



Dear Friends:

*This issue of the **Jaeckle Advisory: Coverage & Claims** addresses three important issues which frequently arise in the commercial insurance and claims context. Specific attention is drawn to a recent decision by New York's highest court that may dramatically impact coverage for additional insureds. An overview of the often misunderstood standards for the privity defense is also provided. The issue further focuses upon the complexities of business interruption coverage. We hope that you enjoy these articles. Should you have questions on any of them, or any other legal issues, please feel free to contact any one of the attorneys in our coverage and claims group.*

ADDITIONAL INSURED: Who Does the Insurance Policy Actually Cover?

With little fanfare, New York's highest court quietly yet systematically handed down a significant decision that may alter the method in which insurance carriers issue their policies. Failure to heed this decision might lead to unfortunate consequences for policyholders and insureds alike.

One major consideration when reviewing insurance policies is "Who is covered and to what extent?" Typically, in a situation involving a contractual relationship between two or more businesses, the answer depends upon the language of the contract between or among businesses.

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One of the clearest examples of this occurs with additional insured endorsements. An additional insured endorsement in an insurance policy often expands the definition of "insured" to include individuals who, without always being named directly

on the policy, are nonetheless intended to be covered under it. For example, subcontractors are typically insured under the general contractor's policy or vice-versa. The mechanism by which this takes place is the contract between the general contractor and subcontractor, which requires one to procure insurance for the other.

As one might imagine, additional insured endorsements can be expensive enterprises for insurers. One way an insurance carrier might seek to limit its exposure is to include an excess clause in the policy. Such a clause provides that if the additional insured has other insurance covering the same risk, the policy will not apply until the additional insured has exhausted coverage under all of its other applicable policies. The excess clause ordinarily provides that the insurance policy shall be "excess over any other valid and collectible insurance."

However, problems arise when the language in the contract, policy, or other documentation, such as certificate of insurance, differs in meaning or is ambiguous in terms of what and who are covered. For example, the typical contract between a general contractor

and subcontractor was silent on whether the additional insurance should be primary or excess, but both parties' expectations were that it was primary.

Recently, New York's highest court encountered such a situation and its decision should give pause to all agents, commercial insurers and policyholders. In *Pecker Iron Works of New York, Inc. v. Travelers Insurance Co.*, 99 N.Y.2d 391 (2003), Pecker Iron Works ("Pecker") entered a contract with Upfront to perform services at a construction site. The contract specified that Upfront would provide Pecker additional insurance coverage. The contract was silent on whether this coverage was primary or excess. Upfront's insurance policy with Travelers contained a generic

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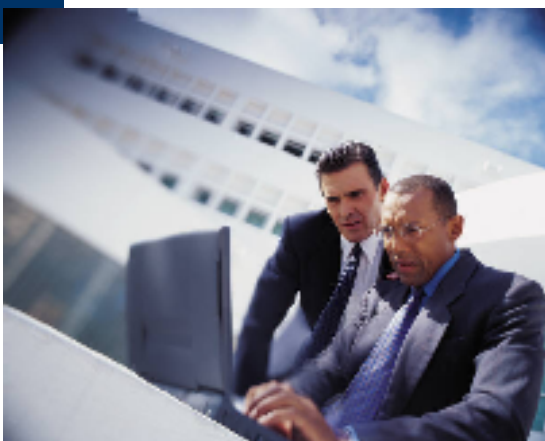
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THE PRIVACY DEFENSE: Easily Overlooked in Errors and Omissions Claims

When a claim for error, omission or misrepresentation is made against a professional, be it an accountant, insurance broker, or real estate agent, the instinctual first reaction is to assess the "merits" of the allegations. Merits aside, in the absence of a contract, it is always important to recall well-established law that requires the party seeking damages to show a close relationship with the defendant that establishes a duty or obligation. This relationship is often referred to as "privity" between the parties.

New York's highest court set forth the standards for privity in *Parrott v. Coopers & Lybrand, L. L. P.*, 95 N.Y.2d 479, 483 (2000). There, the plaintiff brought suit against his former employer's accounting firm, asserting claims of professional negligence and negligent misrepresentation. Mr. Parrott asserted that the accounting firm misrepresented the value of his stock, and that he was in turn harmed when he stipulated to the sale of the shares at the valuation established by the defendant accountants. In dismissing the action, the New York Court of Appeals concluded that there must be an awareness by a defendant that its action or representation was relied upon by some third party for a particular purpose. The court explained that without such requirements, liability could prove to be limitless.



The rule articulated in *Parrott* is equally applicable to causes of action brought against insurance agents and brokers. New York's courts have unequivocally endorsed the requirement of privity in order to sustain a complaint against an insurance agent or broker. See e.g., *Henry v. Michael P. Guastella & Associates*, 113

A.D.2d 435 (4th Dept. 1985); *Wainright v. Charlew Construction Co., Inc.*, 302 A.D.2d 784 (3rd Dept. 2003); *St. George v. W.J. Barney Corp.*, 270 A.D.2d 171 (1st Dept. 2000).

“.....there must be an awareness by a defendant that its action or representation was relied upon by some third party for a particular purpose.”

Even the issuance of a certificate of insurance by an agent or broker is insufficient to establish privity. In *American Ref-Fuel Company of Hempstead v. Resource Recycling, Inc.*, 248 A.D.2d 420 (2d Dept. 1998), American Ref-Fuel entered into a contract with a manufacturer to purchase machinery. The manufacturer in turn hired a separate firm to install the machinery. The contract between the manufacturer and the installer required that the installer obtain a general liability policy naming American Ref-Fuel as an additional insured. After receiving a request from the installer, the installer's insurance broker provided a certificate of insurance naming American Ref-Fuel as an additional insured. The underlying insurance policy, however, did not reflect this change. Subsequently, one of the installer's employees was injured on the job and brought suit against American Ref-Fuel. When the insurance company failed to defend it, American Ref-Fuel brought suit against the broker for failure to procure the requested insurance. The court held that it could not seek damages from the broker, reasoning that, even assuming for sake of argument that the broker was negligent by breaching a duty to the installer, it owed no duty to American Ref-Fuel because it had no relationship with it.

Although the first reaction to a claim is often "how do we defend this?", insurers and businesses are cautioned to examine the relationship with the party asserting the claim. If that party is sufficiently removed from the alleged negligent conduct, the case may be ripe for an immediate motion to dismiss based upon lack of privity.

PROTECTING PROFITS WHEN DISASTER STRIKES: Bridging a Period of Suspension with Business Interruption Coverage

The life-blood of a business is the strength of its cash-flow. Yet many companies only purchase insurance to protect against the risk of damage to their structures, equipment, inventory and other physical assets. They protect what they can see, but fail to protect against a loss which may *far exceed* the actual property damage: lost profits, lost business opportunities, or damage to business relationships from the inability to satisfy existing contracts. For example, a fire might only have limited impact on part of a building or damage only one or two pieces of equipment, yet this limited damage may disrupt an entire assembly line or render an entire building unusable, thereby cutting-off or significantly reducing cash-flow and impeding the company's ability to meet customer demands.



Direct property loss coverage only represents a fraction of the coverage equation. To fully protect a business it is often necessary to purchase insurance that covers lost profits arising from the inability to maintain operations while the physical plant is being rebuilt and the equipment and inventory is being replaced. Business interruption coverage is designed to cover lost profits, expenses that may be necessary to expedite repairs or expenses related to maintaining operations at a temporary location. The funds from the policy provide a sort of financial “i.v.” to nurse the business back to health by infusing it with cash for the period in which it is operationally disabled.

Under a typical business interruption policy, an insured is entitled to recover its lost profits and damage-related expenses for the period of time during which it is necessary to repair and replace the damaged property “with the exercise of due diligence and dispatch” so as to permit the insured to resume operations with essentially “the same quality of service that existed immediately preceding the loss.” This period of time is often referred to as the “suspension period” or the “period of indemnity”. Given the rather elastic nature of

the terms used in these policies, i.e. “diligence” and “quality”, disputes often arise between policyholders and insurers over when the suspension period should terminate. In resolving such disputes, courts generally take a pragmatic approach on a case-by-case basis considering such factors as the nature of business at issue, its operational requirements, its operational history, and industry trends.

“Direct property loss coverage only represents a fraction of the coverage equation.”

However, what happens when an insured claims that the delay in resumption of operations was not caused by a lack of diligence on its part, but rather by the insurer's timing of payment? While courts are inconsistent nationally on this question, authority exists in New York suggesting that the insured is *not* entitled to an extension of the suspension period resulting from an insurer's resistance. See, *Jonari Mgt. v. St. Paul Fire*, 58 N.Y.2d 408, 418-419 (1983); *Esperance v. Royal Globe Ins. Co.*, 134 Misc.2d 718 (N.Y. Cnty. 1987). Other jurisdictions have given the insured the benefit of the doubt with respect to this type of delay. See, *A & S Corp. v. Centennial Ins. Co.*, 242 D.Sup. 584 (N.D. Ill. 1965); *United Land Investors, Inc. v. Northern Ins. Co.*, 476 So.2d 432 (La. Ct. App.23 Cir. 1985); *Arnold v. Liberty Mut. Ins. Co.*, 469 So.2d 1155 (La. Ct. App. 4th Cir. 1985). Additionally, where the delay is neither caused by the insurer nor the insured, but is the product of additional problems which arise *during* the suspension period, courts generally recognize that construction delays, in one form or another, are almost inevitable and often expand the suspension period to encompass such contingencies. *General Ins. Co., Etc. v. Pathfinder Petroleum*, 145 F.2d 368 (9th Cir. 1944). In measuring recovery, however, the critical factor looked to by the courts is the actual impact the damage has upon the insured's revenue generating capability during the suspension period. *Great Northern Oil Co. v. St. Paul F. & M. Ins. Co.*, 303 Minn. 267 (1975).

Although the legal nuances with regard to business interruption coverage are somewhat daunting, pre-loss understanding of the exact coverage provided may substantially reduce post-loss litigation over the policy. Communication to the policyholder by a carrier's agents at policy inception, combined with careful review of coverage by the policyholder to ensure the carrier understands its business, are recommended in order to avoid costly business interruption policy disputes.

Additional Insureds: Who does the insurance policy actually cover?

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additional insured endorsement which stated that its coverage was excess unless the contract executed by Upfront specifically required the coverage to be primary. A problem arose when an Upfront employee was injured at the site, and brought legal action against the owner of the property and the general contractor for the injuries sustained. Both the owner and general contractor in turn commenced an action for indemnity against Pecker.

Pecker sought primary coverage from Travelers for the suit. Travelers maintained that Pecker was only entitled to coverage on an excess basis. New York's Court of Appeals disagreed with Travelers holding that, despite the language of the policy and the silence of the construction contract, the policy actually provided *primary coverage*.

The Court of Appeals concluded that according to the language of the contract, Travelers implicitly agreed to provide primary insurance to any party with whom Upfront contracted. According to the Court, "when Upfront agreed to it, the policy provision was satisfied."

It is perplexing in reviewing the *Pecker* decision to determine what Travelers might have done differently to avoid this situation. The policy, although generic in many respects, did state clearly that any additional insured would be excess unless a contract entered by the insured explicitly stated otherwise. The *Pecker* decision creates more questions than answers with respect to additional insured provisions. What language must be included to ensure the additional insured endorsements are excess, if that is the true intention? Does the *Pecker* decision suggest that such a proposition is impossible? Should carriers, in an abundance of caution, avoid language that affords additional insured coverage by an insured's mere entrance into a written contract, and instead only extend such coverage on a case-by-case basis?

As for policyholders, the lesson of *Pecker* is clear — when entering into a contract which addresses additional insurance, always ensure that the contract specifies whether that insurance is primary or excess.

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