

# Contractual insurance and risk allocation in the offshore drilling industry

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**EDITOR'S NOTE:** *This is the third and final segment of a series on risk allocation and insurance provisions of offshore drilling contracts. The first segment, which appeared in the January/February 1999 edition of DRILLING CONTRACTOR, discussed contractual risk allocation in general, and reviewed customary provisions addressing liability for personnel, equipment and property. The second, published in the March/April 1999 DRILLING CONTRACTOR, reviewed provisions addressing well risks, reservoir loss/damage, general third-party liability and consequential damages in daywork drilling contracts and discussed the principal changes in risk allocation for turnkey and footage contracts.*



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**AFTER THE CONTRACTING** parties have agreed upon a risk allocation matrix for an offshore drilling contract, careful consideration should be given to selection

of the governing law and inclusion of provisions which will assure that the agreed indemnity, risk allocation and insurance provisions are enforceable. Selection of an appropriate governing law, recognition of the pitfalls created by the anti-indemnity statutes, and inclusion of appropriate language expressing the parties' intentions that the indemnities be enforced as written are important aspects of offshore drilling contracts.

## GOVERNING LAW/ANTI-INDEMNITY STATUTES

Assuming that a contract has been drafted in a clear and unambiguous manner without conflicting or potentially overriding provisions, it remains incumbent upon the contracting parties to assure that the contract terms, especially as they relate to liability and indemnity, are enforceable. In this regard, care should be taken to designate a governing law which will enforce the contract as written.

The Texas and Louisiana anti-indemnity statutes (TEX. CIV. PRAC. & REM. CODE ANN Sections 127.001, et. seq.; LA. REV. STAT. ANN. Section 9:2780) render certain liability and indemnity provisions of a drilling contract unenforceable in the absence of mutual indemnities and insurance or, in certain circumstances, in the event of negligence by indemnitee. Other states, such as New Mexico and Wyoming, have similar anti-indemnity statutes which may invalidate indemnity provisions of drilling contracts. Some foreign laws (e.g., French law) similarly cast doubt over enforceability of unconditional indemnities.

Since the parties intend their contract to be enforceable as written, it is essential that an appropriate governing law be designated. Although efforts to designate an appropriate governing law may be thwarted in certain circumstances, such as in performance of inland waterway drilling in a state with an anti-in-

demnity statute, it generally is accepted that the parties are free to designate an appropriate governing law for most international offshore drilling contracts and for domestic contracts involving MODU operations in the Ocean Continental Shelf (where "general maritime law of the United States" is an appropriate governing law designation).

## TALISMANIC LANGUAGE

Even where an appropriate governing law is designated (i.e., no anti-indemnity statute applies), the laws of many jurisdictions and US general maritime law require a clear statement of intent to enforce an indemnity granted to a party that may be charged with negligence or other legal fault. This can be done by including language in the contract expressing an intention that the indemnities be applicable without regard to causation or fault. Sometimes called "magic words" or "talismanic language", wording similar to the following should suffice to express the parties' intent and render the indemnities enforceable:

"It is the intent of the parties hereto that, where responsibility or liability is assumed by either party or where either of the parties agrees to release or indemnify the other party in respect of any claim, demand or cause of action, unless it otherwise is expressly stated, such release, assumption of liability and/or indemnification shall apply notwithstanding the gross, sole, concurrent, active or passive negligence of any party hereto or any person, firm, or corporation for which such party is responsible (whether or not such negligence related to a pre-existing condition or defect), any breach of warranty or representation, unseaworthiness of any rig or vessel owned or hired by either party, or any other legal theory (including tort, strict or product liability) which otherwise may be applicable."

With an appropriate governing law and the "magic words" or "talismanic language", the parties will have an enforceable allocation of risks and will be able to avoid costly duplicate insurance coverages.

## INSURANCE PROVISIONS

Insurance provisions are important aspects of drilling contracts and customarily specify the types of coverage and policy limits which are to be maintained by the contractor. Surprisingly, offshore drilling contracts rarely specify the coverages which should be obtained by the operator, perhaps upon the assumption that an oil company operating in the offshore arena will act prudently in obtaining insurance or otherwise has the financial wherewithal to absorb the risks it contractually assumes.

The insurance provisions specify the types of coverages the contractor is required to maintain, such as worker's compensation, employer's liability, comprehensive general liability, property coverage and excess liability coverage. In offshore contracts, Protection and Indemnity and Hull and Machinery coverages customarily are specified.

## PURPOSE OF INSURANCE PROVISIONS

A fundamental philosophical issue may arise concerning the purpose of the insurance provisions specifying the contractor's

coverages. Many operators assert that, since the cost of such insurance is included in the contractor's rates, the operator should be entitled to the full benefit of contractor's insurance. A contractor may assert that the contractual insurance provisions are only for purposes of assuring the operator that the contractor will have insurance to support its contractual assumptions of liability and indemnities. The latter rationale for inclusion of insurance provisions appears most apropos, since an operator enters into a drilling contract to obtain a rig and crews and not for purposes of procuring insurance to cover risks it otherwise should absorb. Indeed, if contractors routinely extend the full benefits of their insurance to operators, the cost of such insurance could spiral dramatically due to the resulting increase in claims.

#### WAIVERS OF SUBROGATION

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Some proforma contracts prepared by operators contain provisions which fully expose the contractor's insurance to all manner of risks by stating that the liability and indemnity obligations assumed by the operator are inapplicable to the extent the injury, loss or damage is covered by contractor's insurance. Such provisions often will result in effectively overriding many provisions of the liability and indemnity section of the contract since the risk allocations may become a function of the nature

and scope of coverage afforded by the contractor's insurance. The same dubious result may occur when a contract provides that the operator shall be named as an unqualified additional insured under the contractor's insurance policies (other than Worker's Compensation) or states that the contractor's insurance shall be deemed primary coverage. In such circumstances, the parties may inadvertently override many provisions of the liability and indemnity risk allocation section of the contract and also may create troublesome potential issues regarding application of the contractual liability insurance coverage.

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To properly delineate the extent the operator may directly have access to the contractor's insurance, provisions requiring inclusion of the operator as an additional insured under the contractor's policies or stating that such insurance shall be deemed primary coverage often are qualified and limited "to the extent the contractor expressly assumes liability" under the contract. With such qualification and limitation, the operator only may seek direct recourse to the contractor's insurance as a named assured or assert that the contractor's insurance is primary coverage in relation to risks the contractor has expressly assumed under the contract. It also may be appropriate to include the same limiting language in respect of waivers of subrogation.

## POLICY LIMITS/DEDUCTIBLES

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It is preferable to express insurance policy limits as stated amounts rather than as "10 minimum requirements" or coverage in an amount "not less than." This will serve to remove any uncertainties concerning the contractor's insurance obligations, an important delineation whenever a liability or indemnity contractually is limited to the amount of applicable insurance (most commonly in third party liability clauses) or where the operator is an additional insured. It also is prudent to specify the applicable deductible amounts, especially in contracts where the operator effectively absorbs the deductible in certain situations (such as in-hole or subsea equipment losses). The contractual insurance provisions often state that, except where a liability or indemnity expressly is limited to a stated policy limit, the limits of insurance are not intended to serve as limitations on the risks otherwise assumed under the drilling contract.

## PROOF OF INSURANCE

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Proof of insurance ordinarily is established by requiring the contractor to furnish certificates of insurance, which often specify that the contractor's insurance coverages shall not be canceled or modified without prior notice to the operator. Copies of the insurance policies often are requested as proof of insurance, although many contractors will only agree to provide pertinent excerpts of the policies since the insuring agreements are considered confidential.

## CONCLUSION

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Although the CRINE initiative may bring a degree of standardization, offshore drilling contract risk allocation and insurance terms undoubtedly will continue to be influenced by market conditions and the respective negotiating positions of the contracting parties. Initial experience in use of the standardized CRINE contract terms has demonstrated that the risk allocation provisions continue to be the subject of considerable negotiation, which frequently results in modification of the standard wording by over-riding agreed special conditions.

When considered in reference to the risks, rewards and objectives of a drilling venture and the types of insurance coverages and risk retentions which traditionally are maintained by prudent operators and contractors, liability, indemnity and insurance provisions should fairly and logically allocate risks in a manner which creates a clear, unqualified and enforceable risk allocation arrangement and avoids unnecessary duplication of insurance coverages.

## ABOUT THE AUTHOR

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*Cary Moomjian, VP/General Counsel of Santa Fe International Corporation, is Chairman of the IADC Contracts Committee and was the 1996 IADC Contractor of the year. He also chairs Drilling Contractor Publications Inc, IADC's publishing subsidiary. A frequent author and lecturer, Mr Moomjian is widely regarded as one of the industry's foremost experts on drilling contracts. This series of articles is based on remarks made by the author at the 1998 Houston Marine Insurance Seminar.* ■