Indemnity and Risk Allocation: You Can't Always Get What You Want, But it's Good to Know How to Get What You Need

William W. Pugh

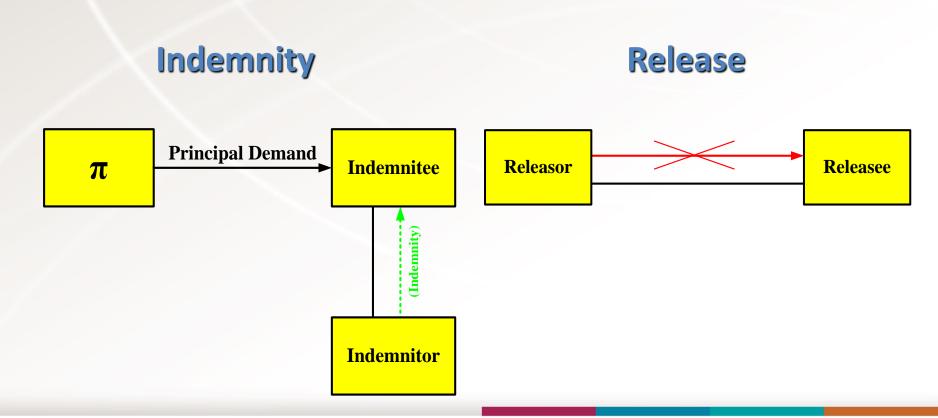
LISKOW&LEWIS

Overview

- General Principles
- Effect of indemnity structure
- Insurance protections
- Restrictions on indemnity and insurance
- What law applies?
- Construction Anti-Indemnity statutes
- Some examples
- Different contracts may mean different issues

General Principles

Indemnity / Release



Recovery of Fees/Costs

Defense Costs

- Maritime and Texas Duty to indemnify includes duty to defend
- Louisiana Only if expressly provided for by contract

Fees/Costs Incurred Pursuing indemnification

Only if expressly provided for by contract

INDEMNITY "MUST HAVES"

 Must have valid "magic language" to obtain indemnity for one's own negligence



Coverage for Your Own Negligence

- •Maritime "Clear and Unequivocal"
- Louisiana "Unequivocal"
- Texas "Express Negligence"
 - Fair notice and conspicuousness

Randall v. Chevron (5th Cir.) (maritime law)

Owner hereby agrees to defend, indemnify and hold harmless Company against all claims for damages, whether to person or property, and howsoever arising in any way directly or indirectly connected with the possession, navigation, management, and operation of the vessel.

HELD – Provision did not adequately express parties' intent to cover indemnitee's negligence.

Smith v. Shell (5th Cir.) (Louisiana law)

Contractor shall defend and indemnify Company, its employees, and agents, against all losses, claims, suits, liability, and expense arising out of injury or death of persons or damage to property resulting from or in connection with performance of this order and not caused solely by Company's negligence.

HELD – Sufficient to include concurrent negligence of indemnitee.

Singleton v. Crown Central (Tex. Sup. Ct) (Texas law)

indemnity for "any and all claims, demands, ... of every kind and character whatsoever, ... excepting only claims arising out of accidents resulting from the sole negligence of Owner"

HELD – Did not satisfy Texas express negligence test – only specified what was not included, and did not expressly say concurrent fault included.

Conspicuousness (Texas)

- "Magic Language" needs to be somehow set off from the rest of the contract
 - All caps
 - Bold font
 - Bigger font
 - Separate paragraph/separate heading
- But, showing of actual knowledge that indemnity includes indemnitee's own negligence is sufficient

INDEMNITY "MUST HAVES"

- Must have valid "magic language" to obtain indemnity for one's own negligence
- Indemnity wording should expressly address certain categories of fault other than negligence

Indemnity for Fault Other than Ordinary Negligence

- Sole or Concurrent Negligence
- Strict Liability
- Unseaworthiness
- Pre-Existing Conditions
- Gross Negligence

Gross Negligence / Punitive Damages

- Maritime law Recent *Deepwater Horizon* ruling states indemnity for gross negligence (as opposed to release) is not against public policy under <u>maritime law</u>, but indemnity for punitive damages is.
- •Louisiana law Civil Code art. 2004 precludes release of gross negligence; unclear for indemnity, especially after *Deepwater Horizon* ruling.
- •**Texas law** Not clear whether indemnity for gross negligence available.
- •Insurance Insurance for punitive damages allowed where not excluded by policy terms (maritime and La.)(maybe in Tex.).

INDEMNITY "MUST HAVES"

- Must have valid "magic language" to obtain indemnity for one's own negligence
- Indemnity wording should expressly address certain categories of fault other than negligence
- Be aware of any issues relating to the scope of the indemnity or the scope of the MSA

Vessel Operations Present Special Issues if Maritime Law Applies

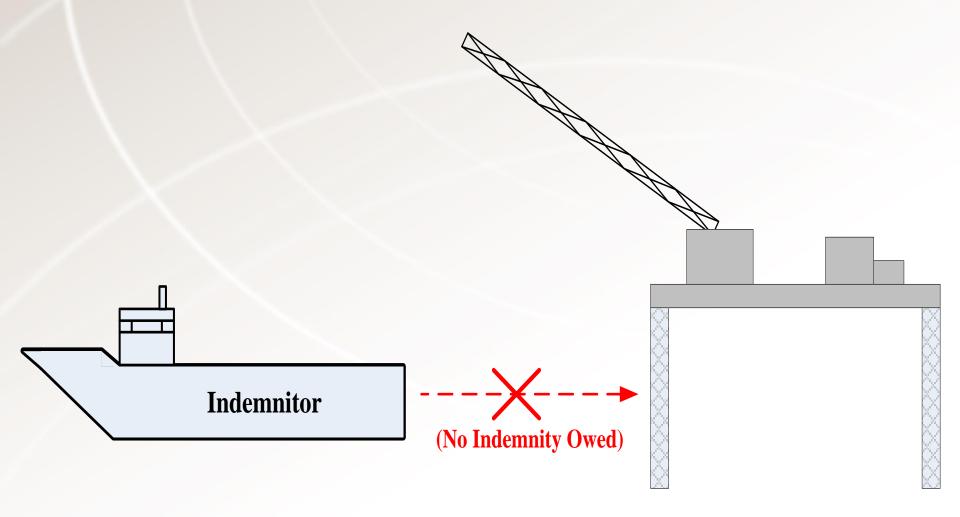
Lanasse - indemnity for claims "directly or indirectly connected with the possession, navigation, management and operation of the vessel"

Smith - indemnity for any claim that "arises out of or is incident to the performance [of the charter]"

Platform owner wears two hats:

- 1. Vessel Charterer
- 2. Platform Owner

Lanasse and Smith



Remedy for Lanasse Issue

Contract wording should expressly include indemnity for:

- "loading and unloading of cargo"
- "ingress and egress"

Sample Indemnity

Contractor shall release, defend, indemnify and hold the Company Group harmless from and against any and all claims, damages, liabilities, and expenses (including attorneys' fees and all costs of defense) for bodily injury to, illness or death, or any damage to or loss of property, of any member of Contractor Group to the extent such bodily injury, illness, death, damage or loss arises out of or is incident to the performance of the Services, including loading, unloading, ingress, and egress of personnel or cargo, regardless of the cause, even though caused in whole or in part by a pre-existing condition, or the negligence (sole or concurrent), strict liability, or the unseaworthiness, unairworthiness or defective condition of vessels, craft or premises owned, supplied, hired, chartered or borrowed under other agreements or otherwise of or by Company Group, excluding in each case to the extent that such injury, illness, death, damage, or loss was caused or contributed to by the gross negligence or willful misconduct of the party seeking defense, indemnity or release.



INDEMNITY "MUST HAVES"

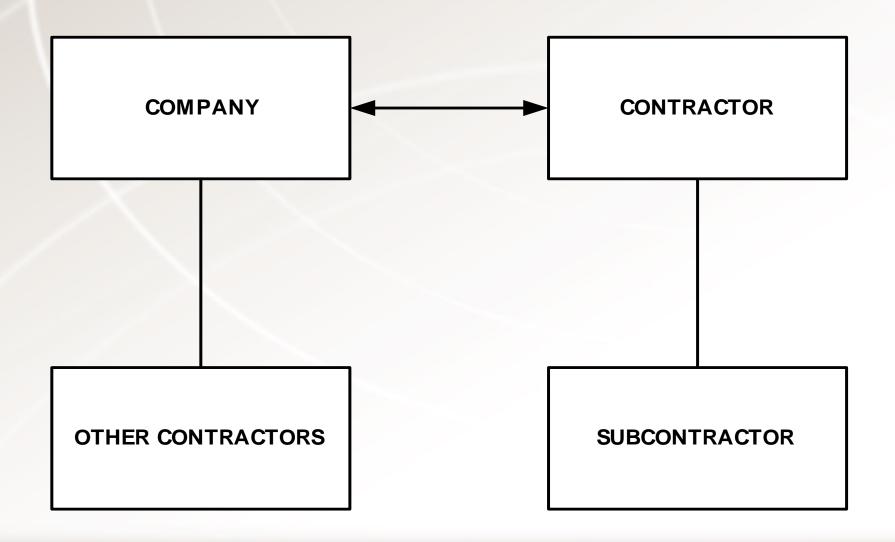
- Must have valid "magic language" to obtain indemnity for one's own negligence
- Indemnity wording should expressly address certain categories of fault other than negligence
- Be aware of any issues relating to the scope of the indemnity or the scope of the MSA
- Indemnity must be broad enough to extend to all intended beneficiaries – "Pass-Through Indemnity"

Indemnity Structure

Major Contract is a Key Driver

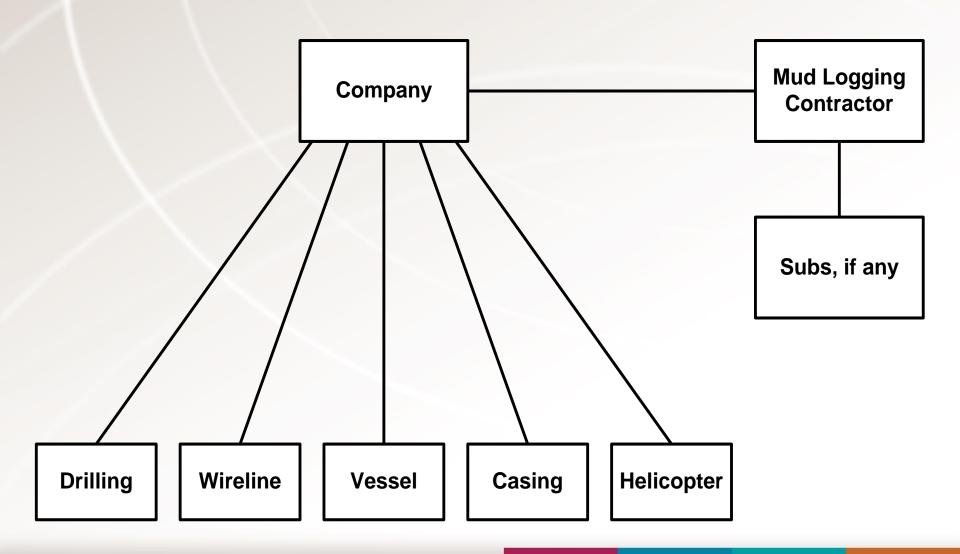
- Essential contract for Operator
- Likely a broad reciprocal indemnity
 - Drilling contractor will want indemnity for Operator's people and property and people and property of Operator's other contractors
- With broad reciprocal in drilling contract,
 Operator will owe indemnity to drilling contractor every time there is an accident

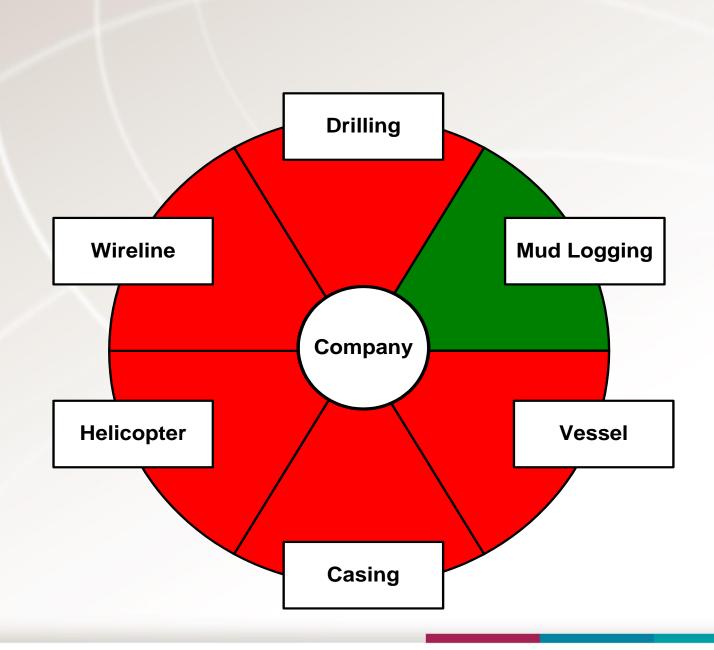
Contractor's View





Operator's View



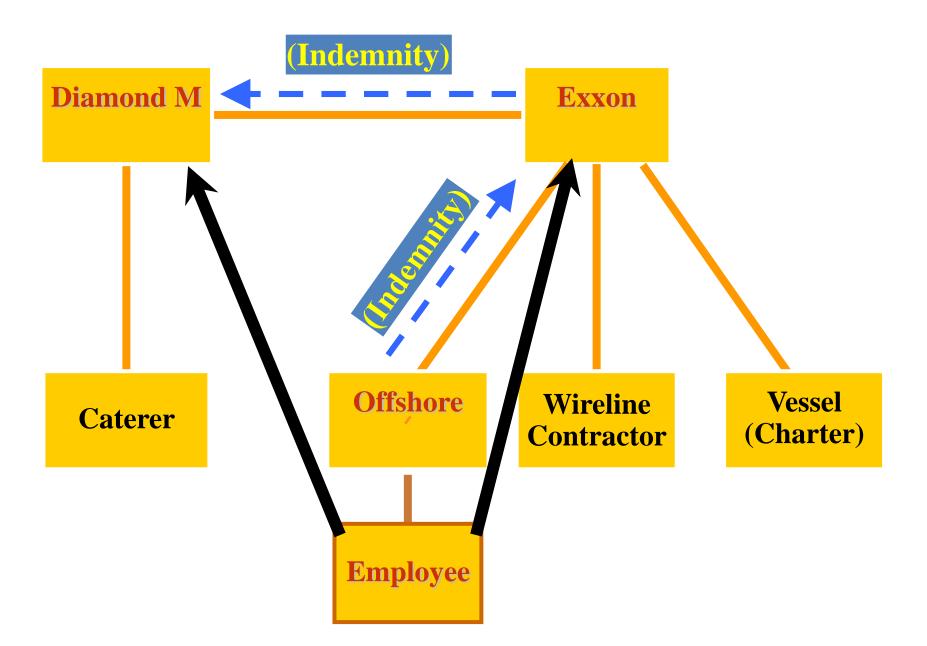


PASS THROUGH Pugh Wheel (basic) **Drilling Mud Logging** Wireline Company Helicopter **Vessel** Casing

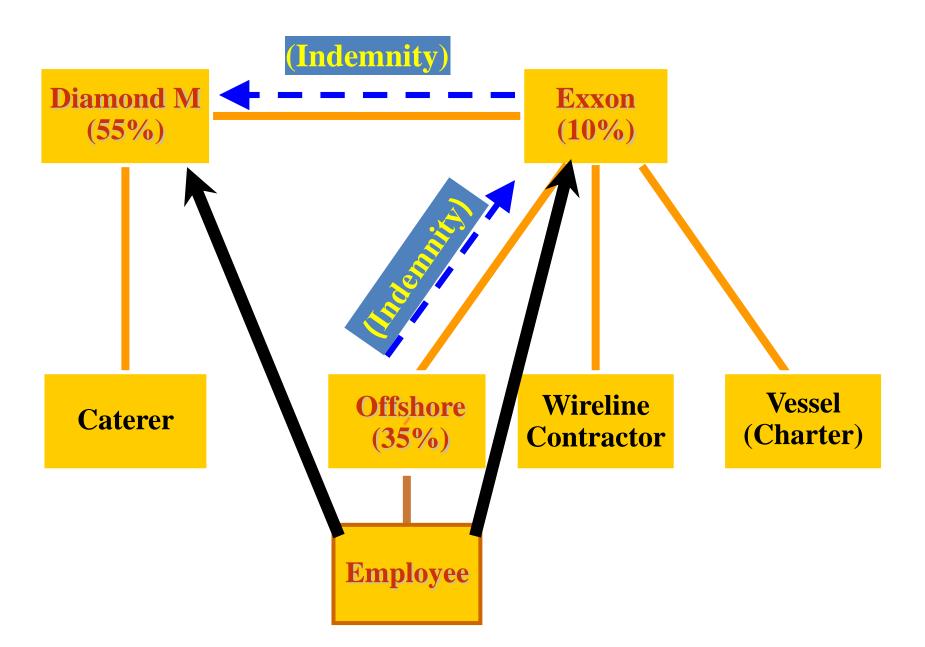
What Happens without a Pass-Through Provision?

For every instance in which Company owes a <u>broad reciprocal</u> indemnity, but the underlying contract has <u>no pass-through</u> provision, Company has <u>no recourse</u>

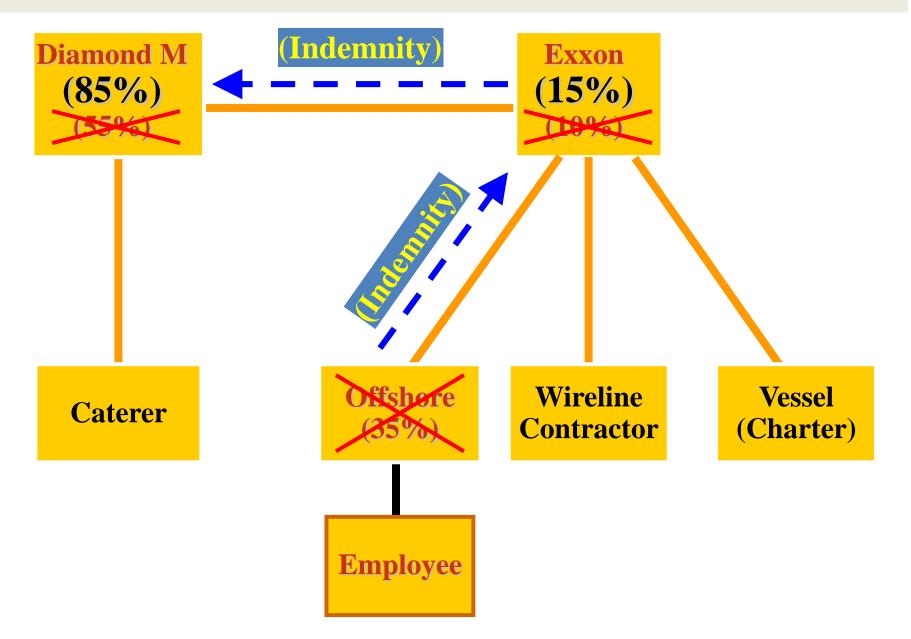
Foreman v. Exxon - Contractual Situation



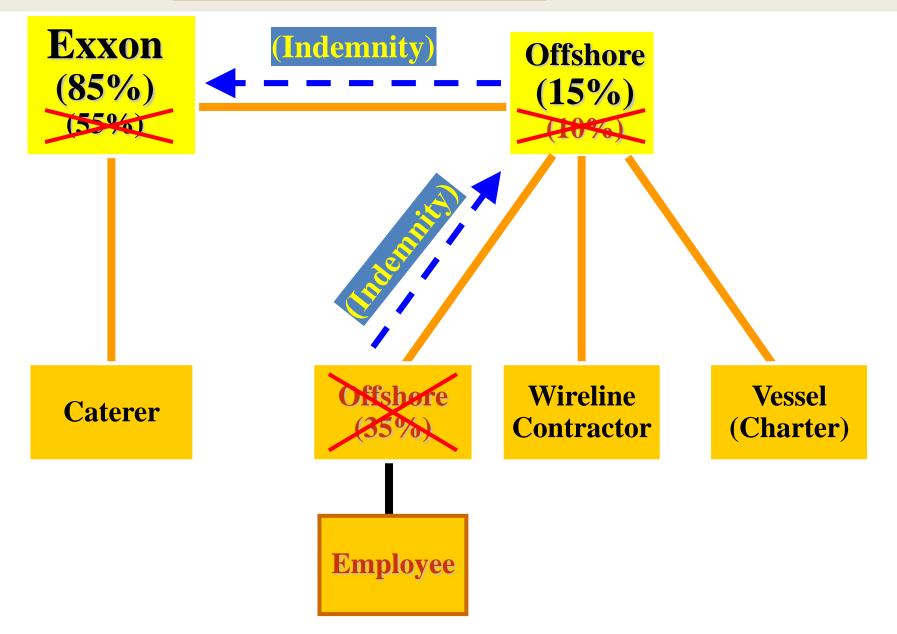
Foreman v. Exxon - Contractual Situation



Foreman v. Exxon - Result



Foreman v. Exxon - Result



Options for Obtaining a Pass-Through

- Require indemnity for any contractual liability to third parties
- Specify that indemnity is owed to indemnitee and anyone to whom the indemnitee owes contractual liability
- Use "Company Group" definition to expand the indemnitee to include contractors, subcontractors, and others

Insurance "Must Haves"

Three Necessary Protections

- Waiver of subrogation
- Additional insured
- Additional assured coverage should be primary, at least for risks assumed
- Additional insured coverage should extend all protection to "Company Group" (or cover insurance pass-through in a different way)
- Insurance requirements should dovetail with indemnity provisions

Insurance as a Limit on Indemnity

- Dickerson case Contract required the Contractor to maintain insurance "with limits of not less than \$___ ... to cover all obligations imposed" by the indemnity." Held to limit indemnity to amount of insurance required.
- Easily resolved with sentence stating the minimum insurance limits requirements are not intended to limit the extent of Contractor's indemnity.

Ogea and Tullier – Insurance First, Then Indemnity

- Where the indemnity portion of a contract required one party to indemnify the other, but the insurance section required that the indemnitor be named as an additional insured in the liability policies maintained by the indemnitee, Fifth Circuit held the insurance obligation primary and the indemnity obligation secondary.
- Avoid the potential problem by limiting the additional assured coverage "to the extent of liabilities assumed under the contract."

Maritime Insurance Endorsements

- Protection and Indemnity (P&I) policies typically provide coverage to an assured in its capacity "as owner" of one or more vessels.
- Where an oil company/platform owner is named as an additional insured in a vessel owner's P&I policy, the "as owner" language in the policy serves to limit the oil company's coverage to liability incurred in its capacity as charterer of the vessel (but not as platform owner).
- Must have endorsement to provide full coverage to Group regardless of any "as owner" coverage limitation.
- Must have endorsement preventing reduction of limits available to Group even if owner can limit liability

Restrictions on Indemnity and Insurance

Texas Oilfield Anti-Indemnity Act ("TOAIA")

- Applies to property damage and personal injury/death
- Exceptions for indemnity supported by insurance
 - unilateral indemnity (\$500,000)
 - mutual indemnity (up to amount of insurance obtained "for the benefit of the other party as indemnitee") – no longer required to specify equal amounts
- Unilateral and Mutual indemnities have specific definitions. Unclear whether a failed mutual leaves nothing or possibly \$500,000 under unilateral.

Getty Oil Co. v. Ins. Co. of N. Am.

 In the event an indemnity obligation fails, the insurance that supports it fails as well

 If there is a second, separate obligation to procure insurance, that obligation will be enforceable.

Longshore and Harbor Workers' Compensation Act

- Maritime indemnities are generally enforceable except that 33 U.S.C. § 905(b) prohibits an indemnity claim by a "vessel" against the employer of an injured longshoreman
- BUT, insurance is fully enforceable and mutual indemnity on OCS is enforceable

Louisiana Oilfield Indemnity Act ("LOIA")

- LOIA restricts indemnity <u>and</u> insurance
- LOIA only applies to contracts pertaining to a well
- Applies to personal injury/death, not property damage
- Additional insured endorsement invalid unless indemnitee pays the premium for the endorsement under Marcel v. Placid Oil Co.
- Compare Amoco v. Lexington (La. App.) with Rogers v. Samedan (5th Cir.)

Meloy and Actual Negligence

- LOIA prevents receiving indemnity for bodily injury arising out of the indemnitee's own negligence
- If the indemnitee can show it was not negligent, it can recover its defense costs
- Split between federal and state courts on settlement and litigating negligence later (Feds no, state yes)
- Immediately tender to maximize amount of recoverable atty's fees

Marcel v. Placid Oil

- Judge made law, not statutory
- Not an exception, merely a workaround
- Party wishing to get insurance must pay "all material costs" of extending the insurance
- Cannot handle payment as a bookkeeping exercise, someone must pay the underwriter or broker
- Can turn into administrative nightmare

LOIA v. TOAIA

LOIA

Personal Injury



Additional Insured

Supported by Insurance



TOAIA

Personal Injury



Property Damage



Additional Insured



Supported by Insurance (Mutual/Unilateral)



What Law Applies?

Applicable Law

- If available, maritime law should be considered as it is most likely to enforce the parties' indemnity plans
- If maritime law applies, choice of law provision should be enforceable
- If OCSLA controls, choice of law provision will be unenforceable
- If state law applies on its own, both TOAIA and LOIA are strong statements of public policy and choice of law provisions that select other law or attempt to waive them are unlikely to succeed

OCSLA

 The Outer Continental Shelf Lands Act provides that the law of the adjacent state will apply as surrogate federal law when suits arise on the outer continental shelf

- Three-part test:
 - 1. OCSLA situs
 - 2. Maritime law does not apply of its own force
 - 3. State law not inconsistent with Federal law

OCSLA Situs

- Beyond 3 miles
- Permanently or temporarily affixed to sea floor

Grand Isle Shipyard v. Seacor Marine case:

- Tort/injury occurred on a vessel, but majority of work was to be performed on fixed platforms on the OCS
- Court held "focus-of-the-contract" test, not location of the tort, determines the situs for contractual indemnity claims.
- Analyze work under the specific work order, not the totality of work under MSA (Ace American Insurance Co. v. M-I, L.L.C., (5th Cir. Oct. 19, 2012)

Does Maritime Law Apply: Is There Admiralty Jurisdiction?

 Does the contract relate to maritime service or maritime transactions?

- Contractor need not provide the vessel
- Involvement of a vessel not always determinative (e.g., Texaco v. AmClyde (5th Cir.))

Examples of Maritime Contracts

- Lewis, Theriot, Dupre, Dupont contract to provide drilling services aboard a special purpose vessel is maritime
- Corbitt, Campbell, Demette contract to provide casing services aboard a vessel provided by another party is maritime.
- Davis & Sons contract to provide maintenance services on fixed well heads using a spud barge which serves more as a special purpose vessel than a means of transportation is maritime.

Examples of Non-Maritime Contracts

- Thurmond contract to provide wireline services on fixed structures using a transportation barge is nonmaritime.
- Laredo contract to construct a stationary platform is non-maritime.
- Union Texas Petroleum contract to construct an offshore pipeline is non-maritime.
- Alleman contract to provide helicopter services is nonmaritime.

Texas Construction Anti-Indemnity Act

Sec. 151.102. AGREEMENT VOID AND UNENFORCEABLE.

Except . . . 151.103, a provision in a construction contract, or in an agreement collateral to . . . , is void and unenforceable as against public policy to the extent that it requires an indemnitor to indemnify, hold harmless, or defend a party, including a third party, against a claim caused by the negligence or fault, the breach or violation of a statute, ordinance, governmental regulation, standard, or rule, or the breach of contract of the **indemnitee**, its agent or employee, or any third party under the control or supervision of the indemnitee

Sec. 151.103. EXCEPTION FOR EMPLOYEE CLAIM.

Section <u>151.102 does not apply</u> to a provision in a construction contract that requires a <u>person to indemnify</u>, <u>hold harmless</u>, <u>or defend another party</u> to the construction contract <u>or a third party</u> against a claim for the <u>bodily injury or death</u> of an <u>employee</u> of the indemnitor, its agent, <u>or its subcontractor of any tier</u>.

Sec. 151.104. UNENFORCEABLE ADDITIONAL INSURANCE PROVISION.

- (a) Except as provided by Subsection (b), a provision in a construction contract that requires the <u>purchase of</u> additional insured coverage, or any coverage endorsement, or provision within an insurance policy providing additional insured coverage, is void and unenforceable to the extent that it requires or provides coverage the scope of which is prohibited under this subchapter for an agreement to indemnify, hold harmless, or defend.
- (b) This section does not apply to [an OCIP policy]

Sec. 151.105. EXCLUSIONS.

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This subchapter does not affect:
(1) an [OCIP] insurance policy . . . ;
(2) a cause of action for breach of contract or warranty that
exists independently of an indemnity obligation . . . ;
(3) indemnity provisions contained in loan and financing
documents, other than construction contracts to which the
contractor and owner's lender are parties . . . ;
(4) general agreements of indemnity required by sureties as a
condition of execution of bonds for construction contracts;
(5) ... workers' compensation laws of this state;
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(6) ... governmental immunity laws of this state;

Sec. 151.105. EXCLUSIONS (cont'd)

- (7) <u>agreements subject to [TOAIA];</u>
- (8) a license agreement between a railroad company and ...;
- (9) an indemnity provision [for] copyright infringement;
- (10) an indemnity provision . . . pertaining to:
- (A) a single family house, townhouse, duplex, or land development directly related thereto; or
- (B) a public works project of a municipality; or (11) a joint defense agreement entered into after a claim is made.

CAIA Impact is Primarily Limited to Property Liability Exposure

- Indemnity available for bodily injury/death claims
 - Limited to employees or subcontractors
 - Indemnity can be owed to other party or a third party
- Insurance still available for bodily injury/death claims
 - Additional insured protection still enforceable
 - Section 151.104 only prohibits insurance to the extent it would provide coverage for a prohibited agreement to "indemnify, hold harmless, or defend"

Property Damage - Best Case Argument

- CAIA does not prohibit owner of property from insuring its property and releasing its claim against the other party
 - "Releases" are not prohibited
 - No prohibition of "waivers of subrogation"
 - Arguably nothing to prevent property owner from releasing all claims, regardless of fault, and requiring its insurers to waive subrogation

Louisiana Construction Anti-Indemnity Act

Many Similarities to TCAIA

- "Construction contract" defined very broadly
- Includes "design, construction, alteration, renovation, repair or maintenance of a building, structure, highway, . . . oil line, gas line, appurtenance, or any other improvement to real property . . . "
- Not applicable if LOIA applies
- Broad application

Prohibits Indemnity, Defense, Hold Harmless and Additional Insured

- 9:2780.1.B. "[a]ny provision . . . in . . . a construction contract which purports to . . . or has the effect of indemnifying, defending, or holding harmless, the indemnitee from or against any liability for loss or damage resulting from the negligence . . . of the indemnitee, . . . is null, void, and unenforceable."
- 9:2780.1.C. same prohibition for requiring liability insurance

New Exception - Indemnity

- 9:2780.1.I. Nothing in this Section shall invalidate . . . :
- (1) Any clause . . . containing the indemnitor's promise to indemnify, defend, or hold harmless the indemnitee . . . if the contract also requires the indemnitor to obtain insurance to insure the obligation to indemnify, defend, or hold harmless and there is evidence that the indemnitor recovered the cost of the required insurance in the contract price. However, the indemnitor's liability. . . shall be limited to the amount of the proceeds that were payable under the insurance policy

New Exception - Insurance

- 9:2780.1.I. Nothing in this Section shall invalidate . . . :
- (2) Any clause . . . that requires the indemnitor to procure insurance or name the indemnitee as an additional insured . . . but only to the extent that such additional insurance coverage provides coverage for liability due to an obligation to indemnify, defend, or hold harmless authorized pursuant to Paragraph (1) . . . , provided that such insurance coverage is provided only when the indemnitor is at least partially at fault or otherwise liable for damages ex delicto or quasi ex delicto.

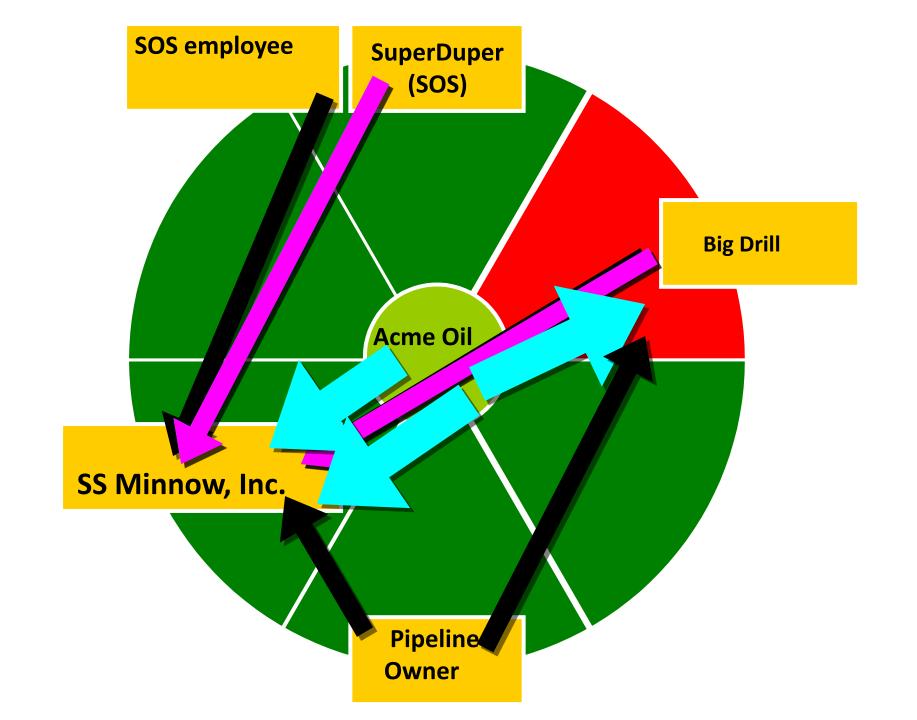
Best Case Argument

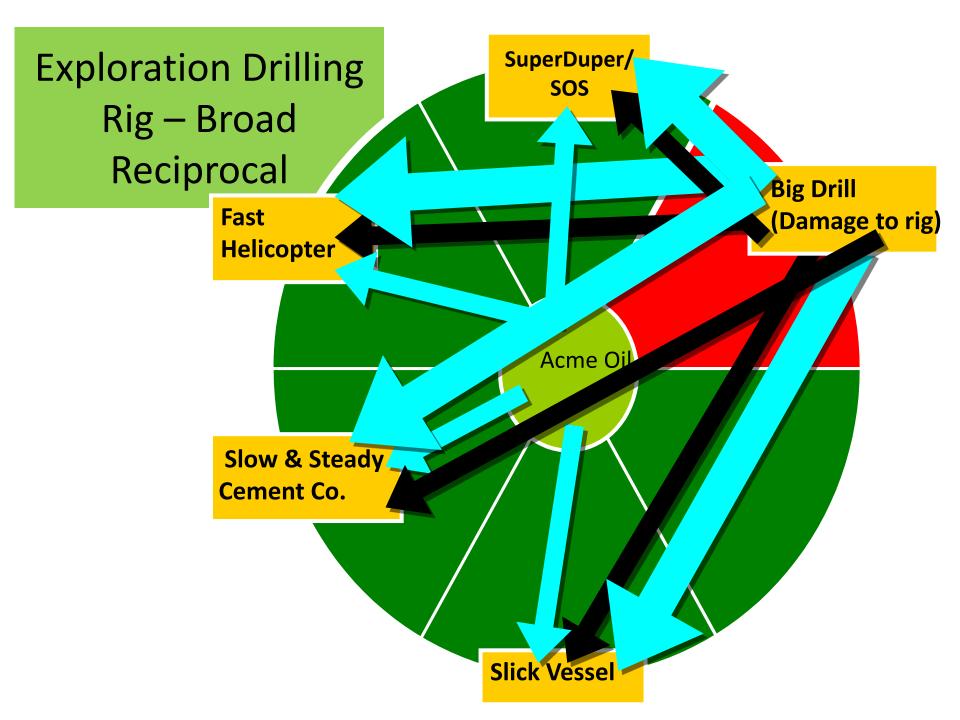
- LCAIA does not prohibit owner of property from insuring its property and releasing its claim against the other party
 - "Releases" are not prohibited
 - No prohibition of "waivers of subrogation"
- Doesn't apply if LOIA applies
- Can support indemnity with insurance if paid for but limited to insurance and may have to exclude sole negligence

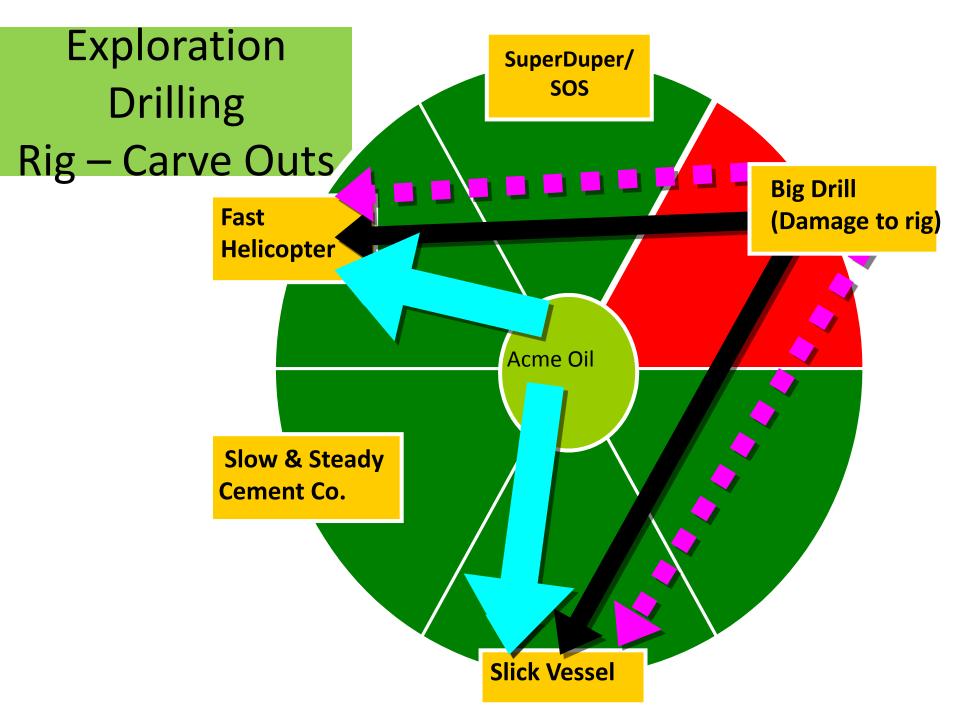
Some Examples

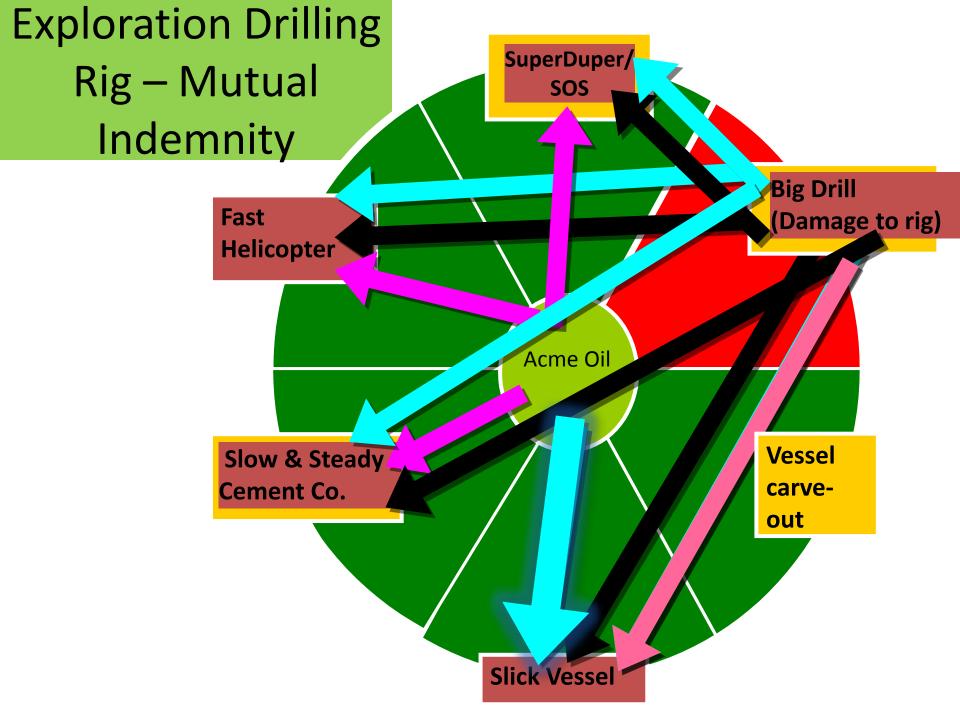
Indemnity Factual Scenario

- Acme Oil hires Big Drill drilling contractor
- Big Drill rig is damaged by SS Minnow gas truck
- Rig is badly damaged (\$15 million in repairs) and will take 90 days to repair
- SOS Wireline employee is injured
- Rig derrick has damaged a nearby pipeline
- What are the issues?









Different Contractors – May Mean Different Issues

- Drilling
- Well services
- Vessels
- Flight services
- Construction

Drilling Contracts

- Need pass through provision or Mutual Indemnity
- Avoid inappropriate "magic" language
 - "floating" or sound location
- Beware of liability for damage to the drilling rig (sound location; vessels/helicopters) and uncapped repair time
- Avoid broad consequential damage provisions
- Commercial provisions can be dangerous
 - uncapped exposure for day rate during repairs
 - uncapped exposure for standby rate

Well Service Contracts

- Building block for risk allocation program
- Use a pass through provision
- Consider approach to consequential damages
- Drilling contractor carve outs
- Beware "catastrophic loss" provision
- Additional carve outs (transportation/CCC)
- Dovetail insurance

Master Time Charters

- Need a pass-through provision
- Vessel will want a broad reciprocal indemnity
 - creates significant risk, particularly in conjunction with MSA carve out for transportation and/or drilling contract carve out for damage to drilling rig
 - consider matching carve out as to rig
- Maritime endorsements are critical

Conclusion

Conclusion

- Understand the basics
- Choose your indemnity structure wisely
- Anticipate potential exposures and problems
- Choose the best option under the circumstances
- If there is a problem . . .



If Problems do Occur --Be Creative and Learn to Cope



Flooding in Ireland

