INSURANCE AND INDEMNITY ISSUES IN THE OIL PATCH

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CHAPTER 2
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INSURANCE AND INDEMNITY ISSUES IN THE OIL PATCH

I. INTRODUCTION

Insurance and indemnity issues frequently arise in the oil and gas industry. This article is intended to provide a general overview of insurance and indemnity matters that repeatedly emerge in the oil patch, as well as a brief summary of some of the most significant current insurance and indemnity issues in Texas.

As discussed below, choice of law considerations are crucial to the determination of insurance and indemnity obligations, as Texas law may differ greatly from the laws of other states and federal law concerning these obligations. Further, the Texas Supreme Court is currently considering a number of important insurance and indemnity matters that may reshape Texas law on these obligations.

II. OVERVIEW OF INSURANCE AND INDEMNITY OBLIGATIONS IN OILFIELD CONTRACTS

A. Function of Indemnity and Insurance Provisions in Oil Services Contracts

Contracts governing activities in the oil patch usually contain provisions governing the allocation of risk arising out of those activities. To that end, many of these contracts include provisions requiring an indemnitor to indemnify an indemnitee for the indemnitee’s own negligent acts or omissions. In addition, these contracts commonly require that the indemnitor name the indemnitee as an additional assured under the indemnitee’s insurance policies. The application and effect of these provisions depends in large part on what body of law applies to the provisions.

B. Choice of Law

Choice of law issues arise frequently in oil services contracts to be performed in the Gulf of Mexico and, in particular, off the coasts of Texas and Louisiana.

The choice of law analysis begins with the Outer Continental Shelf Lands Act (“OCSLA”), which provides in pertinent part:

To the extent that they are applicable and not inconsistent with this subchapter or with other Federal laws and regulations of the Secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent state, . . . are declared to be the law of the United States for that portion of the subsoil and seabed of the outer Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward to the outer margin of the outer Continental Shelf, and the President shall determine and publish in the Federal Register such projected lines extending seaward and defining each such area.¹

In the context of oil and gas operations conducted on the Outer Continental Shelf (“OCS”),² the law of the adjacent state applies as surrogate federal law if the following three conditions are satisfied: (1) the controversy arises on a situs covered by the OCSLA; (2) federal maritime law does not apply of its own force; and (3) state law is not inconsistent with federal law.³

By contrast, a contract related to a vessel and involving maritime activities generally is governed by maritime law.⁴

A determination of what law applies is crucial to the analysis of an insurance or indemnity provision because the law regarding the applicability and validity of these provisions – particularly as between Texas law, Louisiana law, and maritime law – may be vastly different.

C. Texas Law on Insurance and Indemnity Obligations

Two aspects of Texas law – the express negligence rule and the Texas Oilfield Anti-Indemnity Act⁵ – significantly affect insurance and indemnity obligations. Whether parties can indemnify for punitive damages, however, remains unsettled.

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² The OCS is generally understood to include “the seabed and subsoil adjacent to the coastal nation, but beyond the [state] territorial sea, to a depth of 200 meters or beyond where the depth of the superjacent water admits of the exploitation of the natural resources.” See The 1958 Convention on the Continental Shelf, 92 I.D. 459, 460. Through the OCSLA, however, Congress apparently intended the outer limits of the OCS to expand “as U.S. jurisdiction and control expand.” Id; see Apryl E. Hand, Comment, The Role of State Law in the Outer Continental Shelf Lands Act, 72 Tul. L. Rev. 2139, 2140 n.6 (1998).


⁴ The United States District Court for the Fifth Circuit has applied a fact-intensive, six-factor test to determine whether a contract is maritime. See Davis & Sons, Inc. v. Gulf Oil Corp., 919 F.2d 313, 316 (5th Cir. 1990).

1. **Fair Notice Doctrine**

The fair notice doctrine consists of the express negligence rule and the requirement of conspicuousness. Under the express negligence rule, an agreement that purports to indemnify a party from the consequences of its own negligence will not be enforced unless the agreement explicitly states that intent within the four corners of the contract.6 Further, the indemnity provision must be conspicuous enough to give the indemnitor fair notice of the provision.7

2. **Texas Oilfield Anti-Indemnity Act**

The Texas Oilfield Anti-Indemnity Act (“TOAIA”) generally provides that an indemnity agreement requiring indemnity for the indemnitee's negligence is invalid except (a) in the case of mutual indemnity agreements, where the parties agree in writing to provide liability insurance to cover the indemnity obligations, in which instance the agreements are enforceable up to the amount of the insurance coverage; or (b) in the case of a unilateral indemnity agreement, where the indemnitor agrees to provide liability insurance to cover the indemnity obligation, in which instance the agreement is enforceable up to the amount of the insurance, not to exceed $500,000.8 However, under certain circumstances (i.e., an insurance requirement that does not directly support an invalid indemnity), the TOAIA does not bar agreements that require the naming of an additional assured under an insurance policy.9

3. **Indemnification for Punitive Damages or Gross Negligence**

In Atlantic Richfield Co. v. Petroleum Personnel, Inc., the Texas Court observed, in dicta, that indemnification for one's own gross negligence or intentional conduct may raise public policy concerns.10 Nonetheless, insurance protection for punitive damages claims have been allowed in Texas.11 As discussed infra, this question has been certified by the United States District Court for the Fifth Circuit to the Texas Supreme Court in Fairfield Ins. Co. v. Stephens Martin Paving, LP and also is before the Texas Supreme Court on petition for review in Westchester Fire Ins. Co. v. Admiral Ins. Co.12 The Texas Supreme Court has not yet issued an opinion in either case.

D. **Louisiana Law on Insurance and Indemnity Obligations**

The Louisiana Oilfield Indemnity Act (“LOIA”) significantly affects insurance and indemnity obligations by barring enforcement of oilfield agreements that require indemnification for the indemnitee's negligence.13 The LOIA also voids agreements that require the naming of an additional assured under an insurance policy, unless the party seeking coverage has paid the cost of obtaining that coverage.14 The LOIA is broadly written and has been broadly interpreted.15

In contrast, several cases suggest that Louisiana law permits indemnification for claims by a third party for punitive damages.16 Note should be taken, however, of Civil Code art. 2004, which provides, “Any clause is null that, in advance, excludes or limits the liability of one party for intentional or gross fault that causes damage to the other party.” While this article directly prohibits a release for liability between the parties, its impact on indemnity agreements for claims by third parties is not completely clear. In any event, Louisiana law seems clear with respect to insurance coverage: if the liability insurance policy is silent regarding punitive damages, then the insured will be covered.17

E. **Maritime Law on Insurance and Indemnity Provisions**

Under maritime law, a clear and unambiguous agreement requiring indemnification for an indemnitee's negligence is generally enforceable, as are additional insured provisions. The Longshore and Harbor Workers' Compensation Act, however, voids agreements requiring indemnification of a vessel owner (or charterer) by the employer of a

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6 See Ensearch Corp. v. Parker, 794 S.W.2d 2, 8 (Tex. 1990).
7 See id. at 8-9.
8 See TEX. CIV. PRAC. & REM. CODE ANN. § 127.001-007.
9 See Getty Oil Co. v. Insurance Co. of N. Am., 845 S.W.2d 794, 804 (Tex. 1992).
10 768 S.W.2d 724, 726 n.2 (Tex. 1989).
12 381 F.3d 435 (5th Cir. 2004); Westchester Fire Ins. Co., 152 S.W.3d 172.
13 See LA REV. STAT. ANN. § 9:2780.
14 See id. at § 9:2780(G); Marcel v. Placid Oil Co., 11 F.3d 563, 569 (5th Cir. 1994); Rogers v. Samedan Oil Corp., 308 F.3d 477 (5th Cir. 2002); but see Amoco Production Co. COG-EPCO 1992 Ltd. Partnership v. Lexington Ins. Co., 745 So. 2d 676, 1998-1676 (La. App. 1 Cir. 9/30/99), writ denied, 755 So. 2d 253, 199-3553 (La. 2/25/00).
15 See Roberts v. Energy Dev. Corp., 104 F.3d 782, 784 (5th Cir. 1997).
longshoreman for the vessel owner's negligence. 18
Even so, mutual indemnity agreements between vessel
owners and employers of longshoremen are valid
where the longshoremen are working on fixed
platforms on the Outer Continental Shelf are valid. 19
In addition, additional insured protection is enforceable
even if the indemnity is invalid. 20
On the other hand, recent jurisprudence suggests
that enforceability of indemnity provisions covering
gross negligence or punitive damages is unclear under
maritime law. Although the jurisprudence in this area
is limited, some cases suggest a tendency to deny
coverage when maritime law applies. 21

III. SIGNIFICANT INSURANCE ISSUES IN
TEXAS
A. Recovery of Settlement Payments by Insurer
for Non-Covered Claims
On February 15, 2006, the Texas Supreme Court
heard oral argument in the rehearing of Excess
Underwriters at Lloyd's, London v. Frank's Casing
Crew and Rental Tools, Inc. 22 The Texas Supreme
Court issued its original opinion on May 27, 2005,
holding that an insurer may recover from an insured
settlement payments made for a non-covered claim,
even where the insured did not agree to reimburse such
payments. 23 As of the writing of this article, the Court
has not yet issued a decision on the rehearing of the
case.

In Frank's Casing, the insured demanded that the
excess underwriters accept a settlement offer of $7.5
million to resolve claims against the insured arising out
of the collapse of a drilling platform. 24 The excess
underwriters agreed to accept the offer, but not before
informing the insured that they would seek
reimbursement from the insured for payment of any
non-covered claims. 25 The excess underwriters also
expressly reserved their rights to pursue claims against
the insured. 26

In its May 27, 2005 opinion, the court held that an
insurer has a quasi-contractual right to reimbursement
when an insured demands that the insurer accept a
settlement offer within policy limits or agrees that a
settlement offer should be accepted and where “the
insurer has timely asserted its reservation of rights,
notified the insured that it intends to seek
reimbursement, and paid to settle claims that were not
covered.” 27

B. Coverage of Construction Defects
On February 14, 2006, the Texas Supreme Court
heard oral argument in Lamar Homes, Inc. v. Mid-
Continent Cas. Co., 28 which presented the following
certified questions from the Fifth Circuit:

(i) When a homebuyer sues his general
contractor for construction defects and
alleges only damage to or loss of use of
the home itself, do such allegations
allege an “accident” or “occurrence”
sufficient to trigger the duty to defend or
indemnify under a CGL [commercial
general liability] policy?

(ii) When a homebuyer sues his general
contractor for construction defects and
alleges only damage to or loss of use of
the home itself, do such allegations
allege “property damage” sufficient to
trigger the duty to defend or indemnify
under a CGL policy?

(iii) If the answers to certified questions 1
and 2 are answered in the affirmative,
does article 21.55 of the Texas
Insurance Code apply to a CGL insurer's
breach of the duty to defend? 29

As of the writing of this article, the Texas Supreme
Court has not yet issued an opinion on these issues.
In Lamar Homes, the insured tendered to the
insurer for defense a lawsuit asserting breach of
contract and breach of warranty claims against the
insured arising out of the insured’s alleged negligent
design and construction of a home. 30 The insurer
refused to defend the insured, asserting that property
damage arising out of construction defects is an
uninsured economic loss. 31

18 See 33 U.S.C. § 905(b)
19 See id. at § 905(c).
20 See Voisin v. O.D.E.C.O. Drilling Co., 744 F.2d 1174,
1176 (5th Cir. 1984); Price v. Zim Israel Navigation Co.,
Ltd., 616 F.2d 422 (9th Cir. 1980).
21 See Daughdrill v. Ocean Drilling & Exploration Co., 665
F.Supp. 477 (E.D. La. 1987); Dominici v. Between the
23 Id.
24 Id. at * 1.
25 Id.
26 Id. at * 2.
The district court ruled in favor of the insurer, holding, among other things, that the breach of contract and breach of warranty claims were not “occurrences” and did not constitute “property damage” under the insurance policy. The court reasoned that “if the factual allegations read as a contractual breach for construction defects requiring repair or replacement instead of negligence resulting in property damage, the resulting damage for economic loss does not fall within the coverage of the insurance policy.”

C. Coverage of Punitive Damages

On August 19, 2004, the Texas Supreme Court heard oral argument in Fairfield Ins. Co. v. Stephens Martin Paving, which presented a certified question from the Fifth Circuit regarding whether the public policy of Texas “prohibit[s] a liability insurance provider from indemnifying an award for punitive damages imposed on its insured because of gross negligence.” As of the writing of this article, the Court has not issued an opinion in this matter.

In Fairfield, the insured pursued coverage for a workers’ compensation death action seeking punitive damages from the insured based on gross negligence allegations. The insurer filed a declaratory judgment action, asserting that Texas public policy bars insurance coverage for punitive damages and thus the insurer had no duty to defend or indemnify the insured. The district court held that the insurer had a duty to defend and indemnify the insured against any punitive damages award.

Also pending before the Texas Supreme Court is Westchester Fire Ins. Co. v. Admiral Ins. Co, which is on petition for review. In Westchester Fire Ins. Co., the Fort Worth Court of Appeals, sitting en banc, held that coverage for punitive damages under a healthcare liability policy was not contrary to the public policy of Texas.

IV. CONCLUSION

The law regarding insurance and indemnity obligations is constantly in flux, and applicable law considerations remain a crucial factor in discerning these obligations in the oil patch. Forthcoming Texas Supreme Court opinions regarding insurance and indemnity issues will undoubtedly help to shape these obligations in the years to come.

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32 Id. at 759-60.
33 Id. at 759.
34 381 F.3d 435 (5th Cir. 2004).
35 Id. at 437.
36 Id. at 436-37.
37 Id. at 437.
38 Id.
40 Id. at 182.