will accomplish this purpose.

Waiver of Subrogation

The CGL coverage form contains a condition that transfers to the insurer any insured's right to recover from another party (i.e., a third party legally responsible for the covered loss) the amount of payment made under the policy. This right of subrogation on the part of the insurer must not be impaired by any action of the insured after the loss has taken place. However, before a loss, the insured may waive its right of recovery against a third party, and, by doing so, the insured automatically waives the insurer's right with respect to payments made under the policy which the insurer could otherwise recover in subrogation from that third party.

A waiver of subrogation provision is a crucial component of risk allocation in oil and gas contracts. The waiver of subrogation provision prevents the indemnitor's insurer claiming against the indemnified party for its share of a loss. Absent a waiver of subrogation (and putting aside for the moment that the indemnitee should have additional insured status), an insurer that pays a loss is entitled to subrogate against the party at fault to the extent of its negligence or responsibility. Although an insurance company generally cannot subrogate against its own insured or even its additional insured, a waiver of subrogation provision in the CGL policy is still necessary for a few reasons. First, one or both parties to the drilling contract might have a nonstandard CGL policy that does not allow pre-loss waivers of recovery rights by the insured. Any uncertainty on this issue can be avoided by attaching a waiver of subrogation endorsement in which the insurer expressly waives any rights of subrogation against the other party to the oil and gas contract. A standard endorsement (CG 24 04) exists for this purpose.

Furthermore, it is not unheard of for an administrative error or misunderstanding to result in a lack of additional insured protection, even when required by contract. The waiver of subrogation serves, to a certain extent, as a backup to additional insured status. In fact, sometimes a waiver of subrogation provides more protection than being named as an additional insured. An example might be helpful to illustrate how this could be possible. Assume that the operator is named as an additional insured under a vessel owner's CGL policy and a waiver of subrogation endorsement is attached to the policy. An injured independent contractor's employee sues both the operator and the vessel owner and the vessel owner's insurance pays the full amount of the judgment awarded to the employee. However, the operator's additional insured status is limited to bodily injury and property damage claims arising solely from the charter or operation of the vessel itself as opposed to claims arising from the operator's other activities on the vessel (such as hiring a contractor to operate a crane on a fixed platform of the vessel). It is ultimately determined the operator was only covered for a portion of the judgment because the employee's injuries were due, in part, to the crane operator's negligence while using the crane on the fixed platform (e.g., an activity not related to the charter or operation of the vessel). Since the vessel owner's insurer waived its right of subrogation against the operator, the insurer cannot recover the uninsured portion of the judgment from the operator. Absent such a waiver, the insurer would be permitted to pursue recovery of the uninsured portion of the judgment from the operator.

A waiver of subrogation in the context of a drilling contract is particularly prudent because the magnitude of property risk is high. Additionally, operators should seek a waiver of subrogation, especially as respects the contractor's equipment, because the operator may not have coverage for such equipment under the CGL policy. Finally, it is important to remember that this insurance protection should be matched to the indemnity obligation. Therefore, the waiver of subrogation should be extended to all of the indemnified parties (e.g., the Operator Group or Contractor Group).

Notice Requirements

The CGL policy imposes certain obligations on each party—the insurer and the insured—to notify the other party of certain events. For example, the insured is required to provide timely notice to the insurer of any suit for damages as well as for any "occurrence" that might give rise to a claim. To delay notice may prejudice the insurer's ability to properly investigate, settle, or defend the claim. The insurer, on the other hand, must provide sufficient notice to the insured of its intent to cancel the policy. In that way, the insured has the opportunity to seek replacement coverage before the policy expires. Typically, the notice of cancellation is 30 days or, in the case of cancellation for nonpayment of premiums, 10 days.

At least two changes are routinely needed on operators, drilling contractors, and other energy industry companies' CGL policies with respect to notice requirements. First, the policy should clarify when the insured will be considered "aware" of a claim or an occurrence. This type of modification was discussed previously with respect to the policy's notice condition. Second, when an operator's or drilling contractor's insurance is canceled or not renewed, it will almost certainly take longer than 30 days to arrange satisfactory replacement coverage. Energy industry companies should negotiate a longer notice period of 60, 90, or even 120 days. In most instances, endorsements will be required to effect these changes, as discussed below.

Extended Notice of Cancellation, Nonrenewal, or Policy Change

The standard CGL conditions state that the insurer must provide 30 days' written notice of cancellation, except in the case of nonpayment of premiums, in which case only 10 days' notice is required. No advance notice is required of the insurer's intent to materially alter or to not renew the policy. In today's insurance market, 30 days is simply not adequate time to conduct a proper search for replacement coverage. Specifications and loss data may need to be prepared for underwriters, site inspections may be required, and questions will inevitably need to be answered. Thirty days is not enough time to do all this.

Most states have notice of cancellation requirements that supersede the basic policy requirements. Many states require longer notice of cancellation or nonrenewal, and some states place limitations on insurers' ability to cancel a policy that is already in force. Insurers doing business in these states must attach mandatory endorsements that bring the policy into compliance with the statute. However, even the state requirements may not offer insureds sufficient protection.

Operators, drilling contractors, and other energy industry companies should take this issue up with the underwriter and negotiate reasonable notice of cancellation. Ideally, it would provide equal notice of nonrenewal and material changes in coverage. At a minimum, operators and drilling contractors should negotiate 60 days' notice, and 90 days is preferable. Negotiation of an even longer period of time (e.g., 120 days) is possible in some situations. ISO publishes the earlier notice of cancellation endorsement (CG 02 24) that modifies the required notice of cancellation to the number of days stated in the endorsement schedule. However, this endorsement does not require notice of nonrenewal or material policy change. Some insurers' nonstandard endorsements also require extended notice of nonrenewal, but a manuscript endorsement is often required to obtain a required notice of material policy change.

Modified Notice of Occurrence

The CGL policy conditions state that in the event of an occurrence, notice shall be given to the insurer "as soon as practicable." Failure to comply with this provision may void coverage. However, the notice requirements in the standard CGL policy may not provide adequate protection to the insured. For example, the policy does not qualify what it means to provide "timely" notice upon becoming aware of a claim or an occurrence. If a worker on a drilling site witnesses something that could result in a claim but does not report it to someone with authority to give notice, or even to the worker's supervisor or a project supervisor (who has the responsibility to report such incidents), is the company in violation of its obligation to provide timely notice?

A modified notice of occurrence endorsement, which must be worded on a nonstandard or manuscript basis, specifies when exactly the insured is considered to have knowledge of an occurrence. Specifically, the insured will be deemed to have knowledge of a claim when the individual specified in the endorsement schedule receives information pertaining to the loss. The most favorable modification would be to name the highest-ranking position in the organization (e.g., president/CEO); the least favorable would be to name the drilling site supervisor, because he or she will probably be one of the first people to know. A reasonable compromise is to name the position of risk manager or, in some cases, the vice president of finance as the person responsible for reporting claims in a timely manner. This modification is particularly important in large organizations where employees may have knowledge of a loss and not report it to management.

"Who Is an Insured" Endorsements

Various changes can or should be made to the "who is an insured" provision of the CGL policy. One often-overlooked modification ensures that all of the insured's related entities are covered under the policy. Likewise, operators that engage in joint ventures may need to modify their policies to ensure adequate protection, even if the joint venture is separately insured. And virtually all operators, drilling contractors, well service contractors, and other energy industry companies will need to occasionally add other parties to their policies as additional insureds, and most do so quite frequently. Operators, drilling contractors, and other energy industry companies need to understand the scope of coverage that both standard and nonstandard endorsements provide to additional insureds to ensure the adequacy of the coverage. A number of key endorsements that modify the "who is an insured" provision to include additional parties are discussed below.

Broad Form Named Insured Endorsement

Recall that the named insured in the CGL policy is defined as the person or entity specified as such in the policy declarations. Subsidiaries of a named insured are not automatically covered under the standard policy form. Each related entity must be specifically listed to ensure coverage for that entity. Similarly, joint ventures are not automatically covered under the CGL policy. In fact, they are specifically excluded unless they are listed on the policy declarations as insureds. Two endorsements used to address joint venture coverage are discussed in more detail below.

A broad form named insured endorsement provides automatic coverage for all subsidiary, affiliated, associated, controlled, or allied companies, or corporations of the named insured company. There is no standard endorsement for this purpose, but most insurers have their own nonstandard versions. The individual entities do not have to be listed on the endorsement to be covered. This type of endorsement avoids oversights in adding new acquisitions or newly formed organizations to the policy, as well as simple errors in listing related entities.

Injury to a Fellow Employee

Under the workers compensation laws of most states, the benefits provided under the law are intended to be the “exclusive remedy” available to an injured employee. However, methods of getting around this concept of exclusive remedy have developed over the years. One such technique is that of suing a fellow employee whose negligence somehow contributed to or caused the loss. Supervisors and safety directors are among the most likely targets of suits alleging failure to maintain a safe working environment or similar allegations.

As previously discussed, even though employees are insureds under the CGL, they are not insureds with respect to suits brought by another employee. (Suits brought by employees against “executive officers” are covered.) An injury to a fellow employee endorsement modifies the “who is an insured” provision to provide insured status for specified employees with regard to a suit brought by a coworker. The endorsement, always written on a nonstandard or manuscript basis, will normally specify the employees to which it applies either by name or by position or function. Using broad classes of employees such as “all of operator’s supervisors and loss prevention personnel” is generally a better approach than naming individuals as it prevents unintended gaps when a new employee is hired but not added to the endorsement.

Additional Insured Endorsements

As previously discussed, contracts play a key role in the energy industry, and one of the major insurance protections that is commonly required by indemnified parties is being named as an additional insured. For example, an operator typically requires that it and the Operator Group be named as additional insureds under the drilling contractor’s insurance policies. Likewise, the drilling contractor typically requires that it and the Contractor Group be named as additional insureds under the operator’s insurance policies. In the context of service contracts, an operator may require that its subcontractors name it as an additional insured under the subcontractors’ insurance policies. Drilling contractors typically require the same from their subcontractors.

Just as with waivers of subrogation and primary and non-contributory endorsements, it is important to remember that additional insured status should be matched to the indemnity obligation under the particular contract. This means additional insured status should be extended to all of the indemnified parties (e.g., the Operator Group or Contractor Group).

In the energy industry, an additional insured’s coverage typically mirrors the obligation assumed in the indemnity agreement in the particular contract. Since many energy contracts require mutual or reciprocal indemnity, each party to the contract should be named as an additional insured on the other party’s insurance. Furthermore, the additional insured endorsement, should spell out the scope of the additional insured’s coverage. For example, coverage for each party should be limited “to the extent of the risks and liabilities assumed” by the other party under the contract’s indemnity provision. Otherwise, the additional insured would have coverage for liability in connection with its independent business activities that have no connection to the oil and gas operations specified in the contract.

To accomplish the appropriate limitations, ISO publishes a variety of standard additional insured endorsements for naming various types of entities as additional insureds. The scope of coverage provided under each endorsement will reflect the nature of the relationship between the named insured and the additional insured, including any limitations on coverage. For example, the additional insured endorsement for entities that have a nonoperating working interest in an oil or gas lease provides additional insured coverage for nonoperators, but limits the coverage to the nonoperators' liability arising out of their working interest. Similarly, the additional insured endorsements for owners, lessees, and contractors will explicitly exclude coverage for the named insured's completed operations. In some cases, however, a manuscript approach—involving modification of standard endorsement language or the drafting of an entirely new, nonstandard endorsement—becomes necessary to address unique coverage needs.

The unique risk allocation system in oil and gas contracts has an impact on the appropriate scope of coverage for additional insureds. As previously noted, the additional insured's coverage should mirror the obligations under the indemnity agreement. Under this approach, the coverage provided to the additional insured would, in many instances, include liability arising out of the contributory negligence of the additional insured (intermediate form indemnity). The scope of additional insured coverage should not be limited to the acts or omissions of the insured or those acting on the insured's behalf. Since risk is typically allocated without regard to fault, additional insured coverage is needed for the acts or omissions of the additional insured and the additional insured's group (Operator Group or Contractor Group). For the very same reason, the scope of additional insured coverage should not be limited to ongoing operations. Additional insured coverage for completed operations is needed. Similarly, the scope of additional insured coverage should not be limited to a party's vicarious liability for the actions of its group and should not specifically exclude a party's sole negligence. One way to address this issue is to use alternative wording in an additional insured endorsement which states that coverage under the endorsement, "…shall not specifically exclude sole negligence." The scope of coverage provided to additional insureds has been gradually eroded in the past several years. The evolution of this coverage is examined at length in the "Contractual Risk Transfer in the Energy Industry" course. The scope of coverage provided under the current editions of the standard additional insured endorsements (effective in April 2013 in most jurisdictions) is examined below. Also examined below are some manuscript and nonstandard approaches to tailor the provisions of additional insured coverage to suit the needs of contractual relationships in the energy industry.

ADDITIONAL INSURED ENDORSEMENTS		
Endorsement	**Endorsement #**	**Description**
Oil and Gas Operations—Non-Operating, Working Interests	CG 20 30	Used to add nonoperating, working interest owner to the CGL of the operator who has control of the project
Additional Insured—Designated Person or Organization	CG 20 26	Covers injury or damage caused by the named insured's acts or omissions in performance of the named insured's ongoing operations, in connection with the named insured's premises, or both
Additional Insured—Owners, Lessees or Contractors—Scheduled Person or Organization	CG 20 10	Provides additional insured with coverage during the performance of the named insured’s ongoing operations
Additional Insured – Owners, Lessees or Contractors – Completed Operation	CG 20 37	Provides additional insured status with respect to the products-completed operations hazard in connection with the named insured’s work
Additional Insured—Owners of Gas and Oil Lease Working Interest	Manuscript endorsement	Amends the definition of “insured” to include any co-owner, joint venturer, or mining partner who has a financial interest in and participates in the cost of development and operation of the named insured’s oil and gas property
Automatic (“Blanket”) Additional Insured Endorsements	Manuscript Endorsement	Provides a way to avoid the risk of oversight in executing a request for additional insured status.

Oil and Gas Operations—Non-Operating, Working Interests

As previously noted, a nonoperating working interest in an oil or gas drilling operation refers to an investor in the venture who does not participate in the management of the project. A nonoperating working interest owner is a partner and is usually added as an additional insured on the CGL policy of the operator who has control of the project. The Oil and Gas Operations—Non-Operating Working Interests endorsement (CG 20 30) is used for that purpose.

The endorsement adds as an insured any owner, co-owner, joint venturer, mining partner, or limited liability company having a nonoperating working interest in any oil or gas lease operated by the named insured, but only with respect to their liability arising out of such interest. The extension of insured status to a partner or joint venturer in a partnership or joint venture that is not listed as a named insured under the policy could conflict with one provision of the CGL "Who Is an Insured" section, which stipulates that no person or organization is an insured for the conduct of any current or past partnership, joint venture, or limited liability company that is not shown in the policy declarations as a named insured. To avoid any such conflict, endorsement CG 20 30 specifies that the "Who Is an Insured" limitation with respect to any partnership, joint venture, or limited liability not shown as a named insured in the policy declarations does not apply to the extent coverage would be afforded under this endorsement.

The current edition of CG 20 30 contains significant limitations to the scope of additional insured coverage. First, additional insured coverage only applies "to the extent permitted by law." Second, if coverage provided to the additional insured is required by a contract or agreement, coverage will not be broader than required in the contract, and the most the insurer will pay on behalf of the additional insured is the lesser of: (a) the amount required in the contract or agreement or (b) the amount available under the applicable limit of insurance that appears in the policy declarations. These limitations are prevalent in the other standard additional insured endorsements discussed in below.

Designated Person or Organization

Most standard additional insured endorsements are written to address one of two sets of loss exposures—those that arise from the named insured's services or operations, and those that arise in connection with the named insured's premises. These endorsements are tailored specifically to each loss exposure and usually contain conditions and exclusions specific to either business operations or business premises. The Additional Insured—Designated Person or Organization endorsement (CG 20 26), however, is designed to address in a more generic way either set of loss exposures. It covers injury or damage caused by the named insured's acts or omissions in performance of the named insured's ongoing operations, in connection with the named insured's premises, or both. It is used, in effect, as an "all other" endorsement when no endorsement more specific to the relationship between the named and additional insureds is available. For example, CG 20 26 might be used in connection with additional insured coverage required by mineral leases and farmout agreements, since there is no standard endorsement covering such relationships. It provides coverage for the additional insured with respect to the named insured's operations and in connection with premises owned by or rented by the named insured. Therefore, the endorsement could be used in situations where CG 20 10 would be more customarily used to provide insured status to an upstream party under one of its subcontractors' policies or when a lessor's interest endorsement is used to make a property owner an insured under the policy of a tenant.

Note that CG 20 26 is similar to other standard additional insured endorsements, particularly in the way in which insured status for the designated person or organization is triggered: injury or damage must be caused at least in part by an act or omission of the named insured or someone acting on the named insured's behalf. Recall that the scope of additional insured coverage should not be limited to the acts or omissions of the insured or those acting on the insured's behalf. Instead, additional insured coverage is needed for the acts or omissions of the additional insured and the additional insured's group. Therefore, operators and drilling contractors should seek to have the language of CG 20 26 modified to encompass their respective groups or should use a manuscript endorsement to accomplish this purpose.

The current edition of CG 20 26 contains the same "ongoing operations" limitations as other similar endorsements. Coverage for completed operations is excluded under the endorsement. A different endorsement, CG 20 37 (discussed in greater detail below), is now the only standard form that unequivocally provides additional insureds with completed operations coverage. Since the scope of additional insured coverage should not be limited to "ongoing operations," operators and drilling contractors should seek to have endorsement CG 20 37 attached to their policies or should use a manuscript endorsement that does not impose the "ongoing operations" limitations on additional insured coverage.

Coverage under the current edition of CG 20 26 is subject to the same restrictions regarding state law, coverage not being broader than the underlying contract requirements between the named insured and additional insured, and the dollar amount the insurer will pay on behalf of the additional insured that are discussed in connection with Oil and Gas Operations—Non-Operating Working Interests endorsement (CG 20 30) above.

Owners, Lessees, or Contractors

The ISO portfolio of additional insured endorsements includes two endorsements for making individual project owners, lessees, or contractors additional insureds under the policy. CG 20 10 provides the additional insured with coverage during the performance of the named insured's ongoing operations and CG 20 37 provides additional insured status with respect to the products-completed operations hazard in connection with the named insured's work.

The "Additional Insured—Owners, Lessees or Contractors—Scheduled Person or Organization" endorsement, commonly referred to by its form number, CG 20 10, is frequently used to create insured status under a service provider's CGL policy for the person or organization for which the service is being provided, and is generally associated with construction-related contracts where the upstream party is seeking additional insured coverage under a downstream party's insurance policy. It provides additional insured coverage on a scheduled basis, to the person or organization named in the endorsement with respect to bodily injury, property damage, or personal/advertising injury liability arising from the named insured's acts or omissions or those acting on the named insured's behalf in the performance of the named insured's ongoing operations at the scheduled job sites. There are some significant restrictions on the coverage provided under the endorsement that are problematic for energy industry companies. First, it covers the additional insured only for premises-operations liability. This is accomplished not only by limiting the additional insured's coverage to liability sustained in connection with the named insured's "ongoing operations" for the additional insured but also by a specific statement that coverage does not apply to liability included within the completed operations hazard. Further, coverage applies only with respect to losses caused, in whole or in part, by an act or omission of the named insured contractor or someone acting on its behalf (no coverage for the additional insured's sole negligence). As previously discussed, restricting the scope of additional insured coverage to "ongoing operations" is not recommended. Operators and drilling contractors should seek to have the completed operations coverage endorsement (CG 20 37) attached to their policies or should use a manuscript endorsement that does not impose the "ongoing operations" limitations on additional insured coverage. Moreover, limiting the scope of additional insured coverage to the acts or omissions of the named insured or those acting on the named insured's behalf is not recommended. Operators and drilling contractors should seek to have the language of CG 20 10 modified to encompass their respective groups or should use a manuscript endorsement to accomplish this purpose.

Coverage under the current edition of CG 20 10 is subject to the same restrictions regarding state law, coverage not being broader than the underlying contract requirements between the named insured and additional insured, and the dollar amount the insurer will pay on behalf of the additional insured that are discussed in connection with Oil and Gas Operations—Non-Operating Working Interests endorsement (CG 20 30) above.

Completed Operations Coverage for Additional Insureds

Companies that are contractually required to provide additional insureds with coverage for completed operations claims can request completed operations coverage for additional insureds from their CGL insurer. The Additional Insured – Owners, Lessees or Contractors – Completed Operation endorsement (CG 20 37) is used to provide the additional insured status with respect to the products-completed operations hazard in connection with the named insured's work. Both the additional insured person or organization and the location and description of the completed operations must be scheduled in the endorsement. This endorsement is designed to be complementary to those that provide ongoing operations coverage (such as CG 20 26 and CG 20 10), picking up where those endorsements leave off. Under CG 20 37, no coverage is afforded while operations are still in progress. Rather, coverage applies only to liability arising out of the named insured's operations that fall within the policy's "products-completed operations hazard." An operation is defined as completed at the earliest of the following events.

- All work called for in the contract has been completed.
- All work to be done at a specific job site has been completed (if the contract calls for work at more than one site).
- That part of the work done at a job site has been put to its intended use by anyone other than another contractor or subcontractor working on the same project.

Using a separate endorsement to provide completed operations coverage to additional insureds allows insurers to underwrite and price the exposure separately based on the nature of the specific risk. However, insurers are not required to provide the completed operations endorsement just because they provided the ongoing operations endorsement; it is provided at their discretion. As with the other standard endorsements, coverage applies only with respect to losses caused, in whole or in part, by an act or omission of the named insured or someone acting on its behalf (no coverage for the additional insured's sole negligence). As previously discussed, this limitation is problematic. Operators and drilling contractors should seek to have the language of CG 20 37 modified to encompass their respective groups or should use a manuscript endorsement to accomplish this purpose.

Coverage under the current edition of CG 20 37 is subject to the same restrictions regarding state law, coverage not being broader than the underlying contract requirements between the named insured and additional insured, and the dollar amount the insurer will pay on behalf of the additional insured that are discussed in connection with Oil and Gas Operations—Non-Operating Working Interests endorsement (CG 20 30) above.

Owners of Gas and Oil Lease Working Interest

When the named insured under a CGL policy is insured for business activities in connection with the development and operation of gas and oil properties, coverage can sometimes be arranged on an additional insured basis for co-owners, joint venturers, and partners who participate in the cost of development of such property. Insured status is extended to these persons for their operating "working interest" in the gas and oil operations. The Additional Insured—Owners of Gas and Oil Lease Working Interest endorsement is a manuscript endorsement that amends the definition of "insured" to include any co-owner, joint venturer, or mining partner who has a financial interest in and participates in the cost of development and operation of the named insured's oil and gas property. This endorsement does not extend coverage to nonoperating working interest owners. Instead, coverage for nonoperating working interest owners is achieved through the use of endorsement CG 20 30.

Automatic ("Blanket") Additional Insured Endorsements

An additional insured requirement in the energy industry contract does not automatically translate into additional insured status on the applicable insurance policy. Companies must follow through to make this happen by instructing their agent or broker to add the designated party as an additional insured, and the agent or broker must follow through by submitting the request to the insurance company. Because people make errors, there are times when a request for additional insured status does not reach the insurance company. In that case, the company is in breach of its contractual obligation, and to the extent the other party suffers an uninsured loss due to this error, the company may have to pay the difference out of its own pocket. (If there is an indemnity agreement, some of the loss may be covered as contractual liability.)

Automatic additional insured endorsements, commonly referred to as "blanket" endorsements, provide a way to avoid the risk of oversight in executing a request for additional insured status. ISO publishes two automatic additional insured endorsements which are primarily used in conjunction with construction contracts and equipment leases. However, a standard endorsement may not always suit the coverage needs of the additional insureds or those providing the additional insured status. In such cases, manuscript language must be drafted to define the scope of additional insured coverage.

There is a danger in crafting automatic additional insured endorsements that are too broad in the scope of contractual obligations they address. A blanket endorsement addressing the named insured's obligations under "all written contracts," for example, could provide broader coverage than necessary—or less coverage than required. Consequently, endorsements providing automatic additional insured status should be very specific as to the types of contracts to which they relate in order to assure that appropriate coverage terms and limitations will apply. Given the unique nature of risk allocation in the oil and gas industry, and the multiple parties involved in oil and gas operations, blanket automatic additional insured endorsements should be used with caution.

Additional Insured Coverage Matching Indemnity Obligation

As previously discussed, the scope of an additional insured's coverage should mirror the indemnity obligation in the energy contract. One way to achieve such additional insured status is to use a nonstandard additional insured endorsement in which the additional insured coverage may be shaped by the contractual relationship between the named and additional insureds. Such an endorsement would extend insured status to the named insured's indemnitees listed in the endorsement schedule. Coverage would apply to the additional insured's liability to the extent that the person or organization is indemnified by the named insured's written contract or agreement with the additional insured. In other words, coverage applies to the additional insured's liability only to the extent to which the additional insured has also been indemnified by the named insured and not beyond the coverage scope of the CGL policy itself.

Chapter 9
Umbrella Liability Insurance

Learning Objectives
In this chapter, you will learn how to… 1. explain the functions of umbrella liability insurance and contrast the coverage available under a typical umbrella policy with that of the standard CGL policy and 2. illustrate the major ways in which an oil industry limitation endorsement alters the coverage of an umbrella policy.

An umbrella liability policy provides excess limits of coverage, over and above the limits provided in various basic liability policies. Specifically, most umbrella liability policies provide excess coverage over the firm's general liability, auto liability, and employers liability insurance. However, umbrella liability policies can also sit in excess of other energy industry-specific underlying coverage such as maritime employers liability, non-owned and chartered vessel liability, and aviation liability insurance. The umbrella policy is a crucial element of an energy industry company's insurance program as it provides protection for catastrophic losses. In addition to its high limits of liability, the umbrella policy may afford a broader scope of coverage than do the primary liability policies.

Scope of Coverage

Unlike primary (underlying) liability policies, umbrella liability forms are not standardized, which means each insurer develops its own form. Although similarities exist, substantial differences also exist. Many insurance professionals mistakenly believe that if a particular coverage is provided in an underlying policy, then it is automatically provided in the umbrella policy. This is not true. The only way to know for sure what a particular umbrella form covers is to read it in its entirety.

Insuring Agreement

The insuring agreement of virtually all umbrella policies provides coverage for "personal injury," "property damage," and "advertising liability." Personal injury has a different meaning in the umbrella than it does in the CGL policy. In the CGL policy, personal injury refers to non-bodily injuries (offenses) such as false arrest, libel, and slander. In the umbrella, "personal injury" encompasses both bodily injury and non-bodily injury. The umbrella definition of "personal injury" usually includes perils such as shock, mental anguish, mental injury, and, in some policies, humiliation and discrimination. "Property damage" usually includes liability for actual damage to or destruction of tangible property as well as loss of use of property.

The insuring agreement can be written on either an "indemnify" or "pay on behalf of" basis. The difference between these two obligations is significant. A promise to "indemnify" the insured allows the insurer to wait for an award of damages to be paid and then reimburse the insured for the covered costs. A promise to "pay on behalf of the insured," however, obligates the insurer to pay covered damages and defense costs as they are incurred. The insured, in other words, does not have to front the money and wait for reimbursement from the insurer.

Umbrella coverage is written on an "occurrence" basis, and the definition of "occurrence" is typically similar to that found in the CGL policy. That is, it applies to an "accident," including continuous or repeated exposure to harmful conditions. However, because the CGL policy also provides excess coverage for personal and advertising injury, as well as employers liability and auto liability claims, the umbrella definition should also include broader terms that will trigger coverage, such as "happenings or events."

In general, the scope of umbrella coverage is worldwide. In other words, the policy affords coverage anywhere in the world. Certain policies, however, require that suits be brought in the United States or Canada.

Many umbrellas contain a separate defense insuring agreement that identifies the defense obligations of the insurer. Some umbrellas cover defense costs in addition to the policy limits, while others cover defense costs as damages, in which case they do count toward the policy limit. Obviously, the former approach is most favorable, but depending on market conditions may not be available or may involve significant additional premiums.

The umbrella provides coverage over and above some specified threshold of loss, commonly referred to as the "attachment point." In most cases, the attachment point will be the limits provided on the underlying policies. Once the umbrella is triggered, the coverage terms can be defined either by the umbrella policy or by the underlying policy. The latter approach is commonly referred to as "follow form" coverage. Follow form coverage is advantageous to the insured when primary coverage is broad.

Coverage for losses that were not covered by an underlying policy is generally subject to a retained amount (which the insured must absorb before coverage is triggered) and is always dictated by the umbrella policy terms and conditions.

Limits

Operators should pay particular attention to the limits provided by the excess policy if the project involves a master service agreement. Master service agreements often have burdensome carve-outs for specific events that constitute catastrophic losses, such as blowouts, wild wells, and pollution. These carve-outs place the allocation for certain risks on the operator, and have the potential to create unanticipated losses that might exceed the limits of the umbrella policy. Consequently, operators who enter into master service agreements should make sure the limits of their umbrella policies are adequate to address the losses presented by specific events carve-outs.

Exclusions

The policy exclusions contained in umbrellas are of two basic types: conditional exclusions and absolute exclusions. Conditional exclusions do not apply if there is underlying coverage available for that exposure. Absolute exclusions apply regardless of the existence of underlying coverage. Virtually all umbrella policies contain exclusions for nuclear energy liability, property damage, workers compensation, war, business risks, products recall, and certain advertising injuries. The following paragraphs provide a brief synopsis of additional umbrella exclusions that have special ramifications for operators, drilling contractors, well service contractors and other energy industry companies.

Contractual Liability Exclusion

Just like CGL policies, contractual liability is covered under umbrella policies through an exception to the exclusion under which the exclusion does not apply to an "insured contract." This exclusion should be carefully reviewed to make sure that coverage for an insured contract is as broad under the umbrella policy as it is under the CGL policy. For example, if the CGL policy's definition of "insured contract" removes the "tort" liability requirement from the definition of "insured contract," the definition should also be modified in the umbrella policy. This is especially true for operators and drilling contractors entering into master service agreements and other drilling contracts that contain "pass-through" indemnity clauses since removal of the "tort" liability requirement is one way that parties address "pass-through" liability. Nevertheless, it does not remove the problem of direct liability in the absence of fault. In light of the unique way risk is allocated under oil and gas contracts, the umbrella policy cannot always be relied upon to provide coverage for large, contractually assumed property exposures. Thought should be given to purchasing specialty insurance such as rigs and equipment coverage or OEE/COW insurance for large, contractually assumed property exposures.

Pollution Exclusion

Umbrella policies typically contain pollution exclusions but the form of the exclusion may vary from insurer to insurer. Some umbrella policies contain pollution exclusions that "follow form" to the underlying liability policy's pollution exclusion. Other umbrella policies may contain pollution exclusions that are as broad as the underlying liability policy's pollution exclusion. Therefore, coverage for pollution exposures in the umbrella policy could differ from the coverage for pollution exposures provided by the underlying CGL policy. For example, certain CGL policies provide coverage for first party, voluntary cleanup of the insured's oil and gas lease sites and work sites that does not require legal liability on the part of the insured but this coverage might be absent in an umbrella policy. Furthermore, certain CGL policies provide coverage for cleanup of underground pollutants but coverage for such pollution does not exist in the umbrella policy.

Moreover, the type of pollution exclusion can differ from umbrella policy to umbrella policy, if the exclusion does not follow form to the underlying liability policy. Certain umbrella policies might have an absolute pollution exclusion whereas other umbrella policies might contain a sudden and accidental pollution exclusion or a named perils pollution exclusion. In sum, one should not assume that the pollution coverage afforded by the umbrella policy is identical to that provided by the primary liability policy, and an umbrella policy's pollution exclusion should be carefully reviewed to avoid possible coverage deficiencies.

Oil Industry Limitation Endorsement

Like CGL policies, umbrella policies issued to oil and gas companies typically include the "oil industry limitation endorsement." Like the endorsement attached to the CGL policy, this endorsement clarifies the type of drilling-related damages that are not covered under the umbrella policy.

The endorsement typically excepts coverage for damages that are deemed to be first-party in nature. This makes some sense because primary and umbrella liability policies were not designed to respond to first party losses. However, the risk allocation system present in oil and gas contracts does not always follow ownership. Under certain circumstances, the operator takes direct responsibility for damage to the drilling contractor's property (third-party property). Damage to that property may not be covered under the operator's first-party property policy. For example, the operator could be contractually liable for removing the drilling contractor's wreck or debris. The oil industry limitation endorsement would remove coverage for this loss from the operator's umbrella policy and the operator's first party property policy or the OEE/COW insurance policy might not cover this specific type of third-party property damage. Therefore, attaching this endorsement to an operator's umbrella policy could result in a significant uninsured exposure.

Consider the following example. An operator has an OEE/COW policy which provides for $5 million in coverage for costs incurred because of a well failure. A blowout occurs in April 2012. At the time of the blowout, the OEE/COW policy is in effect and the operator is also insured under a CGL and umbrella policy; however, the CGL policy does not cover expenses associated with control of wells. The operator's expenses for controlling the well, removing debris and wreckage, and remediating pollution exceed $20 million, well above the $5 million limit of the OEE/COW policy. The operator seeks coverage for the expenses under the umbrella policy. The umbrellainsurer denies coverage, because the oil industry limitation endorsement is attached, and it specifically excludes coverage for costs and expenses incurred in bringing a well under control. Consequently, the operator has a $15 million coverage deficiency with respect to the expenses it incurred in connection with the blowout.

Like the endorsement to the CGL policy, there is no "standard form" oil industry limitation endorsement. The wording of the endorsement can differ from policy to policy. Oil industry limitation endorsements in umbrella policies should be carefully reviewed because some forms of the endorsement contain limitations that create coverage deficiencies as well as limitations that are more restrictive than the exclusions contained in the CGL policy.

Professional Services Liability Exclusion

Umbrella policies may contain a designated professional services exclusion or may follow form to the designated professional services exclusion in the CGL policy. Professional services exclusions are broad and can result in unanticipated exposures, especially since one party to energy industry contracts (e.g., the operator) may be required to indemnify another party (e.g., the drilling contractor) for the consultant's negligence if the operator's group includes a consultant providing professional services. Operators and drilling contractors need to be aware of the reduction in coverage that this exclusion creates. Energy industry companies with any professional liability exposure should consider the purchase of oil and gas professional liability insurance.

“Property Damage” Exclusions

Umbrellas typically contain a number of “property damage” exclusions. The impact of the “property damage” exclusions will differ depending on the contractual relationship between the parties. For example, a master service agreement might require an operator to be responsible for damage to the drilling rig or the drilling contractor’s tools even though the damage occurred when the drilling contractor was using the tools. Under a different scenario, an operator or drilling contractor might enter into contracts where work other than oil or gas exploration activities is to be performed (such as construction of a new drilling platform or construction of a pipeline or installation of drilling equipment) and the risk allocation scheme under those contracts may require the downstream party to be responsible for property damage. Either way, the umbrella policy’s property damage exclusions could be applicable, and, therefore, it is important to understand the coverage implications presented by these exclusions. The property damage exclusions with the most important coverage implications for energy industry companies include property in the insured’s care, custody, or control; damage to “your work”; and damage to property on which the company is performing operations . The impact of these exclusions is summarized in Exhibit 9.1. Most of these exclusions compare closely to their CGL counterparts. Not all umbrellas contain all of these exclusions, but most forms contain some combination of these exclusions.

Exhibit 9.1 Comparison of Umbrella "Property Damage" Exclusions to CGL Counterparts	
Owned Property	**Comparable to CGL exclusion**
Alienated Premises	To the extent this exclusion is applicable to oil and gas operations, it is important to ensure the alienated premises exclusion does not apply to "your work" (defined to be the named insured's completed operations including work performed by subcontractors) so that the exclusion does not apply if the premises in question are the named insured's work and were never occupied, rented, or held for rental by the named insured. This approach matches that of the standard CGL policy's alienated premises exclusion.
Property in the Insured's Care, Custody, or Control	The umbrella policy may exclude coverage for nonowned property in the care, custody, or control of the insured. Unlike in the CGL policy, some umbrella policies apply the exclusion to all property, as opposed to just personal property. This substantially restricts the insured's coverage with respect to real property and can result in messy coverage disputes regarding what constitutes "care, custody, or control" of real property. Companies should attempt to have such exclusions modified to match the underlying CGL policy. Furthermore, the Oil Industry Limitation Endorsement may exclude coverage for damage to equipment that is in any insured's "care, custody, or control." Therefore, operators should make sure to secure adequate coverage for drilling equipment and other third party property damage excluded by the Oil Industry Limitation Endorsement.
Damage to "Your Product" and "Your Work"	Like the CGL, umbrella policies routinely exclude damage to the company's completed work. However, unlike in the CGL policy, many umbrella policies do not contain an exception for damage to, or arising out of, work performed by subcontractors. This represents a significant loss of coverage for many insureds; therefore, a vigorous attempt should be made to match the damage to "your work" exclusion to that of the underlying CGL policy.
Impaired Property	Comparable to CGL exclusion

Glossary

additional insured—A person or organization not automatically included as an insured under an insurance policy, but for which insured status is arranged, usually by endorsement. A named insured's impetus for providing additional insured status to others may be a desire to protect the other party because of a close relationship with that party (e.g., employees or members of an insured club) or to comply with a contractual agreement requiring the named insured to do so (e.g., customers or owners of property leased by the named insured). See also Named insured.

aggregate—A limit in an insurance policy stipulating the most it will pay for all covered losses sustained during a specified period of time, usually a year. Aggregate limits are commonly included in liability policies. While not often used in property insurance, aggregates are sometimes included with respect to certain catastrophic exposures—for example, earthquake and flood.

alienated premises—Premises that have been sold or given away to another or abandoned. An exclusion in the standard commercial general liability (CGL) policy states that coverage does not apply to property damage (PD) to such premises arising out of those premises. An exception to this exclusion clearly leaves coverage intact for insureds' completed operations as long as the premises were never occupied, rented, or held out for rental by the named insured.

amine unit—A natural gas treatment unit for removing contaminants such as hydrogen sulfide and carbon dioxide from the gas by use of amines, a group of organic chemical derived from ammonia.

blowout—The uncontrolled eruption of oil, gas, water, or drilling fluid from a well that is in the process of being drilled (blowout) or to the caving in of a well that has already been drilled. Also known as a gusher.

blowout preventer (BOP)—A large valve located at the top of a well that may be closed if the drilling crew loses control of the well. BOPs are safety devices designed to prevent the uncontrolled flow of liquids and gasses during drilling operations and prevent a blowout from occurring. When the driller closes the valve, a pressure-tight seal is formed at the top of the well, preventing the fluids from escaping.

borehole—A deep, narrow hole drilled into the ground, either vertically or horizontally, to locate and extract oil, gas, or water. See also Wellbore.

casing—Steel pipe cemented in an oil or gas well to prevent the wall of the hole from caving in, to prevent movement of fluids from one formation to another, and to maintain control of formation fluids and pressure as the well is drilled.

casing company—A company that specializes in preparing and running casing into a well. Also known as casing contractor.

cement head—A device attached to the top of the casing to facilitate cementing of the casing.

claims-made—A term describing an insurance policy that covers claims first made (reported or filed) during the year the policy is in force for any incidents that occur that year or during any previous period during which the insured was covered under a "claims-made" contract. This form of coverage is in contrast to the occurrence policy, which covers an incident occurring while the policy is in force regardless of when the claim arising out of that incident is filed—1 or more years later.

commercial general liability (CGL) policy—A standard insurance policy issued to business organizations to protect them against liability claims for bodily injury (BI) and property damage (PD) arising out of premises, operations, products, and completed operations; and advertising and personal injury (PI) liability. The CGL policy was introduced in 1986 and replaced the "comprehensive" general liability policy.

conditions—Provisions inserted in an insurance policy that state the rights and the requirements of the insured and insurer. Examples include transfer of rights for recovery and duties in the event of a loss.

contractor's pollution liability insurance—An insurance policy for contractors covering pollution liabilities arising out of the insured's job site operations that are typically excluded under the CGL policy.

contractual liability insurance—Insurance that covers liability of the insured assumed in a contract. Under the standard commercial general liability (CGL) policy, such coverage is limited to liability assumed in any of a number of specifically defined insured contracts, or to liability that the insured would have even in the absence of the contract.

downhole tools—Tools used in the well. See also In-hole tools.

driller—The supervisor of the drilling crew. The driller is responsible for the efficient operation of the rigsite as well as the safety of the crew.

drilling contract—An agreement made between a drilling company and an operating company to drill a well that sets forth the obligations of each party, compensation, method of drilling, depth to be drilled, insurance requirements, etc.

drilling contractor—The company that owns and operates the drilling rig. The drilling contractor typically enters into a contract to rent or lease the drilling rig, along with the equipment and personnel, to oil and gas exploration and production companies.

drilling crew—Employees of the drilling contractor who work on the drilling rig. See also Rig crew.

drilling fluids company— See Mud logging company.

drilling fluids—Any of a number of liquid and gaseous fluids and mixtures of fluids and solids (as solid suspensions, mixtures and emulsions of liquids, gases and solids) used in operations to drill boreholes into the earth. See also Drilling mud.

drilling fluids engineer—See Mud engineer.

drilling mud—See Drilling fluids.

drilling rig—A large structure with equipment used to drill oil wells and natural gas extraction wells. Drilling rigs can be mobile equipment mounted on trucks or trailers, or more permanent land or marine-based structures (such as onshore or offshore platforms).

drilling riser—A large pipe or conduit that provides a temporary extension of an oil well to a surface drilling facility. There are two types of drilling risers. Marine drilling risers are generally used by floating drilling vessels and tie-back drilling risers are typically deployed from fixed platforms or very stable floating platforms. Both types of risers use a blowout preventer.

duty to defend—A term used to describe an insurer's obligation to provide an insured with defense to claims made under a liability insurance policy. As a general rule, an insured need only establish that there is potential for coverage under a policy to give rise to the insurer's duty to defend. Therefore, the duty to defend may exist even where coverage is in doubt and ultimately does not apply. Implicit in this rule is the principle that an insurer's duty to defend an insured is broader than its duty to indemnify. Moreover, an insurer may owe a duty to defend its insured against a claim in which ultimately no damages are awarded, and any doubt as to whether the facts support a duty to defend is usually resolved in the insured's favor.

endorsement—An addendum to an insurance policy that changes the original policy provisions. Endorsements may serve any number of functions, including broadening the scope of coverage, restricting or limiting the scope of coverage, clarifying the application of coverage to some unique exposure, adding other parties as insureds, or adding locations to the policy.

exclusion—A provision of an insurance policy or bond referring to hazards, circumstances, or property not covered by the policy.

equipment service contractor—A company that repairs and performs maintenance on equipment used in oil and gas exploration and production activities.

farmout agreement—Contract used when an oil operator has a mineral lease but does not have any immediate plans to drill on it or cannot afford to drill on it and will "farm out" the lease to another operator who is interested in drilling a well on the lease.

Farmoutee (farmee)—The party to a farmout agreement who actually drills the well.

Farmoutor (farmor)—The party to a farmout agreement who was the original operator and comes back in for a percentage of the completed well's production.

flow line—the surface pipe through which oil or gas travels from a well to processing equipment or to storage.

general aggregate limit—Under the standard commercial general liability (CGL) policy, the maximum limit of insurance payable during any given annual policy period for all losses other than those arising from the products and completed operations hazards.

general liability insurance—Insurance protecting commercial insureds from most liability exposures other than automobile and professional liability.

hydraulic fracturing (fracking)—A process in which fractures in hard to reach shale rock formations below the earth's surface are opened and widened by injecting water, chemicals, and sand under high pressure to extract natural gas and oil trapped in the shale rocks. It enables wells that would flow only at very low rates to produce oil and gas in commercially viable volumes.

hole—See "borehole."

impaired property—Under commercial general liability (CGL) coverage, property that has sustained loss of use because it incorporates the insured's defective product or work and can be restored to use by the repair, removal, or replacement of the defective product or work. Claims for loss of use of impaired property are excluded from CGL coverage.

indemnitee—The person or entity that is held harmless in a contract (by the indemnitor).

indemnitor—The person or entity that holds another (the indemnitee) harmless in a contract.

indemnity provision—A provision in a contract that requires one contracting party to respond to certain legal liabilities of the other party.

in-hole tools—See downhole tools.

injection wells—Wells in which fluids (gas or water) are injected rather than produced, the primary purpose typically being to maintain reservoir pressure. Separated gas from production wells or possibly imported gas may be reinjected into the upper gas section of the reservoir. Water-injection wells are common offshore, where filtered and treated seawater is injected into a lower water-bearing section of the reservoir.

joint operating agreement (JOA)— A contract that sets forth the duties and obligations of both the operator and nonoperating working interest owners of a mineral lease. The JOA serves several purposes, including identifying the property interests of the parties in the mineral lease, designating the party who is to act as operator, and setting forth the method for sharing expenses and for the allocation of liability for the oil and gas exploration and production operations.

joint venture—A business relationship in which two or more persons combine their labor or property for a single undertaking and share profits and losses equally, or as otherwise agreed. General liability policies normally do not cover liability arising from joint ventures unless they are scheduled as an insured. A manuscript endorsement can sometimes be added to handle this exposure. Otherwise, specific coverage arrangements must be made whenever the insured becomes involved in a joint venture.

knock for knock indemnity—A form of indemnity that is reciprocal in nature and is based on ownership of property and personnel as opposed to allocating risk based on fault. Each party to an oil and gas contract agrees to take responsibility for, and to indemnify the other party, against injury and loss to its own property and personnel.

liability—Any legally enforceable obligation. Within the context of insurance, the obligation to pay a monetary award for injury or damage caused by one's negligent or statutorily prohibited action.

master service agreement—A contract used by oil and gas companies to enter into an agreement in advance with their contractors and specifies the terms and conditions that will govern the contractors' work. The agreement is typically used for onsite services performed by oilfield service contractors on a repetitive basis, such as equipment maintenance, well services, and cementing services.

medical payments, general liability—A general liability coverage that reimburses others, without regard to the insured's liability, for medical or funeral expenses incurred by such persons as a result of bodily injury (BI) or death sustained by accident under the conditions specified in the policy.

mineral lease—A contract between a mineral owner (the lessor) and a company or working interest owner (the lessee) in which the lessor grants the lessee the right to explore, drill and produce oil, gas and other minerals for a specified period of time. The oil and gas lease is granted in exchange for royalty payments to the lessor. See also Oil and gas lease.

mobile equipment—A term that is defined in both the commercial general liability (CGL) and commercial auto policies. It refers to equipment such as earthmovers, tractors, diggers, farm machinery, forklifts, etc., that, even when self-propelled, are not considered automobiles for insurance purposes (unless they are subject to a compulsory or financial responsibility law or other motor vehicle insurance law). Liability arising from mobile equipment is covered in the general liability policy.

mud—A term that is typically synonymous with drilling fluid and encompasses most fluids used in hydrocarbon drilling operations, especially fluids that contain significant amounts of suspended solids, emulsified water or oil. Mud includes all types of water-base, oil-base and synthetic-base drilling fluids.

mud engineer—An employee of the mud logging company who is responsible ensuring the properties of the drilling fluid (also known as drilling mud) are within designed specifications. See also Drilling fluids engineer.

mud logging—The creation of a detailed well log of a borehole by examining the cuttings of rock or brought to the surface by the circulating drilling fluid. Mud logging also involves monitoring gas levels (and types) and notifying other personnel on the rig when gas levels may be reaching dangerous levels, so appropriate steps can be taken to avoid a blowout.

mud logging company—Company that performs mud logging services. The company is normally contracted by the operator. See also Drilling fluids company.

named insured—Any person, firm, or organization, or any of its members specifically designated by name as an insured(s) in an insurance policy, as distinguished from others that, although unnamed, fall within the policy definition of an "insured."

negligence—A tort involving failure to use a degree of care considered reasonable under a given set of circumstances. Acts of either omission or commission, or both, may constitute negligence. The four elements of negligence are a duty owed to a plaintiff, a breach of that duty by the defendant, proximate cause, and an injury or damage suffered by the plaintiff. Liability policies are designed to cover claims of negligence.

night dragon cyber attacks—A series of cyber attacks against energy companies which were exposed by the security company McAfee. The attacks involved several techniques including compromising web servers, database servers, stealing passwords and targeting employees for access and executives for data.

nonoperating working interest—One that owns an interest in a gas or oil well or other mineral extraction enterprise but that does not participate in or have any responsibility for actual operation of the well or mine.

notice of occurrence—One of the insured's specified duties under a general liability policy. Notice to the insurer of an occurrence must include the time, place, and circumstances of the occurrence, a description of any resulting injury or damage, and the names and addresses of injured persons and witnesses.

occurrence—In a commercial general liability (CGL) coverage form, an accident, including continuous or repeated exposure to substantially the same general harmful conditions. General liability policies insure liability for bodily injury (BI) or property damage (PD) that is caused by an occurrence.

OEE/COW—See operator's extra expense/control of well insurance

oil and gas lease—See Mineral lease.

ongoing operations—Work or other business activity that has not been completed or abandoned. Standard additional insured status under a general liability policy applies only with respect to liability in connection with the named insured's "ongoing operations," preventing coverage from extending to the additional insured's (AI's) liability for the named insured's completed operations.

operator's extra expense/control of well insurance (OEE/COW): A specialized insurance policy available to oil or gas well operators that covers the cost of regaining control of a wild well. Coverage for pollution, stuck drill stem, evacuation expense, re-drilling, and care, custody, or control (CCC) exposures can be added by endorsement.

oilfield service contractor—Companies that assist the drilling contractor in setting up oil and gas wells. These companies manufacture, repair and maintain equipment used in oil extraction and transport. Specific services can include seismic testing, transportation of land and water rigs, and directional drilling (e.g., drilling angled or horizontal holes). Also known as Well service contractor.

oil gusher—An out of control well. See also Blowout.

operator—The company who has the legal right, either by ownership or by virtue of a mineral lease to produce oil and gas from a particular well. The operator serves as the overall manager and decision-maker of a drilling project. Operators typically have the largest financial stake in the project.

other insurance clause—A provision found in both property and liability insurance policies establishing how loss is to be apportioned among insurers when more than one policy covers the same loss. These provisions vary: some policies provide no coverage when other insurance is in place, some pay a pro rata share, and others apply in excess. They are included to comply with the principle of indemnity, which states that an insured should not profit from an insured loss.

packer—A piece of downhole equipment that consists of a sealing device, a holding or setting device, and an inside passage for fluids. Packers are lowered into the borehole and expanded to seal off sections of the well.

pass-through indemnity clause—A indemnity provision often included in master service agreements and drilling contracts under which the indemnitor is required to assume the indemnitee's own indemnification obligations to other parties (such as the indemnitee's contractors or subcontractors).

personal injury—Under general liability coverage, a category of insurable offenses that produce harm other than bodily injury (BI). As covered by the 1986 commercial general liability (CGL) policy, personal injury (PI) includes false arrest, detention, or imprisonment; malicious prosecution; wrongful eviction; slander; libel; and invasion of privacy. Under umbrella liability insurance, a broad category of insurable offenses that includes both BI and the offenses defined as PI in CGL policies.

pipeline—A tube or system of tubes used to transport crude oil and natural gas from the field or gathering system to the refinery.

pipeline operator—An individual who controls the flow of oil, gas, and other industrial materials within a power plant or oil refinery. Responsibilities include monitoring instruments and regulating pumps and other operational systems. Pipeline operators work within industrial settings, such as power plants, gas distribution facilities, and oil refineries. They regulate the flow of oil, gases, and other materials from pipes into and out of storage tanks, monitor instruments, and communicate with other operators and technicians. Pipeline operators can work at a computer in an industrial control center, monitoring levels for temperature, pressure, and other variables. Operators also directly observe pipes, system tanks, and other equipment for leaks or other damage and communicate with the operators in the control room to ensure safe operation within standards and regulations.

platform—a fixed structure from which development wells are drilled that also houses a processing plant and other equipment necessary to keep an oilfield in production.

pollution legal liability insurance—An insurance policy that covers pollution liabilities that are typically excluded under the CGL policy.

premises-operations—One of the categories of hazards ordinarily insured by a general liability policy. Composed of those exposures to loss that fall outside the defined "products-completed operations hazard," it includes liability for injury or damage arising out of the insured's premises or out of the insured's business operations while such operations are in progress.

products-completed operations—One of the hazards ordinarily insured by a general liability policy. It encompasses liability arising out of the insured's products or business operations conducted away from the insured's premises once those operations have been completed or abandoned.

programmable logic controller (PLC)— a small, embedded industrial control system that runs many automated processes, not only in manufacturing factories but in chemical plants, oil refineries, pipelines, and nuclear power plants.

property damage (PD)—As defined in the general liability policy, physical injury to tangible property including resulting loss of use and loss of use of tangible property that has not been physically injured.

railroad protective liability—Insurance coverage protecting a railroad from liability it incurs because of the work of contractors on or near the railroad right-of-way.

railroad sidetrack agreement—An agreement between a railroad and a business in which the railroad agrees to build a siding on the property of the business, and the business will hold the railroad harmless for certain liability arising out of the use of the sidetrack. Sidetrack agreements are "insured contracts" under the provisions of standard contractual liability insurance coverage.

rigs and equipment insurance—An insurance policy that provides coverage for damage to property that is often excluded under the care, custody, and control exclusion of the CGL policy, such as rigs and equipment, scheduled vehicles, machinery, tools, appurtenances, derricks, and substructures, similar property in the insured's care, custody, or control.

rig crew—See Drilling crew.

rig floor— The relatively small work area in which the rig crew conducts operations and the most dangerous place on the rig because heavy iron is moved around there.

rig up—Make the drilling equipment ready for use by moving the equipment on to the rig floor, assembling the equipment, and connecting the equipment to power sources or pressurized piping systems.

roustabout—Any unskilled manual laborer on the rigsite. A roustabout may be part of the drilling contractor's employee workforce, or may be on location temporarily for special operations. Roustabouts typically perform jobs requiring little training, such as loading and unloading equipment, general maintenance jobs, cleaning up the location, and assist in general operations around the rig.

severability of interests clause—A policy provision clarifying that, except with respect to the coverage limits, insurance applies to each insured as though a separate policy were issued to each. Thus, a policy containing such a clause will cover a claim made by one insured against another insured.

sinker bar—The weight bar used in slickline operations (operations involving a single strand non-electric cable used to deliver and retrieve tools and flow-control equipment into wells) to overcome the effects of wellhead pressure and friction at the surface seal where the wire enters the borehole.

stuxnet virus—A computer worm (virus) that was designed to attack Siemens programmable logic controllers and Windows-based industrial software. First identified in 2010, Stuxnet targeted uranium enrichment centrifuges used by Iran at its nuclear enrichment facilities, was able to reconfigure the centrifuge drive controllers, and caused the equipment to slowly self-destruct.

subcontractor exception—An exception to the "damage to your work" exclusion of the CGL policy, which restores coverage when the damaged work, or the work causing the damage, was performed by the named insured's subcontractor. The subcontractor can be removed from the policy by endorsement.

subrogation—The assignment to an insurer by terms of the policy or by law, after payment of a loss, of the rights of the insured to recover the amount of the loss from one legally liable for it.

sumps—A deep hole or shaft dug or drilled to obtain water or oil or gas or brine.

supplementary payments—A term used in liability policies for the costs associated with the investigation and resolution of claims. Supplementary payments are normally defined to include such items as first aid expenses, premiums for appeal and bail bonds, pre- and post-judgment interest, and reasonable travel expenses incurred by the insured at the insurer's request when assisting in the defense of a claim. Actual settlements/judgments are considered damages rather than supplementary payments. Attorneys' fees may be considered either damages or supplementary payments, depending on the policy. Commercial general liability (CGL) and business automobile liability policies cover supplementary payments in addition to their limits of liability.

surface use agreement—Contract between a landowner and an oil or gas company that address surface activities the company wants to undertake on the landowner's property, such as the placement of access roads or pipelines or storage tanks, as well as terms and conditions for use of the surface land during the process of oil and gas exploration and production.

swab—A tool that is lowered down the pipe on a wire line and used for swabbing a well.

tank batteries—A group of tanks that are connected to receive crude oil from a well. In the tank battery, the oil volume is measured and tested before pumping the oil into the pipeline system.

that particular part—A key phrase in the property damage (PD) exclusion of general liability and some umbrella coverage forms that eliminates coverage for damage to work performed by (or on behalf of) an insured contractor that arises from that work. The language precludes coverage for "that particular part of real property" on which the work is performed. The intent is to exclude the faulty work itself and yet cover resulting damage to work already in place. The phrase has been defined by the courts as "a single item of property which, though composed of many parts, is clearly a unit of property within itself, self-contained and a single item."

third-party-over action—A type of action in which an injured employee, after collecting workers compensation (WC) benefits from the employer, sues a third party for contributing to the employee's injury. Then, because of some type of contractual relationship between the third party and the employer, the liability is passed back to the employer by prior agreement. Additionally, there are instances in which the third party can circumvent the exclusive remedy doctrine of WC and enjoin the employer in the action. Depending on the nature and allegations of the action, coverage may be afforded under the contractual liability section of the employer's commercial liability policy or the employers liability section of the employer's WC policy.

total pollution exclusion—Eliminates virtually all coverage for pollution incidents, including those retained in the standard commercial general liability (CGL) policy despite its "absolute" pollution exclusion. The three Insurance Services Office, Inc. (ISO), total pollution exclusion endorsements (CG 21 49, CG 21 55, and CG 21 65) remove coverage for bodily injury (BI) or property damage (PD) that "would not have occurred in whole or part but for" a pollution incident. The second of these endorsements, CG 21 55, includes a specific exception for damages caused by smoke, heat, or fumes from a hostile fire. The third, CG 21 65, makes exceptions both for hostile fire and for BI caused by fumes from faulty building heating equipment. Insureds should attempt to avoid any of these endorsements and should negotiate for CG 21 65 if the insurer insists on adding one of them.

umbrella liability policy—A policy designed to provide protection against catastrophic losses. It generally is written over various primary liability policies, such as the business auto policy (BAP), commercial general liability (CGL) policy, watercraft and aircraft liability policies, and employers liability coverage. The umbrella policy serves three purposes: it provides excess limits when the limits of underlying liability policies are exhausted by the payment of claims; it drops down and picks up where the underlying policy leaves off when the aggregate limit of the underlying policy in question is exhausted by the payment of claims; and it provides protection against some claims not covered by the underlying policies, subject to the assumption, by the named insured, of a self-insured retention (SIR).

underground resources and equipment hazard—One of the categories of hazards that is typically excluded from coverage under general liability policies issued to energy industry companies. The hazard is defined as "property damage" to: oil, gas, water, or other mineral resources not yet pumped or mined; wells, holes, formations, strata, or areas in or through which exploration or production is carried on; and casing, pipes, bits, tools, pumps, and other drilling and well-servicing machinery and equipment located below-ground in any well or hole included in item 2. above or beneath the surface of any body of water. Coverage for this hazard can accomplished by attaching the underground resources and equipment coverage endorsement to the CGL policy.

underlying coverage—With respect to any given policy of excess insurance, the coverage in place on the same risk that will respond to loss before the excess policy is called on to pay any portion of the claim.

waiver of subrogation— An agreement between two parties in which one party agrees to waive subrogation rights against another in the event of a loss. The intent of the waiver is to prevent one party's insurer from pursuing subrogation against the other party. Generally, insurance policies do not bar coverage if an insured waives subrogation against a third party before a loss. However, coverage is excluded from many policies if subrogation is waived after a loss because to do so would violate the principle of indemnity.

wellbore—See Borehole.

well heads—the equipment installed at the surface of the wellbore.

well service contractor—A company that performs well service activities such as maintenance procedures on an oil or gas well after the well has been completed and production from the reservoir has begun. These activities are generally conducted to maintain or enhance well productivity. Also known as Oilfield service contractor.

well swabbing—The process of mechanically pulling water and other fluid from the wellbore in an attempt to get the well to flow on its own. Swabbing is necessary when the formation pressure is not high enough to blow the fluids in the pipe to the surface.

workmanship exclusion—A liability insurance exclusion that precludes coverage for damage to the insured's work resulting from that work.

workover rig—A portable rig used to perform major maintenance or remedial treatments on an oil or gas well.