

KEY CONSIDERATIONS IN CONSTRUCTION PROJECTS RELATED TO DEEPWATER OPERATIONS

**William W. Pugh
Liskow & Lewis**

SYNOPSIS

§ 1.01 Introduction

§ 1.02 Background

[1] Deepwater

[2] Types of deepwater facilities

§ 1.03 Applicable Law: Maritime Law, State Law, and the OCSLA

[1] Application of State Law Under OCSLA

[a] OCSLA situs

[b] Federal law applying of its own force

[i] Pre-*Davis & Sons* cases

[ii] *Davis & Sons*

[c] State law inconsistent with federal law

[2] Effect of Choice of Law Provisions

[3] How is the “Adjacent” State Determined Under the OCSLA?

§ 1.04 Liability Risk Allocation-Indemnity and Insurance

[1] The Requirements for Enforceable Indemnities

[a] Is the intent to indemnify clear?

[b] The “Conspicuousness” requirement

[c] Duty to defend and right to recover defense costs

[d] “Pass-through” indemnity

[e] The scope of the indemnity

[2] Maximizing Insurance Protection

[a] General requirements

[b] Insurance and indemnity interplay

[i] Insurance provisions may prime indemnity provisions

[ii] Important vessel coverage endorsements

[3] Interaction Between Construction Contract and Other Contracts

§ 1.05 Exceptions to the Right to Seek Indemnity

[1] LHWCA Section 905(b)

[2] The Louisiana Oilfield Indemnity Act

[3] The Texas Anti-Indemnity Act

[4] Keep Options Open

§ 1.06 Allocation of Risk of Loss or Damage to the “Work”

§ 1.07 Contractual Provisions Relating to Performance Issues

[1] Delays, Cost Overruns, and Changes

[2] Standard of Care and Warranty Protection

[3] Default, Termination, and Remedies

§ 1.08 A Case Study: *AGIP Petroleum Co., Inc. v. Gulf Island Fabrication, Inc.*

[1] Insured Losses and Risk Allocation

[2] Contractual Waivers

[3] Uninsured Losses and Risk Allocation

[4] Choice of Law and Economic Damages

[5] Lessons to be Learned

§ 1.09 Conclusion

KEY CONSIDERATIONS IN CONSTRUCTION PROJECTS RELATED TO DEEPWATER OPERATIONS

§ 1.01 Introduction

Construction contracts relating to deepwater operations by their nature involve an increased degree of risk as compared to other construction contracts. The monetary values involved and the potential effect of delay or downtime are all greatly magnified. In addition, the technical difficulties involved mean that the lead time for any project has to be greater, completion will take longer, and more time will be required to solve any problem. Accordingly, an increased degree of foresight is critical. Owners and contractors alike must attempt to recognize potential pitfalls and address them in advance to the extent possible. Whether in the area of risk allocation, compensation, default, or remedies, it is important to think through the problems that might occur and set forth the parties' intended method of resolution. Uncertainty is to be avoided if at all possible.

Many of the key considerations in deepwater construction contracts are the same as in other construction contracts. Accordingly, this paper is not an attempt to catalog all of the issues in offshore contracts, but rather is intended to discuss some of the most important issues that should be considered. Some of the most significant issues include identifying the applicable law, allocating liabilities between the parties via indemnity and insurance, allocating risk of loss or damage to the work itself through insurance or other means, making sure the construction contract fits together with other contracts, and anticipating and addressing performance and related issues (such as warranty, delay, change orders, default, termination, and remedies).

There are a variety of different approaches to addressing these various issues, but the threshold step is to recognize and anticipate the problem.

§ 1.02 Background

[1] Deepwater

Deepwater, defined by the Minerals Management Service (“MMS”) as 1,000 feet of water or greater, has shown an enormous increase in oil and gas exploration, development, and production within the past few years. Operators continue to set and surpass records in water depth and length using new and improved technology. While initial exploratory action proceeded at a slow pace in the deepwater of the Gulf of Mexico, companies still invested in the development of technology and were rewarded with high-producing reserves.

[2] Types of deepwater facilities

There are several deepwater development systems used in the Gulf of Mexico, according to the MMS website.¹

1. Fixed Platform: consists of a jacket (a tall, vertical section made of tubular steel supported by piles driven into the seabed) with a deck. The deck provided space for crew quarters, a drilling rig, and production facilities. The fixed platform is economically feasible for water depths of up to 1,500 feet.

2. Compliant Tower: consists of a narrow, flexible tower and piled foundation, capable of supporting a conventional deck. The compliant tower can withstand significant lateral deflections and is used in water depths between 1,000 and 2,000 feet.

3. Tension Leg Platform (“TLP”): consists of a floating structure that is held in place by vertical, tensioned tendons connected to the sea floor by pile-secured templates. The

¹ <http://www.gomr.mms.gov>.

tendons allow the structure to have limited vertical motion. These platforms have been used in water depths approaching 4,000 feet.

4. Mini-Tension Leg Platform: consists of a floating, mini-tension leg platform that is relatively low cost and is used for production of smaller reserves.

5. SPAR Platform: consists of a large diameter vertical cylinder supporting a deck. There is a fixed platform with a surface deck with drilling and production equipment, three types of risers (production, drilling, and export), and a hull moored using a system of lines anchored to the sea floor. SPAR's are used in water depths up to 3,000 feet.

6. Floating Production System ("FPS"): consists of a semi-submersible unit equipped with drilling and production equipment. It is anchored in place with rope and chain or dynamically positioned through rotating thrusters. This system is used in a range of water depths from 600 to 7,500 feet.

7. Subsea System: ranges from single subsea wells producing to a platform, floating production system, or tension leg platforms to multiple wells producing through a manifold and pipeline system to a distant facility. This system can be used in water depths greater than 5,000 feet.²

² This information may be found at the Minerals Management Service website <http://www.gomr.mms.gov>. Another type of facility is a Floating Production, Storage & Offloading System ("FPSO"), which consists of a large vessel moored to the seafloor and is designed to process and stow production from nearby wells and to periodically offload stored oil to a smaller shuttle tanker. An FPSO is suited for remote deepwater areas where a pipeline infrastructure does not exist, but there are none currently in use in the Gulf.

§ 1.03 Applicable Law: Maritime Law, State Law, and the OCSLA

[1] Application of State Law Under OCSLA

In analyzing issues arising out of a deepwater construction contract, one of the critical threshold issues is what law applies. The legal 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 hereby 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.³

Accordingly, in the context of contractual disputes arising from operations conducted on the Outer Continental Shelf (“OCS”),⁴ the Fifth Circuit, in *Union Texas Petroleum Corp. v. PLT*

³ 43 U.S.C. § 1333(a)(2)(A) (1986).

⁴ The OCS is generally understood to include “the seabed and subsoil adjacent to the coastal nation, but beyond the [three mile] 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. However, through the OCSLA, Congress apparently intended the outer limits of the OCS to expand “as U.S. jurisdiction and control expand.” *Ibid*; 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).

Engineering,⁵ held that state law applies as surrogate federal law (pursuant to the OCSLA) 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. Each prong of this test creates its own issues.

[a] OCSLA situs

The OCSLA situs test is applied quite broadly and is satisfied relatively easily. For the OCSLA situs requirement to be met, the controversy must arise on the subsoil, seabed, or artificial structure permanently or temporarily attached thereto.⁶ If the facility being constructed is a fixed platform, this condition will easily be met.⁷ The same is true if the facility is a pipeline because the pipeline is permanently attached to the seabed,⁸ and the result should be the same for any subsea systems. There might be more of an issue when considering a deepwater facility such as a TLP or a SPAR, but both types of facilities have been found to be non-vessels because

⁵ 895 F.2d 1043, 1047 (5th Cir. 1990), *cert. denied sub nom.* Union Texas Petroleum Corp. v. State Serv. Co., 498 U.S. 848 (1990).

⁶ 43 U.S.C. § 1349(b); *Campbell v. Sonat Offshore Drilling, Inc.*, 979 F.2d 1115 (5th Cir. 1992); *Laredo Offshore Constructors, Inc. v. Hunt Oil Co.*, 754 F.2d 1223, 1226-27 (5th Cir. 1985).

⁷ See, *e.g.*, *Scott v. Delmar Offshore Serv. Inc.*, 943 F. Supp. 764, 768 (S.D. Tex. 1996) (Galley hand's accident onboard fixed platform on OCS met situs prong of OCSLA application.); *Laredo*, 754 F.2d at 1226-27.

⁸ *Union Texas Petroleum v. PLT Engineering*, 895 F.2d at 1047.

of their relative permanence so the same conclusion regarding situs should apply.⁹

Consequently, the main question regarding situs, if any, probably would relate to an FPS or an FPSO. Even with those facilities, however, the courts would likely find OCSLA situs once the facilities were in place using the same theory that applies to jack-up rigs and other special purpose vessels, *i.e.*, when the rig is jacked up and its legs become “temporarily attached” to the seabed.¹⁰ In other words, most facilities on the OCS, even drilling rigs (at least when in contact

⁹ Fields v. Pool Offshore, Inc., No. CIV.A. 97-3170, 1997 WL 767634 at 982 (E.D. La. Dec. 8, 1997); McKay v. Offshore Specialty Fabricators, Inc., No. CIV.A. 97-2077, 1997 WL 289365, at *2 (E.D. La. May 30, 1997).

¹⁰ See 43 U.S.C. 1333(a)(1) (1986); Dennis v. Bud’s Boat Rental, Inc., 987 F. Supp. 948, 950 n.6 (E.D. La. 1997). According to the legislative history of the 1978 amendments to § 1333(a)(1), it is “clear that federal law is to be applicable to all activities on all devices in contact with the seabed for exploration, development, and production. The committee intends that federal law is, therefore, to be applicable to activities on drilling ships, semi-submersible drilling rigs, and other watercraft, when they are connected to the seabed by drillstring, pipes, or other appurtenances, on the OCS for exploration, development, or production purposes.” H.R. Rep. No. 95-590, 95th Cong., 2d Sess. 128 (1977), reprinted in 1978 U.S. Code Cong. & Admin. News 1450, 1534; but see Dupre v. Penrod Drilling Corp., 788 F. Supp. 901 903-04 (E.D. La. 1992) (apparently rejecting the suggestion that a jack-up rig’s “attachment” to seabed through the drillstring satisfied the situs prong for OCSLA application); Falcon Operators, Inc. v. P.M.P Wireline Serv., Inc., No. CIV.A. 97-825, 1997 WL 610825 (E.D. La. Sept. 30, 1997) (In a case involving a worker injured while walking on a gangway between a fixed platform and a jack-up rig, the court did not remark upon the fact that the jack-up rig’s legs were touching the sea

with the seabed), satisfy the OCSLA situs test. Consequently, the most important test is likely to be whether maritime law applies “of its own force.”

[b] Federal law applying of its own force

Federal law will apply “of its own force” when the issue implicates a federal statute or, more commonly, when a dispute involves a maritime contract. Whether a particular contract can be properly characterized as “maritime” depends on (1) the situs of its performance or execution, and (2) the nature and character of the contract.¹¹ In many instances, before a contract can be considered maritime, the analysis focuses on whether there is a direct link between the contract and a vessel’s operation or maritime commerce.¹² For example, if a drilling contract requires the services of a jack-up or semi-submersible drilling rig, such drilling rigs are considered to be

bottom in making its OCSLA situs analysis.); *Demette v. Falcon Drilling Co.*, 280 F.3d 492, 498 (5th Cir. 2002).

¹¹ *Davis & Sons, Inc. v. Gulf Oil Corp.*, 919 F.2d 313, 316 (5th Cir. 1990); *Theriot v. Bay Drilling Corp.*, 783 F.2d 527, 538 (5th Cir. 1986).

¹² *J.A.R., Inc. v. M/V Lady Lucille*, 963 F.2d 96 (5th Cir. 1992) (A maritime contract is one that relates “to a ship in its use as such, or to commerce or navigation on navigable waters, or to transportation by sea or to maritime employment.”); *Davis & Sons*, 919 F.2d at 316; *Theriot*, 783 F.2d at 538-39; *AGIP Petroleum Co. v. Gulf Island Fabrication, Inc.*, 920 F. Supp. 1330, 1339 (S.D. Tex. 1996); see *Wilson v. J. Ray McDermott & Co.*, 616 F. Supp. 1301 (E.D. La. 1985) (“[D]rilling and other oilfield-related contracts are to be construed by admiralty law if the contract affects operations aboard a vessel.”) (emphasis in the original).

vessels and the law is clear that such contracts are governed by maritime law.¹³ However, if the drilling will be performed from a drilling rig stationed on a platform, maritime law does not apply of its own force because the platform is considered to be an island, and the law of the adjacent state is applicable pursuant to the OCSLA.¹⁴ This type of analysis, while potentially very important in other contexts,¹⁵ is not necessarily the most accurate framework for analyzing what law applies to an offshore construction contract.

[i] Pre-*Davis & Sons* cases

One of the preeminent Fifth Circuit cases involving the maritime contract issue is *Davis & Sons v. Gulf Oil Corporation*.¹⁶ However, the applicability of the *Davis & Sons* analysis to non-personal injury cases, particularly construction cases, has been questioned. In any event, to understand the *Davis & Sons* analysis of the issues, a brief review of some of the prior jurisprudence is helpful.

¹³ Smith v. Penrod Drilling Corp., 960 F.2d 456, 459-60 (5th Cir. 1992); Campbell, 979 F.2d at 1123-24; Vickers v. Chiles Drilling Co., 822 F.2d 535, 537 (5th Cir. 1987); Mobil Exploration & Producing U.S., Inc. v. A-Z/Grant Int'l Co., 1992 WL 186975, No. CIV.A. 91-3124, at *2 (E.D. La. Jul. 28, 1992); Seaux v. Lynn, 708 F. Supp. 134, 136 (E.D. La. 1989).

¹⁴ See Demette v. Falcon Drilling Co., Inc., 280 F.3d 492 (5th Cir. 2002).

¹⁵ The parties to the construction contract will have various other contracts, and the law applicable to each contract is analyzed separately. Consequently, the framework for determining what law applies to other contracts will significantly impact how all the contracts, particularly any drilling contracts, fit together. See section 1.04 *infra*.

¹⁶ 919 F.2d 316 (5th Cir. 1990).

In *Laredo Offshore Constructors, Inc. v. Hunt Oil Company*,¹⁷ the court determined whether maritime jurisdiction existed over a claim for breach of a contract to construct a fixed platform on the OCS. The court held that maritime law did not apply to that contract. The court acknowledged that the contract undoubtedly contemplated the hiring of vessels and seamen to build the structure (*i.e.*, maritime obligations), but the court held that the principal obligation, the construction of a stationary platform, was a non-maritime obligation.¹⁸ To this day, *Laredo* remains the most directly applicable Fifth Circuit jurisprudence addressing the law applicable to a contract to construct an offshore platform, and the analysis is presumptively equally applicable to construction of any deepwater facility that is not considered a vessel (*i.e.*, a TLP or SPAR). Under *Laredo*, such a deepwater construction contract would be governed by the law of the adjacent state under OCSLA.¹⁹

In *Union Texas*,²⁰ a significant non-personal injury case, the Fifth Circuit again focused on the principal obligation of the contract despite the presence of significant maritime performance. At issue were many subcontracts entered into in conjunction with a principal contract to construct an offshore pipeline. The court held the subcontracts were governed by

¹⁷ 754 F.2d 1223 (5th Cir. 1985).

¹⁸ The court did find, however, that there was federal question jurisdiction under the OCSLA because the controversy was connected with an operation conducted on the OCS “involving the development of mineral resources.” *Id.* at 1224-25.

¹⁹ See also *Wagner v. McDermott, Inc.*, 79 F.3d 20, 22 (5th Cir. 1996), (holding that a subcontract for welding in connection with construction of an offshore platform was not a maritime contract).

²⁰ 895 F.2d at 1043.

state law rather than maritime law, although some maritime operations were undoubtedly contemplated. The court considered the subcontracts collectively (rather than looking individually at the particular service provided under each subcontract) and concluded that the OCSLA required application of state law because the principal contract was non-maritime. Under this decision, a contract to construct an offshore pipeline would be governed by state law. However, the district court in *In the Matter of Torch, Inc.*,²¹ accepted the argument that maritime law was applicable to the portion of a pipe-laying contract that involved a vessel.²²

[ii] *Davis & Sons*

In *Davis & Sons v. Gulf Oil Corp.*,²³ the Fifth Circuit, noting “apparent” inconsistencies in the jurisprudence, outlined a two-part test “based on a fairly consistent underlying approach” utilized by previous cases to determine whether a contract was governed by maritime law. First,

²¹ No. CIV.A. 94-2300, 1996 WL 185765, at *8 (E.D. La. April 16, 1996).

²² This latter analysis would have been supported by the result in *Lewis v. Glendel Drilling Company*, 898 F.2d 1083, 1086-87 (5th Cir. 1990), in which the Fifth Circuit held that a contract for the drilling of an offshore well and a contract to furnish a barge rig was a maritime contract. Following *Theriot v. Bay Drilling Corporation*, 783 F.2d 527 (5th Cir. 1986), the Court found maritime law applicable. It was difficult to reconcile the pre-*Davis & Sons* cases, which was clearly acknowledged in *Lewis*; however, one possible common thread related to the nature of the underlying claim. Non-personal injury cases, such as *Union Texas* and *Laredo*, for example, saw courts stretching to apply state law. See *Sohyde Drilling & Marine Co. v. Coastal States Gas Producing Co.*, 644 F.2d 1132 (5th Cir. 1981); *Houston Oil & Minerals Corp. v. American Int'l Tool Co.*, 827 F.2d 1049 (5th Cir. 1987).

²³ 919 F.2d 313, 315-16 (5th Cir. 1998).

the court considered the “historical treatment in the jurisprudence” of the particular type of contract at issue, which prevented any impact on the drilling contract cases. Second, the court outlined the following six-pronged fact specific inquiry: (1) What did the specific work order in effect at the time of injury provide?; (2) What work did the crew assigned under the work order actually do?; (3) Was the crew working aboard a vessel in navigable waters?; (4) To what extent did the work being done relate to the mission of that vessel?; (5) What was the principal work of the injured worker?; and (6) What work was the injured worker actually doing at the time of the injury?

While the *Davis & Sons* analysis is generally considered the current test, clearly the factors articulated by the court emphasized the application of the test to a case involving personal injury as opposed to property damage.²⁴ In any event, however, the analysis ultimately focused

²⁴ *Davis & Sons* was purportedly followed in *Domingue v. Ocean Drilling & Exploration Co.*, 923 F.2d 393 (5th Cir. 1991), *cert. denied sub nom. Ocean Drilling & Exploration Co. v. Dimensional Oilfield Serv.*, 502 U.S. 1033 (1992). *Domingue* involved a contract to perform wireline services on a jack-up drilling rig. The Fifth Circuit concluded that wireline services were non-maritime in nature and were insufficiently related to the mission of the vessel to take on “a salty flavor.” The court’s analysis in *Domingue* is very questionable but the ultimate holding has not yet been revised. On the other hand, *Campbell v. Sonat Offshore Drilling, Inc.*, 979 F.2d 1115, 1120-21 (5th Cir. 1992), characterized a contract to provide drive pipe, hammer work, and casing services aboard a jack-up drilling rig provided by another party as maritime. Although the contractor did not provide the vessel, the contract was nevertheless found to be maritime in nature based on the performance of the contract aboard a vessel and the contribution of the services to the vessel’s mission. *Campbell* and *Domingue* form the bookends in this area

more on the significance of the transportation function of the vessel involved as opposed to focusing primarily on the principal obligation of the contract. Based on a review of the six factors, which demonstrated that the plaintiff's accident in *Davis & Sons* arose during the fulfillment of a work order calling for maintenance activities to be conducted from a special purpose vessel, the court held that the work order and the blanket agreement should be viewed as a maritime contract. This conclusion was based in part on the court's determination that the transportation function of the vessel was more than merely incidental to its primary purpose of serving as a work platform, and that the plaintiff contributed to the accomplishment of the vessel's mission. This type of analysis could easily support the conclusion that a contract requiring the use of a vessel, such as an offshore construction contract, should be governed by maritime law.

Thereafter, in *Smith v. Penrod Drilling Corporation*,²⁵ the Fifth Circuit determined whether a contractual claim for indemnity arising when an employee was injured while standing on a fixed platform performing workover operations was maritime. Noting that the workover operations were performed pursuant to a general contract for the drilling and completion of a well using a jack-up drilling vessel, the court, applying the *Davis & Sons* analysis, found that the contract was governed by maritime law. While this arguably was required by the prior jurisprudence concerning drilling contracts, *Smith* shows that the *Davis & Sons* analysis can

of jurisprudence with respect to evaluating the applicable law for contracts performed on a jack-up drilling rig. How contracts in the spectrum between these two cases will be resolved is still an open question, and one that will have a significant impact on how offshore construction contracts fit with other related contracts.

²⁵ 960 F.2d 456 (5th Cir. 1992).

support the conclusion that it is the importance of the vessel, not the location of the work, that is critical.²⁶

In a non-personal injury case after *Union Texas*, a district court in *Freeport McMoran Resource Partners v. Kremco, Inc.*,²⁷ held that a contract to design and construct three drilling rigs was non-maritime. Finding the six factor test set forth in *Davis & Sons* inapplicable in a non-personal injury case, the court relied heavily on *Laredo* and *Union Texas*. Whether the Fifth Circuit will accept a distinction based on whether or not the underlying claim is related to personal injury, however, remains to be seen.²⁸

²⁶ See also *Dupre v. Penrod Drilling Corp.*, 993 F.2d 474, 477-78 (5th Cir. 1993) (Under *Davis & Sons* test, contract to supply and use a vessel to drill and complete oil wells was maritime.); *Dupont v. Sandefer Oil & Gas, Inc.*, 963 F.2d 60, 62 (5th Cir. 1992) (not applying the *Davis & Sons* analysis, but reaching correct decision that contract to provide jack-up drilling rig and to drill and complete a well was maritime by distinguishing *Thurmond* and *Domingue* as not requiring the furnishing of a vessel as a principal obligation of the contract).

²⁷ 827 F. Supp. 1248, 1251-52 (E.D. La. 1993).

²⁸ The court in *Kremco* distinguished *Theriot*, *Lewis*, and *Smith* on the ground that the contract at issue in *Kremco* did not require that a vessel be provided. It is not possible, however, to construct an offshore platform without providing a vessel, which was arguably acknowledged by the court in both *Laredo* and *Kremco*. While the court may well have been bound to follow *Laredo*, the most supportable rationale for the result in *Kremco* would have been that a contract to construct a vessel is not a maritime contract (*J.A.R., Inc. v. M/V Lady Lucille*, 963 F.2d 96 (5th Cir. 1992)), and therefore a contract to construct a drilling rig cannot be maritime either. The stated rationale (that the contract did not require providing a vessel) appears to be factually

It appears that the most likely distinction to be made in conjunction with what law applies to an offshore construction contract is the distinction between design and fabrication on one hand and transportation and installation on the other. In *AGIP Petroleum Co. v. Gulf Island Fabrication, Inc.*,²⁹ the district court was faced with various tort and contract disputes arising out of the construction of an offshore platform. Relying on *Laredo* and *Molett v. Penrod Drilling Co.*,³⁰ the court concluded that the design and fabrication contracts were non-maritime and were governed by law of the adjacent state as surrogate federal law under OCSLA. Accordingly, any contractual choice of law provisions were held to be invalid. On the other hand, there was a separate contract to transport and install the vessel, and that contract was held to be maritime. The result in *Gulf Island* raises questions as to whether it would be beneficial from a choice of law standpoint to consider entering into separate fabrication and installation contracts.³¹ In addition, the analysis used in *Gulf Island* leaves open the argument that even a single contract might be considered a mixed contract if it incorporated both the onshore fabrication and the transportation/installation component,³² but any such argument would arguably be inconsistent with the result in *Laredo*. How all of this relates to a pipeline

incorrect as well as legally incorrect (inasmuch as *Campbell* demonstrates that a contract which does not call for the provision of a vessel can nevertheless be maritime).

²⁹ 920 F. Supp. 1330 (S.D. Tex. 1996).

³⁰ 826 F.2d 1419 (5th Cir. 1987).

³¹ There are other problems raised by separating the two contracts, the primary one being concern that any problem during installation will likely result in finger pointing between the two contractors.

³² See, e.g., *Hollier v. Union Texas Petroleum Corp.*, 972 F.2d 662 (5th Cir. 1992).

construction contract also remains unclear; *Union Texas* stands as precedent in favor of applying state law, but at least one district court, in *In re Torch*,³³ has reached a different result, and a contrary argument has significant theoretical validity.

[c] State law inconsistent with federal law

Most cases involving the law applicable under the OCSLA have involved enforceability of indemnity or insurance provisions. In the absence of a maritime contract, often the only argument for enforceability is that either the Louisiana Oilfield Indemnity Act (“LOIA”)³⁴ or the Texas Anti-Indemnity Act³⁵ is inconsistent with federal law. Neither of these arguments, however, has met with success in federal courts, which have repeatedly held that neither act is inconsistent with federal law.³⁶

[2] Effect of Choice of Law Provisions

If state law applies only as surrogate federal law under the OCSLA and maritime law is not applicable on its own accord, a maritime choice of law clause will not be enforced to avoid

³³ No. CIV.A. 94-3200, 1996 WL 185765, at *8 (E.D. La. April 16, 1996).

³⁴ La. Rev. Stat. Ann. § 9:2780 (West 1991 & Supp. 2002).

³⁵ Tex. Civ. Prac. & Rem. Code Ann. § 127.001(1)(B) (Vernon Supp. 1994).

³⁶ *Knapp v. Chevron USA, Inc.*, 781 F.2d 1123, 1130 (5th Cir. 1986); *Hodgen v. Forest Oil Corp.*, 87 F.3d 1512, 1528 (5th Cir. 1996); *Graham v. Freeport Sulphur Co.*, 962 F. Supp. 82, 84 (E.D. La. 1997); *Falcon Operators, Inc. v. P.M.P. Wireline Services, Inc.*, 1997 WL 610825, at *6 (E.D. La. Sept. 30, 1997); *Bourg v. Continental Oil Co.*, No. CIV.A. 95-3192, 1997 WL 79298, at *1 (E.D. La. Feb. 21, 1997).

application of a state anti-indemnity statute.³⁷ For instance, where Louisiana law is applicable to activities taking place on a fixed structure on the OCS, a maritime choice of law provision in the contract is unenforceable to avoid the LOIA. The court in *Matte v. Zapata Offshore Company*³⁸ held that the LOIA is a statement of Louisiana public policy and that an attempt to adopt maritime law to avoid LOIA's prohibitions is invalid. The OCSLA is considered a congressionally mandated choice of law provision.³⁹

In non-OCSLA situations, the result is not as clear. In *Roberts v. Energy Development Corp.*,⁴⁰ the Fifth Circuit held that Louisiana's conflicts of law articles govern the enforceability of a maritime choice of law clause with respect to operations on a fixed platform in Louisiana territorial waters, but also interpreted those articles as requiring application of the LOIA in a case involving a Louisiana contractor. However, in the construction context, there is a specific statute requiring application of Louisiana law.⁴¹ On the other hand, a recent Texas decision,

³⁷ *Matte v. Zapata Offshore Co.*, 784 F.2d 628, 631 (5th Cir.), *cert. denied sub nom. Zapata Offshore Co. v. Timco, Inc.*, 479 U.S. 872 (1986).

³⁸ 784 F.2d at 631.

³⁹ *Union Texas Petroleum Corp. v. PLT Engineering, Inc.*, 895 F. 2d 1043, 1050 (5th Cir. 1990). In *Hollier v. Union Texas Petroleum Corp.*, 972 F.2d 662, 666 (5th Cir. 1992), the Fifth Circuit held that a Texas choice of law provision did not apply to an action arising from a fatality on a platform adjacent to Louisiana because it violated the OCSLA.

⁴⁰ 235 F.3d 935, 942-43 (5th Cir. 2000).

⁴¹ La. Rev. Stat. Ann. § 9:2779 (Supp. 2002).

Chesapeake Operating, Inc. v. Nabors Drilling USA, Inc.,⁴² concludes that the law applicable to a particular contractual issue depends on the issue and the facts and concludes that a claim for contractual indemnity is governed by the law of the state in which the underlying suit was asserted. Accordingly, use of a maritime choice of law clause should be considered whenever possible, and there may be some benefit to attempting to select a forum contractually as well.⁴³

Significantly, maritime law does permit the enforcement of a Louisiana choice of law provision, including application of the LOIA, even though the contract would otherwise be considered maritime and the indemnity allowed.⁴⁴ Although a joint choice of law clause (*i.e.*, Louisiana law and maritime law) has been held not to preclude maritime law,⁴⁵ any potential ambiguity in a contract should be minimized. Even more importantly, a choice of law provision selecting only Louisiana law should be avoided at all costs unless the parties specifically intend for Louisiana law, and the LOIA, to apply in all instances, even if maritime law would otherwise be applicable.

Another applicable law issue relates to choice of law provisions that do not directly implicate state public policy issues. Many cases have broad language stating that the OCSLA is a mandatory choice of law provision. Nearly all of those cases, however, involved public policy statutes (such as the LOIA or the Texas Anti-Indemnity Act) or statutes such as the Louisiana Oil

⁴² Nos. 14-00-00173, 14-00-00580, 2002 WL 31628769 (Tex. App.-Houston [14th Dist.] Nov. 21, 2002).

⁴³ But see La. Rev. Stat. Ann. § 9:2779 (Supp. 2002).

⁴⁴ *Stoot v. Fluor Drilling Serv., Inc.*, 851 F.2d 1514 (5th Cir. 1988); see *Rodrigue v. Gros*, 563 So. 2d 248 (La. 1990).

⁴⁵ See *Angelina Casualty Co. v. Exxon Corp., U.S.A.*, 876 F.2d 40, 42 (5th Cir. 1989).

Well Lien Act (“LOWLA”) which may not rise to the level of public policy but at least comes fairly close. An argument can be made that many choice of law provisions would be enforceable under maritime law, the laws of the adjacent state, and presumably general federal common law, and that such consensual choice of law provisions should not be invalid just because they appear in a contract related to the OCS. This type of argument appears to have been adopted in *AGIP Petroleum Co. v. Gulf Island Fabrication, Inc.*,⁴⁶ in which the court honored a choice of maritime law and prohibited a party from recovering economic damages. The court reasoned that the parties were sophisticated entities that had allocated risks. However, there is no trend indicating that such an argument will prevail even though it would promote the parties’ ability to select an applicable law that might facilitate commercial development of the OCS, a goal in accordance with the purposes of the OCSLA.

[3] How is the “Adjacent” State Determined Under the OCSLA?

If the contract at issue involves a fixed platform on the OCS, and the OCSLA is implicated, which state’s law will apply? The OCSLA does not have a definition of “adjacent,” and the directive requiring the President to extend the boundaries of the states by determining the “projected lines” has never been implemented. Although at least one federal district court case seemed to support the conclusion that the test would be a factual one based solely on geographical proximity,⁴⁷ the Fifth Circuit has now held in *Snyder Oil Corp. v. Samedan Oil*

⁴⁶ 17 F.Supp. 2d 655, 658, 659 (S.D. Tex. 1998).

⁴⁷ *Pittencrieff Resources, Inc. v. Firstland Offshore Exploration Co.*, 942 F. Supp. 271 (E.D. La. 1996) (holding that a Joint Operating Agreement (“JOA”) covering Main Pass Blocks 253 and 254 was governed by Alabama law because the blocks were closer to Alabama than to Louisiana or Florida).

*Corp.*⁴⁸ that the test will be one that looks at various factors, including federal and state government agency determinations.

The result in *Snyder* is consistent with the one other case that contained a factual discussion as to what law applies under the OCSLA as the law of the “adjacent” state. In *Reeves v. B & S Welding, Inc.*,⁴⁹ the issue was whether a High Island Block was “adjacent” to Louisiana or Texas for purposes of the OCSLA. The court did not decide the issue, however, because the only two “acceptable” boundaries under the facts presented, the traditional boundary between the states and the boundary projected from Texas’ three league territorial boundary, both placed the disputed area under Texas law.⁵⁰ While the *Reeves* court may not have been presented with

⁴⁸ 208 F.3d 521, 524 (5th Cir. 2000).

⁴⁹ 897 F.2d 178 (5th Cir. 1990).

⁵⁰ In determining boundaries for distributing federal funds under the Coastal Zone Management Act of 1972, as amended in 1976, Congress directed Coastal Zone Management to establish “lateral seaward boundaries” on the basis of the international law applicable to lateral boundaries determinations. The boundary between Louisiana and Mississippi was established as the midpoint between (a) the line each of whose points are equidistant from the two applicable states (which would maximize federal waters considered to be “adjacent” to Louisiana) (the “equidistant line”) and (b) a line somewhat closer to Louisiana (which would expand the federal waters considered to be adjacent to Mississippi, and presumably Alabama) based on the “special circumstances” created by Louisiana’s curving coastline. The rationale of these two lines, and other alternatives, is discussed at length in *The Delimitation of Lateral Seaward Boundaries Between States in a Domestic Context*, 75 Am. J. Int’l. Law 28 (1981).

sufficient evidence to make a reasoned decision, the Fifth Circuit considered the MMS interpretation as well as geographical proximity as factors in its decision.

Based on the approach taken in *Snyder*, there may be no definitive answer as to what law will apply as the law of the “adjacent” state in areas where some of the factors may point to different jurisdictions and there has been no definitive court decision. *Snyder* provides guidance, but it also appears to leave some questions open.⁵¹

Ultimately, the determination as to what law will apply to an offshore construction contract can present some difficult issues. However, the conclusion will have a major impact on several provisions of the contract. This is particularly true in the area of liability risk allocation, which is discussed below.

§ 1.04 Liability Risk Allocation—Indemnity and Insurance

One of the most significant issues in any offshore construction contract relates to the liability risk allocation provisions, primarily indemnity and insurance obligations. Accordingly it is important to understand the various requirements and approaches to enforceable liability risk allocation. In addition, there are potential legal restrictions on indemnity and insurance, which need to be taken into account as well, both with respect to the construction contract itself and with respect to any other contracts that the parties may be entering into with third parties. As

⁵¹ For example, several cases have held platforms in the Main Pass Blocks to be adjacent to Louisiana with no discussion of possible application of Mississippi law, see, *e.g.*, *Freeport McMoRan Resource Partners, L.P. v. Kremco, Inc.*, 827 F. Supp. 1248 (E.D. La. 1992) (Main Pass 299); *Haynie v. Dynamic Offshore Contractors, Inc.*, No. CIV.A. 89-4552, 1991 WL 33615 (E.D. La., March 17, 1991) (Main Pass 116B), while *Pittencrief* focused solely on geographic proximity, as respects Main Pass Block 261.

discussed above, it is possible that maritime law will apply to some contracts (or perhaps to the installation portion of a construction contract) while state law (usually that of Louisiana or Texas, but not necessarily) applies otherwise.

[1] The Requirements for Enforceable Indemnities

There are various general requirements for an enforceable indemnity provision. Complying with these requirements is particularly critical if the indemnity is intended to apply without regard to fault, which is usually the case when allocating liability risks in advance.

[a] Is the intent to indemnify clear?

Under maritime law, an agreement to indemnify against the indemnitee's negligence is enforceable when the intent is expressed in clear and unequivocal terms.⁵² In *Randall v. Chevron U.S.A., Inc.*,⁵³ the court held that the words "howsoever arising" did not adequately express the parties' intent to provide indemnity for damages caused by the indemnitee's negligence. By comparison, the court in *Theriot*⁵⁴ found that language indemnifying one party "without limit and without regard to the cause or causes thereof or the negligence of any party" was clear and unequivocal.⁵⁵

⁵² *Theriot v. Bay Drilling Corp.*, 783 F.2d 527, 540 (5th Cir. 1986).

⁵³ 13 F.3d 888, 905-06 (5th Cir. 1994), *overruled on other grounds by* *Bienvenu v. Texaco, Inc.*, 164 F.3d 90 (5th Cir. 1999).

⁵⁴ 783 F.2d at 540.

⁵⁵ Thus, as a general proposition, it is permissible for a contract to require that one party (the indemnitor) indemnify another party (the indemnitee) for the indemnitee's own negligence. It is critical, however, that the intent be clearly expressed. To avoid any potential ambiguity, the indemnity provision should include a reference to "release" as well as "defend and indemnify."

Likewise, Louisiana law recognizes the right of indemnification for the negligence of the indemnitee if the intention is expressed in “unequivocal terms.”⁵⁶ Although no “magic words” are required, there should be mention of the “negligence” of the indemnitee in the contractual indemnification provision to avoid any alleged ambiguity. A Louisiana court has held that a clause excluding sole negligence evidenced the parties’ intent to encompass the negligence of the indemnitee.⁵⁷

Originally, Texas courts also followed the “clear and unequivocal” test.⁵⁸ In *Ethyl Corporation v. Daniel Construction Company*,⁵⁹ however, the Supreme Court of Texas rejected that test on the ground that it permitted ambiguity and allowed the indemnitee to conceal from the indemnitor the true intent of the indemnity provision. The court stated that thereafter the law of Texas would be the “express negligence doctrine,” that the intent to indemnify the indemnitee for his own negligence must be stated in specific terms. There must be express inclusion of indemnification for the negligence of the indemnitee. Unlike Louisiana law, it apparently is not sufficient under Texas law to provide indemnity for “causes of action of any nature whatsoever (except if caused by [indemnitee’s] sole negligence).”⁶⁰

⁵⁶ Perkins v. Rubicon, Inc., 563 So. 2d 258, 259 (La. 1990); Polozola v. Garlock, Inc., 343 So. 2d 1000, 1003 (La. 1977).

⁵⁷ DeWoody v. Citgo Petroleum Corp., 595 So. 2d 395, 397 (La. App. 3d Cir. 1992).

⁵⁸ Joe Adams & Son v. McCann Const. Co., 475 S.W.2d 721, 723 (Tex. 1971).

⁵⁹ 725 S.W.2d 705, 707-08 (Tex. 1987).

⁶⁰ Linden-Alimak, Inc. v. McDonald, 745 S.W.2d 82, 85-6 (Tex. App. -- Forth Worth 1988), *relying on* Singleton v. Crown Central Petroleum Corp., 729 S.W.2d 690 (Tex. 1987) (per curiam) (agreement which provided indemnity for “any and all claims, demands, * * * of every

It is advisable under all three tests, maritime, Louisiana, and Texas, for the contract to cover not merely indemnification for the “negligence” of the indemnitee, but to specifically include the “sole or concurrent” fault or negligence of the indemnitee. Otherwise, the indemnitor may argue that the provision is not sufficiently clear. For example, in *Atlantic Richfield Company v. Petroleum Personnel, Inc.*,⁶¹ a Texas appellate court denied indemnity because of the lack of a specific reference to the type of negligence covered (*e.g.*, sole or concurrent) even though the indemnity provision included coverage for all claims “including but not limited to any negligent act or omission” of the indemnitee. The Texas Supreme Court reversed on appeal, but any ambiguity should be avoided if possible.

Strict liability, unseaworthiness, and pre-existing conditions can make the situation different.⁶² However, the safest drafting approach is to include express references to strict liability, unseaworthiness, and pre-existing conditions.

kind and character whatsoever, * * * excepting only claims arising out of accidents resulting from the sole negligence of Owner” did not satisfy the express negligence test).

⁶¹ 758 S.W.2d 843, 844 (Tex. App. Corpus Christi 1988), *rev'd*, 768 S.W.2d 724 (Tex. 1989).

⁶² In *Sovereign Ins. Co. v. Texas Pipe Line Co.*, 488 So. 2d 982, 983-84 (La. 1986), the Louisiana Supreme Court held that indemnification for strict liability need not be stated in unequivocal terms if an intent to indemnify for strict liability can be gleaned from other language in the contract. Based on the reasoning in *Sovereign*, the court in *Owens v. U.S. Home, Inc.*, 552 So. 2d 998, 1005 (La. App. 1st Cir. 1989), refused to interpret an indemnity provision as providing indemnification for liability under article 667 of the Louisiana Civil Code where the court found no evidence of an intent to provide such indemnity in other provisions of the

[b] The “Conspicuousness” requirement

Under Texas law, in addition to the express negligence requirement, the indemnity provision must be sufficiently “conspicuous” that the indemnitor can be presumed to be sufficiently aware of and consent to the indemnity. In *Dresser Industries, Inc. v. Page Petroleum, Inc.*,⁶³ the Texas Supreme Court held that indemnity provisions and releases must be “conspicuous,” and adopted the standard for conspicuousness provided in the Texas Uniform Commercial Code.⁶⁴ Again, the safest drafting course is to comply with the conspicuousness contract. Applying general principles of contractual interpretation, the court construed the contract against the potential indemnitee/drafter because of its failure to make the indemnity provision clear with regard to indemnification for liability under article 667. In a similar federal case, *Mott v. Odeco*, 577 F.2d 273, 277-78 (5th Cir. 1978), *cert. denied sub nom. Ocean Drilling & Exploration Co. v. Quality Equipment, Inc.*, 440 U.S. 912 (1979), the Fifth Circuit, applying Louisiana law, held that pre-existing defects were not covered by the use of the phrase “any and all claims” in an indemnity provision. In addition to the above cases interpreting Louisiana law, the Texas Supreme Court in *Houston Lighting & Power Company v. Atchison, Topeka & Santa Fe Ry.*, 890 S.W.2d 455, 459 (Tex. 1994), held that parties to an indemnity agreement must expressly state their intent to cover strict liability claims.

⁶³ 853 S.W.2d 505, 510-11 (Tex. 1993).

⁶⁴ See Tex. Bus. & Com. Code Ann. § 1.201(10) (Tex. U.C.C.) (Vernon 1988). Indemnity provisions or releases located on the back of work orders in a series of uniformly numbered paragraphs with no heading and without contrasting type are not sufficiently conspicuous. *Dresser*, 853 S.W. 2d at 511. Similarly, an indemnity provision on the back of a contract in fine italic print is not conspicuous under Texas law. *McGehee v. Certaineed Corp.*, 101 F.3d 1078,

requirement, which should be easily satisfied by bolding or using all caps for the “magic language” portion of the indemnity provision.

[c] Duty to defend and right to recover defense costs

Whether the contractual obligation of the indemnitor to indemnify and/or to defend includes an obligation to reimburse defense costs depends on the applicable law. Under maritime law, it appears that the duty to indemnify includes the duty to defend.⁶⁵ The Fifth Circuit has interpreted Louisiana law as not allowing defense costs based solely on an obligation to indemnify. In *Perry v. Chevron, U.S.A., Inc.*,⁶⁶ the court held that a requirement that the indemnitor “shall indemnify and hold [indemnitee] harmless” was insufficient to satisfy Louisiana law’s requirement that attorneys’ fees could only be awarded if expressly provided for by contract or by statute. The contract did not mention that the indemnitor would defend the indemnitee or would pay attorneys’ fees. The court in *Perry* acknowledged that *Meloy v. Conoco, Inc.*⁶⁷ allowed reimbursement of defense costs under a contract that obligated the

1080 (5th Cir. 1996). In contrast, an indemnity or release that appears in an unhidden paragraph on the front side of a one page contract under a clearly identified and separate heading (and not surrounded by unrelated terms) satisfies the conspicuousness requirement. *Enserch Corp. v. Parker*, 794 S.W. 2d 2, 9 (Tex. 1990). The requirements of conspicuousness are inapplicable, however, when the indemnitor possesses actual knowledge of the indemnity agreement. *Dresser*, 853 S.W. 2d at 508 n. 2.

⁶⁵ *Lirette v. Popich Brothers Water Transport, Inc.*, 699 F.2d 725 (5th Cir. 1983).

⁶⁶ 887 F.2d 624, 629-30 (5th Cir. 1989).

⁶⁷ 504 So. 2d 833 (La. 1987).

contractor to “defend against claims . . . at no cost to Company.”⁶⁸ However, the court refused to decide whether the “duty to defend” allowed recovery of defense costs, citing an alleged conflict between *Stephens v. Chevron Oil Company*⁶⁹ and *Ogea v. Loffland Brothers Company*.⁷⁰ The existence of such a conflict, however, seems questionable as *Ogea* involved an issue different than that in *Stephens*.

Texas courts have determined that the duty to protect, indemnify and save harmless does include the payment of costs of defense.⁷¹ Without an express reference in the indemnification provision to claims based on negligence, however, there is no indemnity for defense costs incurred in connection with a negligence claim, irrespective of whether the claim is ultimately proved.⁷² The Louisiana rule is different in that it allows recovery of defense costs (assuming defense costs are covered in the applicable provision) even if there is no reference to negligence provided the indemnitee is found free from fault.⁷³

Absent a specific provision, an indemnitee has no right to recover legal fees incurred in seeking to prove the right to indemnification, as distinguished from legal fees expended to

⁶⁸ 887 F.2d at 629, *citing* Meloy, 504 So. 2d at 836 n. 4.

⁶⁹ 517 F.2d 1123, 1124-25 (5th Cir. 1975) (allowing attorneys’ fees where contract obligated indemnitor to “defend and hold Company . . . harmless”).

⁷⁰ 622 F.2d 186, 190 (5th Cir. 1980) (denying attorneys’ fees incurred as a result of a breach of a contractual obligation to provide insurance).

⁷¹ See, *e.g.*, *Delta Drilling Co. v. Cruz*, 707 S.W.2d 660, 667-68 (Tex. App. -- Corpus Christi 1986, *writ ref’d* n.r.e.).

⁷² *Fisk Electric Co. v. Constructors & Assocs., Inc.*, 888 S.W.2d 813, 813-14 (Tex. 1994).

⁷³ Meloy, 504 So. 2d at 836.

defend the principal claim on the merits.⁷⁴ A provision allowing recovery for attorneys' fees incurred in enforcing the contract can be negotiated into the contract. If the provision is reciprocal, however, it can be a double-edged sword.

[d] “Pass-through” indemnity

Absent express language, an indemnity provision will not cover the indemnitee's contractual liability to a third party.⁷⁵ An indemnity provision covering all claims for or on account of personal injury to a contractor's employee provides the indemnitee with protection if it is sued by the employee. If the indemnitee, however, has itself agreed to indemnify another party for such personal injury claims to its contractors' employees, and the other party (such as a drilling contractor) is sued, the indemnity from the employer/contractor will not cover the indemnitee's contractual liability to the third party. Under both Louisiana law⁷⁶ and maritime law⁷⁷ the indemnitee's contractual obligation to a third party “arises” from its contract with the third party not from the injury or claim by the plaintiff.

Obtaining protection for a contractual indemnity obligation requires a specific provision. One alternative is to require indemnity protection for any contractual liability to third parties.

⁷⁴ Texas Eastern Transmission Corp. v. McMoRan Offshore Exploration Co., 877 F.2d 1214, 1229 (5th Cir. 1989), *cert. denied sub nom.* Marathon Oil Co. v. McMoRan Offshore Exploration Co., 493 U.S. 937 (1989); Weathersby v. Conoco Oil Co., 752 F.2d 953, 959 (5th Cir. 1984).

⁷⁵ Foreman v. Exxon Corp., 770 F.2d 490, 495 (5th Cir. 1985); Corbitt v. Diamond M Drilling Co., 654 F.2d 329, 333-34 (5th Cir. 1981).

⁷⁶ Foreman, 770 F.2d at 495.

⁷⁷ Corbitt, 654 F.2d at 333-34.

Another alternative is to specify that the indemnity obligation is owed to the indemnitee and anyone to whom the indemnitee owes contractual indemnity. A third alternative is to expand the categories of persons or companies entitled to indemnity protection such that the indemnitor agrees to indemnify the indemnitee and (i) its related companies, (ii) its co-lessees, partners, etc., (iii) its other contractors and subcontractors, and (iv) all of their respective employees, etc. Absent one of these alternatives, or some other specific provision, the indemnitee will not be able to obtain indemnity protection for its contractual liability to a third party and will not be able to “pass-through” its indemnity protection to any such third party.⁷⁸

As discussed below, this can be a critical issue in an offshore construction contract because the construction contractor will generally want the Owner to indemnify the contractor for any bodily injury or property damage sustained by the Owner or its other contractors. Given this broad indemnity obligation, the Owner will have no back-up indemnity from its other contractors unless there is a “pass-through” indemnity provision in each of those other contracts, and the absence of such a “pass-through” indemnity can be very costly.⁷⁹

⁷⁸ An illustration of an effective “pass-through” can be found in *Campbell v. Sonat Offshore Drilling, Inc.*, 979 F.2d 1115, 1126-27 (5th Cir. 1992). There, the Fifth Circuit held that a contractor had a duty to defend and indemnify both an oil company and a vessel owner for its employee’s claims, because under the indemnity agreement, the contractor owed indemnity to both the oil company and its contractor (the vessel owner) (*i.e.*, the third alternative referred to above).

⁷⁹ For instance, if there is no “pass-through” provision in the other contract, the Owner may end up with more liability exposure than it would have had in the absence of any indemnity provision. In *Foreman v. Exxon*, 770 F.2d at 495, for example, an employee of an oil company’s

For the same reason, it is important that the construction contract have a provision that will “pass-through” the indemnity of the contractor (for claims for its people and property and subcontractors) to any other contractors of the Owner. Otherwise, if there is any underlying contract in which the Owner has agreed to indemnify one of its other contractors for bodily injury or property damage to the construction contractor, the Owner would owe indemnity for injuries to the contractor’s employees (and for damage to its vessel(s)), but would not have the ability to rely on the indemnity from the contractor.

The intent to provide this pass-through coverage must be clear. If the pass-through protection is intended to be provided by expanding the category of indemnitees, the Owner must be careful to put the expanded language in the indemnity provision or clearly cross-reference it

contractor was injured, and the plaintiff sued the oil company and the drilling contractor. The oil company owed indemnity to the drilling contractor for injuries to the contractor’s employees, such as the plaintiff. While the contractor/employer of the plaintiff owed indemnity to the oil company, the indemnity, however, did not cover the oil company’s obligation to the drilling contractor. At trial, the parties had to “switch chairs,” with the oil company defending the drilling contractor, and the contractor/employer defending the oil company. The court found both negligent, but the negligence of the drilling contractor was significantly greater than that of the oil company. Because of the indemnity, however, the oil company had to pay for the proportionate fault attributed to the drilling contractor, which was more than five times greater than that attributed to the oil company. Depending on the circumstances of each particular case, the availability of a “pass-through” indemnity can be critical.

in the indemnity provision.⁸⁰ One approach is to utilize a separate term, such as “Company Group,” to identify the parties entitled to indemnity.

[e] The scope of the indemnity

It is important to understand that the scope of indemnity depends on the specific contract language. If the indemnity broadly covers claims “arising out of” the work, the key inquiry may be whether the injuries were related to the work, not whether the activity of the tortfeasor arose out of the contract. In *Rodrigue v. LeGros*,⁸¹ the plaintiff was the captain of a vessel hired by

⁸⁰ In *Melvin Green, Inc. v. Questor Drilling Corporation*, 946 S.W. 2d 907, 910-11 (Tex. App. Amarillo 1997), for example, the court held that a consultant was not entitled to indemnity despite the fact that the indemnity obligation was owed to the “Operator,” which had previously been defined to include consultants. The court concluded that the unnumbered paragraph merely identified those entities with authority to direct the contractor. The court stated that if the parties wished to include consultants within the ambit of the indemnity provision, they should have done so specifically in the indemnity provisions or made the cross reference more clear. In a somewhat similar case, *Walter Oil & Gas Corporation v. Safeguard Disposal Systems, Inc.*, 961 F. Supp. 931, 934 (E.D. La. 1996), the court held that a definition of “Company” including “subcontractors” in the preamble of a master service contract was not sufficient to entitle the Company’s drilling contractor to indemnity from the service contractor. The court primarily relied on its conclusion that the drilling contractor was not a “subcontractor,” but also held that, in any event, the mere reference to “subcontractors” in the preamble of the contract would have been insufficient to put the service contractor on notice that the Company intended to shift its indemnity obligations (owed to the Company’s drilling contractor) to the service contractor.

⁸¹ 552 So. 2d 703 (La. App. 3d Cir. 1989), *aff’d* 563 So. 2d 248 (La. 1990).

Mobil to provide service to a rig drilling a well for Mobil. While transiting water en route to the drilling rig, the plaintiff's vessel was struck by another vessel owned by Mobil but not engaged in work being performed under the drilling contract. The court found that Mobil was entitled to indemnity, holding that the injury arose out of the performance of work under the contract. The court of appeal stated, "It does not matter that the fault-cause of the injury, the activity of Mobil's [other vessel], did not arise out of the performance of 'the Work.'"⁸²

The Louisiana Supreme Court in *Rodrigue* relied, in part, on *Fontenot v. Mesa Petroleum Company's*⁸³ broad interpretation of analogous language, stating:

As the court stated in *Fontenot* . . . the Fifth Circuit has "broadly construed language identical or similar to the 'arising in connection herewith' language . . . to unambiguously encompass all activities reasonably incident or anticipated by the principal activity of the contract." The court there ultimately concluded that "where the presence of the injured person at the scene of the injury is attributable to or might reasonably be anticipated by his employment responsibilities, then his injuries occur 'in connection with' those responsibilities." That is the situation here, so we find that the injury of the employee while engaged in contractual work is sufficient to support a conclusion that the claim resulted from that work.⁸⁴

⁸² *Rodrigue*, 552 So. 2d at 705-06.

⁸³ 791 F.2d 1207 (5th Cir. 1986).

⁸⁴ *Rodrigue*, 563 So. 2d at 257, *quoting* *Fontenot*, 791 F.2d at 1214-15 (citations omitted).

The *Rodrigue* court distinguished *Lanasse v. Travelers Insurance Company*.⁸⁵ *Lanasse* involved a time charter of a vessel and contained language limiting the indemnity to “claims for damages . . . directly or indirectly connected with the possession, navigation, management and operation of the vessel.” The *Lanasse* court held that the indemnity language was “too loose” to cover the claim because the cause of the accident, negligent operation of the crane, was not even remotely related to the operation, navigation or management of the vessel.⁸⁶

The cases since *Lanasse* have concerned whether contractual indemnity provisions are sufficiently broad to achieve indemnity coverage beyond that allowed in *Lanasse*. *Smith v. Tenneco Oil Company*⁸⁷ extended the *Lanasse* holding to include an indemnity agreement covering any claim that “arises out of or is incident to performance [of the charter].” The Fifth Circuit held that the arguably broader language made no difference. No indemnity was owed because the accident, which was caused solely by the crane operator’s negligence, was not directly or indirectly connected with the operation of the vessel.⁸⁸ The *Smith* court acknowledged that the sole fault of the oil company would not relieve the vessel owner of its indemnity obligation had the coverage of the indemnity provision been triggered.

⁸⁵ 450 F.2d 580, 582 (5th Cir. 1971), *cert. denied sub nom.* Chevron Oil Co. v. Royal Ins. Co., 406 U.S. 921 (1972).

⁸⁶ *Id.* at 582 n.4 and 583.

⁸⁷ 803 F.2d 1386, 1388 (5th Cir. 1986).

⁸⁸ See generally *Wilson v. Job, Inc.*, 958 F.2d 653 (5th Cir. 1992) (No indemnity was owed by vessel where contract employee, who was injured aboard vessel while cleaning drilling equipment under charterer’s orders, was engaged in drilling operations, not vessel operations.).

Despite *Smith*, it is possible to use contractual language that will broaden the scope of the indemnity coverage.⁸⁹ A similar problem involving restrictions on insurance coverage can also be resolved by using the proper contractual language in the insurance requirements.⁹⁰ While the problem is not as likely to occur under a construction contract, the potential impact of not having

⁸⁹ For example, in *Thigpen v. James L. Gray-Offshore, Inc.*, 620 So. 2d 494, 496-97 (La. App. 4th Cir.), *writ denied*, 626 So. 2d 1169 (La. 1993), the court distinguished *Lanasse* and held that an indemnity provision in a marine transportation contract providing indemnification for claims “arising out of or in any way incidental to, or in connection with, the performance of the work hereunder” was broad enough to include a claim for injuries sustained by a catering hand while receiving groceries from a truck onto a vessel. Yet another example of a sufficiently broad indemnity provision is *Gaspard v. Offshore Crane and Equip. Co.*, 106 F.3d 1232 (5th Cir. 1997). The indemnity provision there included indemnity for personal injury or death arising out of or in any way directly or indirectly connected with the “loading or unloading of cargo.” *Id.* at 1234. Based on the inclusion of the “loading or unloading of cargo” language, the Fifth Circuit allowed indemnity for an injury sustained on board a vessel resulting from platform negligence. Similarly, in *Clement v. Marathon Oil Company*, 724 F. Supp. 431, 433 (E.D. La. 1989), the indemnity provision provided indemnity for “the related activities of [the oil company] in the vicinity [of the vessel], including but not limited to loading or unloading.” Based on this broader provision, the court in *Clement* allowed indemnity for defense. Using a similar analysis, in *Lavergne v. Chevron U.S.A., Inc.*, 782 F. Supp. 1163, 1170-71 (W.D. La. 1991), *aff’d*, 980 F.2d 1444 (5th Cir. 1992), the court upheld a *Lanasse* argument based on the absence of indemnity language referring to loading or unloading.

⁹⁰ See section 1.04[2][b][ii], *infra*.

the appropriate language can be very significant, and the problem can occur in any situation involving a vessel that is working at or adjacent to a dock or any facility that is either a fixed platform or treated as such.

[2] Maximizing Insurance Protection

[a] General requirements

As a general rule, the insurance requirements should dovetail with the indemnity provisions, both for the purpose of insuring solvency and for the purpose of maximizing enforceability of the agreed risk allocation. Accordingly, there are certain general insurance requirements that should be included by the Owner whenever possible.

- Insurance protection should be extended to all indemnified parties (*i.e.*, use same defined term).
- The contract should require a waiver of subrogation in favor of all indemnified parties. This is particularly important in offshore installation contracts because of the magnitude of the property damage risk if there is loss or damage to the contractor's vessel(s).
- It is important that all indemnified parties be named as additional assureds.
- The insurance should be required to be primary as respects any other coverage in favor of the indemnitees, at least for risks assumed by the indemnitor. This precaution will avoid an argument that the indemnitee's insurer is also required to respond in the event of a claim based on "other insurance" clauses present in nearly all liability policies.

- The insurance requirements should state that the minimum limits are not a limitation or restriction on indemnity (except to the extent expressly mandated by applicable law).⁹¹
- The contract should include a provision requiring all subcontractors to meet the minimum insurance requirements (unless Owner concludes that a lesser requirement or leaving the issue up to the contractor is acceptable).
- There should be a requirement of advance notice to the indemnitee/additional assured of any policy cancellation, non-renewal, or material change.
- The applicable policies should be required to provide adequate territorial and navigation limits.
- There should be a requirement that the policies be obtained from acceptable/suitable insurers.
- Where required by applicable law, establish minimum limits (*i.e.*, Texas “unilateral” indemnity).
- If the contract includes a Texas “mutual” indemnity, the contract should include language in the indemnity provision requiring that each party obtain insurance for the benefit of the other as an indemnitee (with a reference to some minimum insurance or self insurance limit).
- For protection and indemnity policies, it is important to require an endorsement providing full coverage regardless of any “as owner” coverage restriction,⁹² and to delete any restriction of coverage in the event of limitation of liability.⁹³

⁹¹ Dickerson v. Continental Oil Co., 449 F.2d 1209, 1222 (5th Cir. 1971), *cert. denied sub nom.* Ins. Co. of North America v. Continental Oil Co., 405 U.S. 934 (1972).

- Depending on applicable law, insurance may provide more protection than indemnity. Under *Getty Oil Company v. Insurance Company of North America*,⁹⁴ insurance that does not directly support an indemnity may be fully enforceable without regard to the Texas Anti-Indemnity Act. But if the Louisiana Oilfield Indemnity Act may apply, consider possible application of *Marcel v. Placid Oil Company*,⁹⁵ which requires that the party receiving the insurance benefit bear all material cost of the insurance.

- Remember that if maritime law applies, insurance protection is enforceable even if the indemnity provision is invalid under section 905(b) of the Longshore Act.⁹⁶

To obtain full insurance protection, the most critical requirements are to include an additional insured provision, a waiver of subrogation provision, and a provision that insurance

⁹² Lanasse, 450 F.2d at 80; *Helaire v. Mobil Oil Co.*, 709 F.2d 1031, 1042 (5th Cir. 1983); *Texas Eastern*, 877 F.2d at 1214, *cert. denied sub nom.*; *Marathon Oil Co. v. McMoRan Offshore Exploration Co.*, 493 U.S. 937 (1989); *Gaspard*, 106 F.3d at 1232. See section 1.04[2][b][ii] for a discussion of this issue.

⁹³ *Crown Zellerbach Corp. v. Ingram Industries, Inc.*, 783 F.2d 1296 (5th Cir. 1986), *cert. denied*, 479 U.S. 821 (1986). See section 1.04[2][b][ii].

⁹⁴ 845 S.W.2d 794, 803-05 (Tex. 1992), *cert. denied sub nom. Youell & Cos. v. Getty Oil Co.*, 510 U.S. 820 (1993). For a discussion of the *Getty* exception to the Texas Anti-Indemnity Act, see section 1.05[3].

⁹⁵ 11 F.3d 563, 569 (5th Cir. 1994). For a discussion of the *Marcel* exception to the LOIA, see section 1.05[2].

⁹⁶ See discussion in section 1.05[1].

required under the contract will be primary.⁹⁷ In addition, all three of these insurance benefits should be owed to all entities for whom the Owner desires protection (*i.e.*, the entities protected by the indemnity provisions in the contract). Finally, the insurance provisions should have the same type of pass-through provision as the indemnity provision so that the insurance coverage is extended to the Owner’s other contractors and subcontractors (or those to whom the Owner owes indemnity or insurance protection).

[b] Insurance and indemnity interplay

[i] Insurance provisions may prime indemnity provisions

Whenever possible, insurance requirements should dovetail with the applicable indemnity provisions. An incautious statement in an indemnity provision may lead to a conclusion that an otherwise enforceable indemnity obligation is limited to the amount of insurance required under the contract. For example, language requiring the purchase of insurance with “limits of not less than” a specific dollar amount “to cover all obligations imposed” by the indemnity provision of the contract in *Dickerson v. Continental Oil Company*⁹⁸ was interpreted as restricting the

⁹⁷ In *Hodgen v. Forest Oil Corp.*, 862 F. Supp. 1567 (W.D. La. 1994), *aff’d in part, questions certified to Louisiana Supreme Court*, 87 F.3d 1512 (5th Cir. 1996), *cert. quest. denied*, 681 So. 2d 354 (La. 1996), *aff’d*, 115 F.3d 358 (5th Cir. 1997), the oil company was covered as an additional insured in the vessel’s Protection & Indemnity (P&I) policy. However, the district court held that the vessel policy had a stronger “other insurance” clause (“escape clause”) such that the oil company could not recover anything from the vessel’s insurers.

⁹⁸ 449 F.2d 1209, 1222 (5th Cir. 1971), *cert. denied sub nom.* Insurance Co. of North America v. Continental Oil Co., 405 U.S. 934 (1972); *Hicks v. Ocean Drilling & Exploration*

indemnity recovery to the required minimum limit of insurance. However, in *Smith v. Shell Oil Company*,⁹⁹ the court refused to limit a contractor's indemnity liability to the minimum insurance limits as required by the contract. Unlike *Dickerson*, the contract language in *Smith* did not state that the insurance was intended "to cover all obligations imposed" by the indemnity clause. The court concluded that there was no clear intent to limit liability to the stated limits of the required insurance. The *Dickerson* limitation is easily resolved by adding a sentence in the contract stating that the minimum insurance requirements are not intended in any way to limit the contractor's indemnity obligations.

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 indemnitees' liability policies, the Fifth Circuit concluded, in *Ogea v. Loffland Bros. Company*,¹⁰⁰ that the insurance obligation was primary and the indemnity obligation only secondary. Under this holding, when there are conflicting indemnity and insurance requirements, the insurance of the indemnitee must first respond up to the dollar limit of coverage. Only then must the indemnitor honor its hold harmless obligation to the indemnitee.¹⁰¹

Co., 512 F.2d 817, 826 (5th Cir. 1975), *cert. denied sub nom.* H. B. Buster Hughes, Inc. v. Ocean Drilling and Exploration Co., 423 U.S. 1050 (1976).

⁹⁹ 746 F.2d 1087, 1095 (5th Cir. 1984).

¹⁰⁰ 622 F.2d 186, 189-90 (5th Cir. 1980).

¹⁰¹ See also *Tullier v. Halliburton Geophysical Services*, 81 F.3d 552 (5th Cir. 1996); *Kelpac v. Champlin Petroleum Co.*, 842 F.2d 746 (5th Cir. 1988); *Woods v. Dravo Basic Materials Co.*, 887 F.2d 618 (5th Cir. 1989); *Ridings v. Danos and Curole Marine Contractors, Inc.*, 723 So. 2d 979 (La. App. 4th Cir. 1998); but see *Spell v. NL Indus., Inc.*, 618 So. 2d 17, 19 (La. App. 3d

In practice, this situation is often eliminated by the addition of a sentence limiting the applicability of the additional assured requirement to the risks and liabilities assumed by that party.

There are some situations in which insurance protection is more likely to be enforced than an indemnity obligation. In *Getty Oil Company v. Insurance Company of North America*,¹⁰² the Texas Supreme Court held that an additional insured provision that does not directly support an indemnity agreement is not prohibited by the Texas Anti-Indemnity Act. Accordingly, insurance protection can be fully enforceable under a contract governed by Texas law even if the indemnity provision is invalid.

[ii] Important vessel coverage endorsements

Protection & Indemnity (“P&I”) policies typically provide coverage to an assured in its capacity “as owner” of a vessel. This coverage restriction can be problematic in the context of offshore operations. When an oil company is named as an additional insured in a vessel owner’s P&I policy, the “as owner” language in the policy has been interpreted as limiting the oil company’s coverage to liability incurred in its capacity as charterer of the vessel. This was the holding of the Fifth Circuit in *Lanasse v. Travelers Insurance Company*,¹⁰³ where there was no P&I policy coverage for the platform-based negligence of the oil company’s crane operator.

Cir. 1993) (apparently an aberration resulting from contractor’s failure to obtain additional assured coverage for other party as required by contract).

¹⁰² 845 S.W.2d 794, 803-05 (Tex. 1992), *cert. denied sub nom.* Youell & Cos. v. Getty Oil Co., 510 U.S. 820 (1993); see also *Certain Underwriters at Lloyd’s, London v. Oryx Energy Co.*, 142 F.3d 255 (5th Cir. 1998).

¹⁰³ 450 F.2d at 584.

While there had been some conflict in the case law, the Fifth Circuit in *Randall v. Chevron U.S.A., Inc.*¹⁰⁴ made it clear that negligence of an operator in directing a vessel to operate in rough weather conditions constitutes negligence “as time charterer” and therefore qualifies as liability incurred “as owner” of the vessel for purposes of obtaining P&I coverage.

Subsequent to *Lanasse*, oil companies began including provisions in their charter agreements requiring vessel operators to have the “as owner” coverage limitation deleted from their P&I policies. In what was arguably *dicta*, the Fifth Circuit in *Helair v. Mobil Oil Company*¹⁰⁵ agreed that deletion of the “as owner” restriction expanded the scope of P&I coverage to include liability an oil company may have in its capacity as a platform operator. The ability to delete the “as owner” clause appeared, however, to have been negated by the Fifth Circuit’s decision in *Texas Eastern Transmission Corp. v. McMoRan Offshore Exploration Co.*¹⁰⁶ There, faced with an oil company’s non-vessel owner liability and a contractual provision allegedly seeking to expand the vessel owner’s P&I policy’s scope, the Fifth Circuit held, without discussion or citation of *Helair*, that there was no language in the policy that could be deleted to extend coverage to non-shipowners. More recently, the Fifth Circuit addressed this issue in *Gaspard v. Offshore Crane and Equipment, Inc.*¹⁰⁷ In *Gaspard*, the court held that the deletion of the “as owner” language may extend coverage to the oil company’s vessel related negligence, committed as platform owner. Thus, deletion of the “as owner” clause creates, at the

¹⁰⁴ 13 F.3d at 905-06.

¹⁰⁵ 709 F.2d at 1031.

¹⁰⁶ 877 F.2d at 1227-28.

¹⁰⁷ 106 F.3d 1232 (5th Cir. 1997).

very least, an issue of material fact as to whether such coverage exists.¹⁰⁸ In reaching this conclusion, the court relied on *Helair* for the principle that deletion of “as owner” can expand coverage to include negligence as platform operator. Thus, if the parties intended for the deletion of the “as owner” language to broaden the scope of coverage, then such coverage existed.

The court in *Gaspard* then addressed the apparent inconsistency between its holding and *Helair* on the one hand and *Texas Eastern* on the other. In *Gaspard* and *Helair*, the parties agreed to the deletion of the “as owner” language from the P&I policy, effectively broadening the scope of the coverage. In *Texas Eastern*, however, the contractual provision was not as clear, and the *Gaspard* court interpreted *Texas Eastern* as concluding that the charterer simply required that its coverage as additional insured should be co-extensive with that of the vessel owner; because the owner was not covered for acts of platform negligence, neither was the charterer. While *Gaspard’s* interpretation of the *Texas Eastern* decisions seems somewhat questionable, it is now clear that contractual and policy language can be expanded to provide coverage for platform negligence and that deletion of the “as owner” language is therefore crucial to achieve maximum protection. Accordingly, there should be language in the contractual insurance provision requiring an affirmative endorsement expanding the coverage afforded by the P&I policy.¹⁰⁹

¹⁰⁸ *Id.*

¹⁰⁹ It should also be noted that a typical indemnity in a contract involving vessel services will be interpreted as excluding liability incurred other than as owner of the vessel unless appropriate language is added expanding the indemnity provision to cover such activities as loading and unloading.

Importantly, the *Lanasse* analysis does not apply in the context of hull policies. In *Wiley v. Offshore Painting Contractors, Inc.*,¹¹⁰ the court held that the issuer of a hull policy on a vessel damaged in a fire caused by negligent operation of an offshore platform was not entitled to indemnification from the platform owner. The platform owner was an additional insured on the hull policy which covered the loss whether or not the loss resulted from the platform owner's operation or ownership of the vessel.

[3] Interaction Between Construction Contract and Other Contracts

The provisions of the Owner's other contracts can affect negotiation of the construction contract. To assume responsibility for its other contractors, by providing indemnity for claims by such other contractors or their employees as generally requested in an offshore construction contract, the Owner must (1) be entitled to equivalent protection from such other contractors and be able to pass such protection through to the construction contractor or (2) be willing to assume extensive unprotected risk. If the Owner recognizes the risk and works to insert a "pass-through" provision in its underlying contracts, the "pass-through" must be clear, or it will not be enforced.¹¹¹ Even if the "pass-through" provision is clear, however, the indemnity obligations in the underlying contract may not be enforceable if state law applies.

If the Owner will not have any other contractors involved in the construction project, these issues will not be too significant. However, it is difficult to know in advance whether other contractors will be involved. Consequently, it is beneficial for the Owner to understand and anticipate these issues. Each Owner will have a variety of contracts with other contractors. The three most prevalent "other" contracts in the context of a construction project are drilling

¹¹⁰ 716 F.2d 256, 257 (5th Cir. 1983) (*on reh'g*).

¹¹¹ See discussion in section 1.04[1][d].

contracts, master service agreements, and vessel charters (such as with crewboats, supply boats, and towing vessels). It is critical that the Owner understand what such contracts may be in place, and whether (and to what extent) the indemnity and insurance provisions in such underlying contracts will be enforceable.¹¹² In the absence of a good understanding of the impact of the underlying contracts, it is very difficult for the Owner to evaluate accurately the risks presented by certain provisions in the construction contract.¹¹³

§ 1.05 Exceptions to the Right to Seek Indemnity

Despite careful drafting and skillful negotiating, some indemnity provisions in deepwater construction contracts will simply be unenforceable due to some significant statutory exceptions

¹¹² Ideally, the Owner should be aware of what underlying contracts are likely to be implicated in connection with any particular construction contract, whether such underlying contracts contain “pass-through” provisions and whether the provisions of such underlying contracts are likely to be enforceable under the applicable law.

¹¹³ For example, some contractors may argue that they are unwilling to agree to a “pass-through” in a master service contract unless they receive a guaranty that they will receive the same protection from other contractors. Knowing whether such a provision is in place in the underlying contracts may make it easier for the Owner to agree to a broad reciprocal indemnity in the construction contract. For a more detailed discussion of the indemnity and insurance issues discussed herein, see William W. Pugh, “The IAOC Offshore Drilling Contract,” *Oil & Gas Development on the Outer Continental Shelf* 8-1 (Rocky Mt. Min. L. Fdn. 1998); William W. Pugh, “You Can’t Always Get What You Want, But You Can Avoid Costly Mistakes: Insurance Issues For Oil & Gas Operators,” 45 *Rocky Mt. Min. L. Inst.* 10-1 (1999).

to the right to seek indemnity. These exceptions include the LHWCA and the oilfield anti-indemnity acts from Texas and Louisiana.¹¹⁴

[1] LHWCA Section 905(b)

Section 905(b) of the LHWCA prohibits an indemnity claim by a “vessel” against the employer of an injured longshoreman. Because section 905(b) defines “vessel” very broadly so as to include not only a vessel and its owner, but also a charterer of the vessel, an Owner that enters into a construction contract for the use of a contractor’s installation vessel or pipelaying vessel can be considered a time charterer within the meaning of section 905(b) and therefore subject to the provision’s prohibition of indemnity.¹¹⁵ Section 905(b) does not prohibit indemnity from a non-employer. Similarly, section 905(b) does not prohibit a non-vessel from obtaining indemnity from an LHWCA employer. When an operator acts in more than one capacity, such as charterer of a crewboat and operator of a fixed platform, section 905(b) may

¹¹⁴ In addition, certain states, such as Mississippi, have construction anti-indemnity acts that would need to be considered if such state’s law could be applicable as the law of the adjacent state under OCSLA. See Miss. Code Ann. § 31-5-41 (Rev. 1990) (stating that indemnification agreements for a party’s own negligence are against public policy); see also *Accu-Fab & Const., Inc. v. Ladner*, No. CIV.A. 96-00692, 2000 WL 274291 (Miss. App. Mar. 14, 2000).

¹¹⁵ *Lewis v. Keyes 303, Inc.*, 834 F. Supp. 191, 195 (S.D. Tex. 1993), *cert. denied*, 502 U.S. 857 (1991); but see *Campbell v. Offshore Pipeline, Inc.*, No. 92-1189, 1993 U. S. Dist. LEXIS 10978 (E.D. La., Aug. 2, 1993) (Oil company that did not own or control the operation of a pipelaying vessel was not a “vessel” for purposes of section 905(b)’s indemnity bar).

preclude indemnity only for “vessel” negligence, *i.e.*, negligence in the capacity of vessel owner or charterer.¹¹⁶

A written indemnity provision in a contract between a “vessel” and an employer of an employee covered by the LHWCA is enforceable if the indemnity contains reciprocal obligations and relates to operations on the OCS. 33 U.S.C. section 905(c) provides in part:

Nothing contained in subsection (b) of this section shall preclude the enforcement according to its terms of any reciprocal indemnity provision whereby the employer of a person entitled to receive benefits under this chapter by virtue of section 1333 of Title 43 and the vessel agree to defend and indemnify the other for cost of defense and loss or liability for damages arising out of or resulting from death or bodily injury to their employees.

In other words, a “knock-for-knock” indemnity provision for work on the OCS is enforceable if it meets the requirements under section 905(c). Moreover, the reciprocal indemnity requirement of section 905(c) can be satisfied by pass-through indemnities from two of the owner’s contractors. In *Campbell v. Sonat Offshore Drilling*,¹¹⁷ the court required a contractor to defend and indemnify both an oil company and the owner of a vessel on which the contractor’s employee was injured because the contractor and the vessel, through contracts with the oil company, had explicitly agreed to reciprocally indemnify each other (through pass-through

¹¹⁶ Meredith v. A & P Boat Rentals, Inc., 414 F. Supp. 788, 791 (E.D. La. 1976); see Crutchfield v. Atlas Offshore Boat Service, Inc., 403 F. Supp. 920 (E.D. La. 1975) (permitting oil company to seek indemnity from employer for non-vessel negligence).

¹¹⁷ 979 F.2d 1115, 1124-25 (5th Cir. 1992).

indemnities) even though the two contractors were not in privity of contract with each other. A similar result was reached in *Demette v. Falcon Drilling Co.*,¹¹⁸ in which the drilling contractor was owed indemnity by the casing contractor, and vice versa, pursuant to pass-through provisions under which each contractor owed indemnity to the “other contractors” of the oil company.

At one point, there was an issue as to whether section 905(c) applied only to employees entitled to LHWCA benefits exclusively by virtue of the OCSLA. That argument has now been definitely rejected in *Demette* and section 905(c) applies to all parties entitled to LHWCA benefits “by virtue of” the OCSLA even if they would otherwise have been covered by the LHWCA.

Even if an indemnity is invalid under section 905(b) and section 905(c) is inapplicable, a requirement that the employer name the “vessel” (*i.e.*, the Owner) as an additional assured is fully enforceable despite section 905(b). “Neither the statute nor its legislative history suggests that additional assured clauses . . . are a proscribed form of indirect liability.”¹¹⁹ This is one of the reasons why it is critical that all parties entitled to indemnity protection also be named as additional insureds.

[2] The Louisiana Oilfield Indemnity Act

Louisiana Revised Statute section 9:2780, commonly known as the Louisiana Oilfield Indemnity Act (“LOIA”), was adopted in 1981. In the LOIA, the Louisiana legislature declared that a provision requiring indemnification would thereafter be void as against public policy to the

¹¹⁸ 280 F.3d 492, 1502-03 (5th Cir. 2002).

¹¹⁹ *Voisin v. O.D.E.C.O. Drilling Co.*, 744 F.2d 1174, 1177 (5th Cir. 1984); see *Price v. Zim Israel Navigation Co.*, 616 F.2d 422 (9th Cir. 1980).

extent that it provided indemnity for negligence on the part of the indemnitee or its agents, employees or independent contractors directly responsible to the indemnitee.

The LOIA, however, addresses only indemnification provisions for death or bodily injury to persons; indemnity for property damage is not precluded by the Act. Also, the courts have interpreted the LOIA as only applying to agreements “pertaining to a well,”¹²⁰ and the Fifth Circuit has adopted a two-step process for determining whether the LOIA applies.¹²¹ This two-

¹²⁰ For example, in *Clarkco Contractors, Inc. v. Texas Eastern Gas Pipeline Co.*, 615 F. Supp. 775, 781 (M.D. La. 1985), a federal district court found the LOIA inapplicable to a contract to perform services on an inland natural gas transmission line. The court acknowledged that subsection C of the LOIA referred to the transportation of oil or gas; however, the court noted that subsection C had to be read in conjunction with subsection A which references “agreements pertaining to wells for oil, gas, or water, or drilling for minerals.” As explained by the court in *Clarkco*, in enacting the LOIA, “the Legislature intended to include only transportation contracts pertaining to wells or drilling for minerals.” *Id.* at 781.

¹²¹ The approach taken in *Clarkco* was refined by the Fifth Circuit in *Transcontinental Gas Pipe Line Corp. v. Transportation Insurance Co.*, 953 F.2d 985 (5th Cir. 1992). Relying on a footnote in *Transcontinental Gas*, the court in *Nerco Oil & Gas, Inc. v. M. R. Friday, Inc.*, 816 F. Supp. 429, 431 (W.D. La. 1993), analogized numerous wells in an inland field to those that radiate from offshore production platforms, and found that a contract to perform maintenance at a compressor station connected to a number of inland wells pertained to one well. While not expressly overruling *Nerco*, the Fifth Circuit in *Johnson v. Amoco Production Co.*, 5 F.3d 949, 954 (5th Cir. 1993), limited the situation contemplated by *Transcontinental Gas* to offshore operations and held that a number of wells surrounding an inland facility are characterized as

step analysis used by the Fifth Circuit has been repeatedly followed by federal courts¹²² and the Louisiana state courts as well.¹²³

While it is not completely clear whether the courts would conclude that a contract relating to a deepwater construction project would necessarily be a contract “pertaining to a individual wells for purposes of the LOIA. The court went on to hold that contract work performed on a compressor station at an inland gas and oil processing facility did not “pertain to a well” so as to render the LOIA applicable.

¹²² See, e.g., *Broussard v. Conoco Inc.*, 959 F.2d 42, 45 (5th Cir. 1992) (LOIA applicable to contract to provide catering and maintenance services to offshore platforms); *Hanks v. Transcontinental Gas Pipe Line Corp.*, 953 F.2d 996, 999-1000 (5th Cir. 1992) (LOIA inapplicable to contract for construction of intermediate segment of interstate gas pipeline); *Thomas v. Amoco Oil Co.*, 815 F. Supp. 184, 188 (W.D. La. 1993) (LOIA not triggered based on lack of sufficient nexus between “a particular well” and the inland natural gas pipeline which was the subject of the agreement); *Brumfield v. Conoco, Inc.*, No. 93-1712, 1994 WL 321080 (E.D. La Jun. 28, 1994) (LOIA applied to void indemnity provision in blanket contract pursuant to which workover operations were performed at various wells on an offshore platform).

¹²³ The Louisiana Supreme Court adopted the *Transcontinental Gas* two-part analysis for application of the LOIA in *Fontenot v. Chevron U.S.A., Inc.*, 676 So. 2d 557, 564 (La. 1996). Louisiana courts have also cited *Clarkco* with approval and refused to extend the LOIA to agreements to perform services at petroleum refineries based on their finding that the legislature intended for the LOIA to apply to wells and drilling, not transportation or refining of oil. See, e.g., *Hutchins v. Hill Petroleum Co.*, 609 So. 2d 312, 319 (La. App. 3d Cir. 1992); *Griffin v. Tenneco Oil Co.*, 519 So. 2d 1194, 1196 (La. App. 4 Cir. 1988).

well,” the results in several cases indicate the LOIA would apply.¹²⁴ As to construction of a pipeline, the issue might well turn on whether the pipeline was being constructed as a gathering line or a transmission line.¹²⁵

There are few exceptions to the LOIA, particularly in the context of offshore operations. Even insurance protection for indemnity is generally invalid because subsection G of Louisiana Revised Statute section 9:2780 invalidates any contractual requirement that a party be named as an additional insured or be granted a waiver of subrogation if there is negligence on the part of the indemnitee.¹²⁶ Both the indemnitor and its insurer may use that defense when a demand is made for additional insured protection by the indemnitee. To the extent there is alleged privity of contract between the indemnitee/additional insured and the insurer under the additional insured provision, that agreement is considered “collateral to” a covered agreement, as set forth in Subsection I of the LOIA.

However, *Marcel v. Placid Oil Company* provides a narrow exception to this rule if the indemnitee/additional insured is able to prove that it paid all material costs for the required

¹²⁴ See *Verdin v. Ensco Offshore Co.*, 104 F. Supp.2d 682 (W.D. La. 2000); *Badeaux v. Torch, Inc.*, No. CIV.A. 88-4896, 1989 WL 140227 (E.D. La. Nov. 13, 1989); *Day v. J. Ray McDermott, Inc.*, 492 So. 2d 83 (La. App. 1st Cir. 1986).

¹²⁵ See authorities cited *supra* notes 120 and 121.

¹²⁶ *Babineaux v. McBroom Rig Building Service, Inc.*, 806 F.2d 1282 (5th Cir. 1987); see generally *Ridings v. Danos and Curole Marine Contractors, Inc.*, 723 So. 2d 979 (La. App. 4th Cir. 1998) (if LOIA applied to MSA, indemnitee would not be entitled to additional assured status in accordance with the MSA).

insurance.¹²⁷ Language that a contractor “may” be required to invoice insurance premiums allocable to work performed does not satisfy the exception.¹²⁸ An unwritten “working policy” whereby contractors could factor in the cost of procuring insurance when submitting bids to work likewise does not satisfy the exception.¹²⁹ Application of the *Marcel* exception was questioned to some extent in *Amoco v. Lexington*, but the facts in that case were unusual, and the Fifth Circuit has recently reaffirmed its application of *Marcel*. One other item to note is that special problems can arise when the proposed indemnitor is self-insured, which can make calculation of the premium difficult.¹³⁰

¹²⁷ 11 F.3d 563, 569 (5th Cir. 1994); see also *Rogers v. Samedan Oil Corp.*, 308 F.2d 477 (5th Cir. 2002); *Patterson v. Conoco, Inc.*, 670 F. Supp. 182 (W.D. La. 1987).

¹²⁸ *Brumfield v. Conoco*, No. 93-1712, 1994 U.S. Dist. LEXIS 8945 (E.D. La. Jun. 28, 1994).

¹²⁹ *Hodgen v. Forest Oil Corp.*, 87 F.3d 1512, 1529 (5th Cir. 1996).

¹³⁰ One other possible exception to the LOIA relates to a waiver of subrogation, but this exception may be limited in scope. In *Fontenot v. Chevron U.S.A.*, 676 So. 2d 557, 564-67 (La. 1996), the Louisiana Supreme Court enforced a waiver of subrogation clause contained in a contractor’s workmen’s compensation insurance policy pursuant to the oil company’s requirement. The court explained that such waivers are invalid only if they “frustrate or circumvent the prohibitions” of the LOIA. La. Rev. Stat. Ann. § 9:2780(G) (Supp. 2002). The court held that absent an indemnity claim, the waiver of subrogation clause in and of itself does not frustrate or circumvent the prohibitions of the LOIA; in such cases, the oil company is not shifting its liability to the contractor or its insurer. Moreover, the court stated, voiding the waiver of subrogation clause would actually punish the injured employee, as the insurer would

[3] The Texas Anti-Indemnity Act

Sections 127.001 through 127.008 of the Texas Civil Practice and Remedies Code Annotated constitute the most recent version of the Texas Anti-Indemnity Act. The Texas Anti-Indemnity Act applies to agreements pertaining to a well or to a mine, but section 127.001(4)(B)(i) specifically excludes purchasing, selling, gathering, storing, or transporting gas or natural gas liquids by pipeline or fixed associated facilities. Accordingly, a contract to construct a pipeline would arguably be unaffected by the Texas Act.¹³¹

Prior its amendment in 1989, the Texas Anti-Indemnity Act, by its terms, did not apply if the parties agreed in writing that the indemnity obligation would be supported by available liability insurance of the indemnitor. The indemnity allowed, however, was limited to the coverage and dollar limits of the insurance agreed to be furnished. The amount of insurance required could not exceed twelve times the state's basic limits for personal injury of \$25,000 (*i.e.*, \$300,000).

The Texas Anti-Indemnity Act now allows a unilateral indemnity up to \$500,000 and a mutual indemnity in an unlimited amount provided that each party agrees to provide insurance or self-insurance for the benefit of the other party as indemnitee. Section 127.001(3) defines “mutual indemnity obligations” as indemnity obligations whereby the contracting parties agree to indemnify one another “and each other’s contractors and their employees” for claims brought

be reimbursed out of his recovery. Accordingly, at least in this case, voiding the waiver was held to hinder, rather than promote, the purposes of the LOIA.

¹³¹ See Phillips Petroleum Co. v. Brad & Sons Constr., Inc., 841 F. Supp. 791, 796 (S.D. Tex. 1993) (“There is no language contained within the Act that encompasses work done in connection with a *pipeline*.”) (emphasis in original).

by their respective employees and their respective contractors and their employees and invitees for bodily injury, death, and damage to property.¹³² Section 127.001(6) defines a “unilateral indemnity obligation” as one in which the indemnitor agrees to indemnify the indemnitee for personal injury or death to the employees of the indemnitor or of the indemnitor’s contractors, with no reciprocal indemnification by the indemnitee to the indemnitor. There is no case specifically stating that all elements of the definition of “mutual indemnity” must be met for the indemnity to qualify as mutual, and *Mid-Continent Casualty Co. v. Swift Energy Co.*¹³³ authorizes some difference between the indemnitees of an oil company and those of a contractor. However, it will certainly be argued that the wording of the statute requires all elements to be met for the indemnity to qualify as “mutual” and a broad reciprocal should be used if a party wants to be certain the mutual indemnity exception will apply.

If the agreement contains mutual indemnity obligations, the Texas Anti-Indemnity Act used to require that the indemnity obligation be limited to the extent of the coverage and dollar limits of insurance or qualified self-insurance that each party as indemnitor had agreed to provide “in equal amounts” to the other party as indemnitee. That requirement, however, has been deleted by amendment, and Section 127.005(b) now just requires that each party agree in writing to support their respective indemnity obligations with insurance or qualified self-insurance that each obtains for the benefit of the other party as indemnitee.

Neither indemnity obligation, unilateral or mutual, will be enforced unless the parties have agreed that the obligations will be supported by liability insurance coverage furnished by

¹³² Note that the LOIA does not apply to property damage. *See* La. Rev. Stat. Ann. § 9:2780 (Supp. 2002).

¹³³ 206 F.3d 487, 495-97 (5th Cir. 2000).

the indemnitor. Under prior jurisprudence, where the indemnitor voluntarily provided more coverage than required, an indemnitee was permitted to collect indemnity up to the amount of insurance actually obtained.¹³⁴ The court in *Greene's Pressure Testing & Rentals, Inc. v. Flournoy Drilling Co.*¹³⁵ questioned whether the rationale of such jurisprudence still applies to the current provisions of the Texas Anti-Indemnity Act.¹³⁶ In addition, the court explicitly stated that the parties agreed that the indemnity provision was a “mutual” indemnity and therefore the unilateral indemnity provisions of section 127.005(c) did not apply. It is not clear whether the parties acquiesced in this result. It seems questionable whether an attempt to obtain mutual indemnity protection should automatically negate the ability to obtain a “unilateral” indemnity, which does not require insurance in equal amounts.

Significantly, the Texas Anti-Indemnity Act does not apply to insurance that does not directly support the indemnity. In *Getty Oil Company v. Insurance Company of North America*,¹³⁷ the court articulated two reasons for its conclusion that the purported additional insured provisions did not “directly support” the indemnity provision. First, the court noted that the last sentence of the indemnity provision expressly required that the seller obtain insurance covering the indemnity agreement and held that such insurance requirement was the one directly

¹³⁴ Campbell v. Sonat Offshore Drilling, Inc., 979 F.2d 1115, 1126 (5th Cir. 1992).

¹³⁵ 113 F.3d 47 (5th Cir. 1997).

¹³⁶ Despite this comment in *dicta*, there should be a good argument that the rationale of the prior jurisprudence remains applicable. Whether that argument will be accepted has not yet been resolved.

¹³⁷ 845 S.W.2d 794, 803-05 (Tex. 1992), *cert. denied sub nom.* Youell & Cos. v. Getty Oil Co., 510 U.S. 820 (1993).

supporting the indemnity, not the sentence in the insurance paragraph. Second, the court noted that the insurance requirements applied to all policies of the seller, not just the insurance required by the contract. It is not clear from the opinion whether both prongs of the court's analysis have to be met in order for *Getty* to apply, but both types of provisions should be included in drafting the construction contract.

[4] Keep Options Open

Given the potentially significant restrictions on indemnity and insurance, the best approach is to design a liability risk allocation scheme that maximizes the chances of enforceability as much as possible given a particular risk allocation scheme. In any particular construction contract, there may be sufficient variables to warrant changing the scheme somewhat, but the more often a consistent scheme is used, the more protection will be available and the more flexible the risk allocation program will be.

§ 1.06 Allocation of Risk of Loss or Damage to the “Work”

In any deepwater construction contract, risk of loss or damage to the facility or thing being built is perhaps the most critical issue. Many such contracts identify the facility being built, and any physical property designated for incorporation therein, as the “Work.” However it is described, risk of loss or damage to the Work at any stage of the project is an issue that must be addressed.¹³⁸ In addition, the standard reciprocal indemnity provisions do not work well for allocating risk of loss or damage to the Work. The contract usually provides that the Owner takes title to the Work as it is constructed, which would transfer full risk of loss to the Owner

¹³⁸ The risk of loss issue, and many other contractual issues, can become much more complicated if the project is being performed under a series of contracts, such as separate fabrication and installation contracts, rather than one single contract.

even though the contractor is in control of the Work and should have at least a substantial portion of the risk of loss.

Historically, risk of loss in large construction contracts, including deepwater projects, has most commonly been handled through a combination of contractual indemnity for some or all of the risk of loss, coupled with purchase of a Builders Risk insurance policy. Such insurance policies, often referred to as Construction All Risk (“CAR”) policies or Builders All Risk policies, typically provide broad insurance coverage for any loss or damage to the Work no matter how caused, unless there is an expressly applicable exclusion from coverage.¹³⁹

Some of the initial considerations in drafting the risk of loss provisions are whether there will be a Builders Risk policy (and, if so, which party will obtain the coverage), whether both Owner and contractor will be covered under the policy, and what level of risk will be assumed by the contractor. Given that the contractor is the party in control and is being paid to construct the Work, the contractor should always be required to assume some responsibility for loss or damage to the Work. However, the scope of this risk can vary dramatically. In some instances, the contractor is in the best position to obtain the Builders Risk policy. If so, the Owner should require that the contractor assume the contractual risk of loss as well; otherwise, the Owner would have the residual risk of loss without control over the terms of the Builders Risk policy or

¹³⁹ Courts have recognized the broad scope of “All Risk” coverage in the Builders Risk context and other insurance contexts; the concept is that the policy covers every risk that is not expressly excluded. See *Dow Chemical Co. v. Royal Indem. Co.*, 635 F.2d 379 (5th Cir. 1981).

a relationship with the insurers. In addition, if the contractor obtains the Builders Risk policy, the Owner needs to be included as a named insured in the policy.¹⁴⁰

On the other hand, even if the Owner obtains the Builders Risk policy, the contractor must retain some portion of the risk of loss sufficient to encourage the contractor to meet an appropriate standard of care; otherwise the contractor will have no financial incentive to avoid such loss or damage. At a minimum, the contractor should be responsible for the deductibles under the Builders Risk policy. In addition, the contractor's responsibility should apply "regardless of fault" to avoid any issues between contractor and Owner as to who or what caused the damage.

Sometimes the Owner will decide not to obtain Builders Risk coverage. In such event, the contractor should still be held contractually responsible for some portion of the risk of loss regardless of fault. Beyond that, the Owner should attempt to have the contractor retain some level of responsibility for loss or damage caused by the contractor since the contractor will still be in control of the project.

Once the determination has been made as to whether to obtain Builders Risk coverage, additional issues will need to be resolved concerning the scope of the coverage. If Owner obtains the coverage, the Owner will need to determine the extent to which it will extend such

¹⁴⁰ The protection afforded an additional insured is not as broad as that provided to a named insured. A party can sometimes be identified as an "additional named insured." In that instance, the scope of the protection afforded will depend significantly on the wording of the policy. In addition, the Owner will want to be sure that the Builders Risk protection extends to all parties for whom the Owner wants protections (such as co-lessees if applicable) and that some form of "pass through" provision is included. See section 1.04 [1][d] *supra*.

coverage to its construction contractor and/or to any other contractors.¹⁴¹ In addition, some coverage for third party liabilities or for damage to existing property has traditionally been available in conjunction with a Builders Risk cover, and the Owner must be comfortable as to whether it wants to extend any of those coverages to the contractor and/or others, what the terms of such extension will be, and the impact of such extension on the liability risk allocation provisions of the contract.

Even more significantly in today's market, if the Owner intends to extend coverage to its contractor under the CAR policy, the Owner must determine what policy conditions may be applicable to such an extension. If there are any requirements that must be met for the contractor to be extended coverage under the policy, the Owner must be certain that any such conditions are included in the contractual requirements that contractor must meet. Otherwise, there could be a gap between what the Owner has agreed to provide and what the insurers have promised. Consequently, the ideal approach for the Owner is to avoid being over committed by only agreeing that contractor can benefit from amounts that are actually paid under the Builders Risk policy, as opposed to agreeing that contractor will be protected. This is true as respects coverage afforded additional insureds under the policy and as respects coverage for problems caused by faulty workmanship or design which might otherwise be considered warranty work.

As respects coverage for additional insureds, for example, the WELCAR form, an increasingly used construction all risk wording, provides that in order for a contractor to be covered as an additional insured, it is a condition precedent that the contractor carry out all work

¹⁴¹ Even if contractor obtains the Builders Risk policy, similar issues will be present to some extent because the Owner will need to determine which of its other contractors, if any, should also be extended protection under the policy.

in full compliance with a suitable Quality Assurance/Quality Control (“QA/QC”) program that may require pre-approval. Of course, such a provision in the CAR policy necessitates corresponding provisions in the contract. Moreover, questions as to what level of QA/QC program is required to satisfy this requirement remain unanswered, which means that an Owner must be careful about assuming risk of loss resulting from contractor fault.

On the performance side, the tightening insurance market has resulted in reduced coverage, if any, for conditions that result from faulty workmanship or faulty design. This will increase the ultimate potential exposure for contractors (by reducing coverage for warranty repairs that might otherwise have been covered by insurance). In addition, it will make it even more important for the Owner to be sure that it has obtained the level of warranty protection that it intends. In other words, as the insurance market tightens, the risks that will need to be allocated without benefit of insurance protection will increase. This will make it even more important for the parties to be sure that the contractual performance provisions are properly drafted to reflect the parties’ intent. Provisions relating to performance, warranty, default, termination, remedies, and force majeure are always important, but they can be even more important if Builders Risk coverage has been significantly reduced or eliminated.¹⁴²

¹⁴² Another example of significantly reduced coverage is in the context of terrorism. Prior to September 11, coverage for acts of terrorism was not excluded from most standard all-risk property insurance policies; instead, the industry focused on, but did not usually invoke, the war risk exclusion. After September 11, however, the insurance industry acted swiftly to exclude coverage for acts of terrorism when writing new policies. An insured must now purchase terrorism coverage, if available, at potentially uneconomic prices. For existing policies a crisis also emerged. Reinsurers, unfettered by state filing and approval requirements, announced their

§ 1.07 Contractual Provisions Relating to Performance Issues

From start to finish, a deepwater construction project is a huge undertaking in terms of time, cost, and manpower. In addition, any particular project can be significant to the Owner's bottom line. Accordingly, basic provisions relating to performance (such as issues relating to delay, cost overruns, standard of care, warranty, default, termination, and remedies) have increased importance. Recognizing and addressing some of these potential issues in advance can prevent major problems later on.

[1] Delays, Cost Overruns, and Changes

There is an inherent tension between the Owner's desire to have the project started timely and completed on schedule, and the contractor's desire to protect itself from liability for delay. The contractor will always resist responsibility for the actual cost of delay,¹⁴³ which will generally be huge from the standpoint of lost revenue sustained by the Owner or even from the standpoint of potential additional costs incurred. Moreover, it is much better for the Owner to

intentions to exclude terrorism coverage under new contracts. Primary insurers, who needed approval from state regulators for revisions, were left with gaps in coverage. The year 2002 saw some large companies offering terrorism coverage at more competitive rates. Still, the insurance amounts may be too low, the premiums may be too high, and the policy may be canceled on short notice. In addition, to avoid gaps in coverage, it is important to be certain that the terrorism coverage mirrors the exclusion in the insurance policy. Gregg J. Loubier & Jason B. Aro, *Insuring the Risks of Terror*, 25 Aug. L.A. Law 18 (2002).

¹⁴³ A release of consequential damages is one of the first provisions that the contractor will try to insist on. In addition, contractors can have significant consequential damages as well, so a mutual release is not without benefit to the Owner.

avoid delay (or at least control it) than it is for the Owner to have to enforce judicial remedies. Consequently, the ideal approach is to structure the contract in such a way that the contractor has strong incentives to start on time and stay on schedule.

One approach to addressing delay is to provide for liquidated damages. However, it is important to avoid a situation in which no consequence can be imposed until after the contract has been completed or is already delayed beyond the completion date. In either of those situations, the problems will already be so far along that any resolution will be difficult. Using milestones can ameliorate some of this problem by allowing the Owner to address delay problems earlier in the process. From the Owner's standpoint it is even better to require a specific work schedule that is continually updated. Then, if the schedule is not being met, the Owner can become involved in determining how best to get back on schedule. In addition, it can be extremely helpful to have a provision that requires the contractor to provide additional manpower and incur additional expense to the extent necessary to minimize the impact of any delay. If the project schedule is closely monitored, and the contractor is required to recapture or minimize any unwarranted delay, many problems can be solved before they get out of control.

The method of compensation can have a large impact on how delay can be handled. If payment is on a lump sum basis, the contractor has every incentive to minimize delay in order to reduce the need to incur additional manpower or other costs.¹⁴⁴ On the other hand, if the contractor is being paid on a time and materials basis, it must be clear in the contract that any additional expenses incurred to minimize delay are the responsibility of contractor and will not be reimbursed. Of course, in either instance, the contractor will resist such provisions or at least

¹⁴⁴ However, lump sum compensation can encourage the contractor to cut corners, although this risk can be minimized by strong warranty requirements.

attempt to cap its exposure by providing a maximum limit. Use of a cap only works, however, until the maximum is reached, at which point the Owner is totally without protection and the contractor has no further incentive to solve any problem. Consequently, if the cap approach is used, the Owner, at a minimum, should have some type of additional remedy – such as perhaps having the right to incur additional expenses to solve the problem and then deduct some percentage of those expenses from the contractor’s compensation.¹⁴⁵

The cost overrun problem is closely related to the delay issue. The best solution is to structure the contract in such a way that the contractor has a strong incentive not to exceed the anticipated cost and there is a mechanism for keeping track of total cost on a regular basis. With that solution, the Owner has the opportunity to identify a problem at an early stage, and the problem is much more likely to be manageable. Again, there should be provisions allowing the Owner to shift the impact of inappropriate cost overruns to the contractor.

One significant concern with respect to both delay and cost overrun issues relates to changes requested by the Owner or requests by the Owner that the contractor later claims were “changes.” The Owner needs the ability to make changes to the Work as the project proceeds, but the contractor cannot be allowed to unduly limit its scope of work. On the other hand, if there is a true change in the scope of work, the contractor can legitimately argue that any delay or excess cost resulting from such changes should be the responsibility of the Owner. The issue can be further exacerbated when the contractor claims that delay caused by a change requested

¹⁴⁵ If compensation is on a cost reimbursable basis (such that contractor’s costs are always reimbursed but some or all of contractor’s profit can go up or down based on ultimate project time or total project cost), the Owner would want there to be some additional remedy if delay or cost exceeded a particular point.

by the Owner, or some other action by the Owner, has impacted the critical path of the project such that the effect of a minor delay has become magnified or the costs have been dramatically increased.

The best solution to the problems relating to changes is twofold. First, the contract should expressly require that any change in the scope of work for which contractor seeks additional compensation must be memorialized in a written change order signed by an authorized representative of the Owner.¹⁴⁶ This will prevent surprises as respects what is considered a “change.” Second, the change order provision should clearly provide that contractor will not receive any additional compensation or extension as a result of any change unless the contractor has identified in the change order any increase in cost or delay that would be caused by a proposed change.

Ultimately, problems with delays, cost overruns, and changes get much worse with the passage of time. The Owner needs to anticipate how and when such things may occur and draft provisions that will allow the Owner to monitor the status and become proactive if necessary. Most importantly, there must be a mechanism for making the contractor assume monetary responsibility for resolving such problems; otherwise, the problems will probably just get worse. A contractual right to claim that the contractor is in default or to seek termination may be an illusory remedy if the cost to the Owner in additional delay and expense is beyond what the Owner can justify. As discussed below, this may be particularly true in the later stages of an offshore construction contract and is therefore to be avoided if at all possible.

[2] Standard of Care and Warranty Protection

¹⁴⁶ Who that representative should be and what should be the scope of his authority are also questions that should be considered.

In entering into a deepwater construction contract, the Owner essentially expects two things: (1) that the contractor will perform the Work in accordance with the appropriate industry standard; and (2) that the contractor at the end of the day will have constructed a facility that is not defective and does what the Owner wants. However, translating these two expectations into contract provisions is often easier said than done.

As respects standard of care, the Owner's underlying assumption is that it has picked a quality contractor that will perform quality work. However, articulating the expected standard of care and identifying the applicable industry standard can be difficult. In addition, any reference to a heightened standard of care will be met with skepticism by the contractor. Nevertheless, the Owner's goal should be to have the contractor agree to perform in a good and workmanlike manner in accordance with the "highest" industry standards applicable to the deepwater construction industry. Identifying the parameters of such a standard at trial may be difficult, but the Owner will at least be able to argue that any actions that would have been taken by others in the industry to insure quality performance should have been undertaken by the contractor.

Breach of warranty, on the other hand, should ideally be much easier to prove because the Owner has the opportunity to describe what the warranty obligations include. In other words, if the Owner expects the facility to perform at a certain level, it should require a performance warranty. The difficulty is that the contractor will strongly resist any warranty of fitness for a particular purpose. The contractor will also be reluctant to provide any performance warranty at all unless the contractor has been hired to perform, and is responsible for, the entire project, from design through installation. Given these two ends of the spectrum, the Owner's goal should be to develop warranty provisions requiring that the Work be free of defects and comply with all specifications and contractual requirements for a negotiated period of time. In addition,

performance warranties should be negotiated to the extent they can be agreed upon. If nothing else, the exercise should help the Owner compare its expectations with those of the contractor. As with many of the other issues, identifying expectations by anticipating problems is the best way to achieve the desired performance.

The Owner should also make clear that warranty work is to be performed by the contractor at its sole cost and that the Owner has the right to perform such warranty work itself (or through others) and obtain reimbursement if contractor does not meet its obligations.¹⁴⁷ In addition, it is important to make clear that warranty obligations are separate from any indemnity obligations, particularly if the Owner has assumed any portion of the risk of loss or damage to the Work. Again, at a minimum, the parties should know what their expectations are in this regard.

[3] Default, Termination, and Remedies

If a deepwater construction project reaches the point where the Owner is seriously considering terminating the contract, the situation is probably disastrous – the delays and increased costs that are likely to result from attempting to change contractors are enormous. Accordingly, everything possible should be done to cure a problem before the issue of termination is ever considered. In many respects, that should be one of the main purposes of a well-drafted default provision in this type of contract – to provide a means of identifying performance problems and requiring that the contractor cure the problem before it becomes so bad that there are no viable solutions.

¹⁴⁷ As noted in section 1.06 regarding Builders Risk coverage, the Owner may agree that contractor can benefit from any payment made under a Builders Risk policy, but the Owner should be very careful not to make any promises concerning the scope of coverage.

The default provision should require the contractor to remedy any defect in performance as promptly as possible under the circumstances. Ideally, there should also be a maximum time period within which the deficiency must be fixed. From the Owner's viewpoint, all costs and delays incurred in remedying the default should be the responsibility of the contractor, or at least subject only to any paramount provisions such as a waiver of consequential damages.¹⁴⁸

Moreover, once a default has occurred, the Owner should have the right, in its discretion, to suspend performance, but such a provision will be resisted, particularly if the contractor is in the process of promptly curing the problem. One compromise solution is to provide for a right to suspend only if the work can not be continued safely or the contractor fails to promptly remedy. This tactic allows contractor to fulfill its obligations, but provides a prompt remedy if contractor fails to do so.

If termination for cause becomes necessary, it is important for the termination provision to be clear as to the causes for termination and the effect. If possible, the contract should allow the Owner to terminate if it becomes apparent that the contractor will not to be able to comply with the contract. For instance, if it becomes clear that the contractor will not be able to meet a required deadline, the Owner should have the right to terminate at that time rather than having to

¹⁴⁸ In some instances, depending on what other work may be ongoing simultaneously, it may be desirable to specify that a default that is not cured within a specified period of time will entitle the Owner to recover delay damages from the contractor (whether liquidated or based on actual costs) because of the Owner's inability to proceed with other work. If such a provision is agreed upon, then it should be expressly mentioned and excluded from the waiver of consequential damages.

wait for the deadline to pass.¹⁴⁹ In addition, the provision should make it clear that the Owner is the Owner of all physical and intellectual property that has been created for the project, or relates to it, and that the contractor will execute whatever assignments or other documents, including any required assignment of subcontracts, necessary to evidence such ownership. The termination provision should also identify the Owner's remedies, particularly if the contractor attempts to insist on an exclusive remedy provision.

One difficult area that arises in connection with termination relates to the Owner's desire to have the ability to terminate the contract, without cause, should the Owner's circumstances change or the Owner otherwise decide that it does not want to go forward with the project.¹⁵⁰ The issue becomes what is the measure of payment by the Owner to contractor in such an instance. There will be no dispute that the Owner must pay contractor for the work already performed, including the profit related to that portion of the work. The question, however, will center around what penalty there should be for early termination. The contractor will often claim

¹⁴⁹ Of course, to defend the termination, the Owner would have to prove that the contractor "could not" meet the particular deadline. Consequently, it is advisable to include a provision that if there is a delay or some other performance problem, the contractor, upon request, must provide the Owner with its plan to remedy the delay or performance problem. If the Owner believes that it can prove that the plan is not feasible or can not succeed, that would provide a basis for supporting a termination.

¹⁵⁰ Somewhat similar issues can arise in connection with termination as a result of a force majeure, but such a termination, by definition, must result from some cause over which the Owner has no control, so the equities are somewhat different. The monetary issues, however, can be similar because the contractor is losing its anticipated revenue through no fault of its own.

that it is entitled to the full contract price (perhaps less any amounts saved) or a very large early termination fee; the Owner will respond that it should not have to pay profit or overhead in connection with work that was not performed. Ultimately, resolution of these issues relating to the amount of the penalty will determine whether the Owner has any practical right to withdraw from the contract and, if so, at what point exercise of that right becomes completely impractical. The issue, however, is an important one from the Owner's perspective because it is very difficult to anticipate what events might occur that would dramatically change the Owner's desire to move forward with any particular project.

From a remedies standpoint, the most important goal is for the Owner to be sure that it has thought through what remedies it expects to have if something goes badly wrong with the contract. The ideal approach for the Owner is to reserve all of its remedies and resist the contractors' efforts to obtain an exclusive remedy provision. However, Owner's remedies will already be restricted if the contract contains a waiver of consequential damages (which will prevent the Owner from fully recovering its ultimate damages unless there is a liquidated damages penalty that approximates such losses).¹⁵¹ In any event, the next best approach is for the Owner to be able to recover (1) at least some liquidated damages for delay and (2) all additional costs incurred by Owner in having the contract reformed by another contractor. Such additional costs however, can be very high, and the contractor will likely attempt to cap such costs and will resist posting any security for its proper performance. Accordingly, the Owner must consider what the effects of a termination will be and determine whether it is willing to accept any restriction on its remedies (other than as set forth in the consequential damage

¹⁵¹ In addition, the warranty provision will often contain a sole remedy provision, so the effect of that provision in the event of termination must be considered as well.

waiver). In addition, it is important that the Owner avoid agreeing to any cap or limitation of liability that would apply to all parts of the contract. At a minimum, the indemnity and insurance provisions and the allocation of risk of loss or damage to the Work should be unaffected by any limitation of liability on the part of the contractor.

§ 1.08 A Case Study: *AGIP Petroleum Co., Inc. v. Gulf Island Fabrication, Inc.*

Having examined several of the most important considerations in deepwater construction contracts, it is helpful to look at how some of these issues occur in the context of an actual case. For example, *Agip Petroleum Co. v. Gulf Island Fabrication, Inc.*,¹⁵² demonstrates some of the potential pitfalls that plague offshore construction contracts.

[1] Insured Losses and Risk Allocation

AGIP had contracted for Gulf Island to fabricate a platform jacket to be installed offshore of Louisiana. The contract provided that Gulf Island would provide all labor, supervision, equipment, and machinery, etc., required for delivery of the jacket and piles. Fabrication of the jacket included attachment of mud mats to provide stability to the jacket for positioning. The jacket was successfully fabricated and transported, but the mud mats broke loose and were eventually removed. The jacket sank and toppled over during pile driving activities, but it was salvaged and reinstalled over three months later.

Agip incurred over \$15,000,000.00 in costs and damages. Underwriters of Agip's policies paid up to the policy limits under a Builders Risk policy and excess policy, and then claimed that they were subrogated to Agip for the loss. Underwriters filed an action against Gulf Island asserting claims of negligence, breach of warranty, design defect, and misrepresentation. Gulf Island filed a counterclaim alleging breach of insurance contract, breach of warranty, fraud,

¹⁵² 920 F. Supp. 1318 (S.D. Tex. 1996), *aff'd*, 281 F.3d 1279 (5th Cir. 2001).

misrepresentation, breach of good faith and fair dealing, and violations of Texas law. Gulf Island claimed that Agip's Builders Risk policy covered it as an "other assured." Agip then filed its own suit for its uninsured losses.

The court first determined that the marine insurance contract was a marine contract within the federal admiralty jurisdiction. In the absence of clearly controlling federal precedent, however, state law applied. Because federal maritime law consistently held that there is no right of subrogation against an additional assured where the claim was covered under the principal assured's policy and because no Texas case suggested to the contrary, the court applied federal maritime law. Where there was no applicable federal law, the court applied Texas law, as the law of the state that had the "most significant relationship" to the issue in question.¹⁵³

Using traditional contract interpretation principles, the court determined that Gulf Island was an "other assured." The contract defined an "other assured" as "contractors and/or subcontractors and/or suppliers and any other Company, Firm, Person, or Party with whom the Assured(s) . . . have . . . entered into agreement(s) in connection with the subject matters of Insurance, and/or any works, activities, preparations, etc., connected therewith." The court determined that the subject matter of the insurance was the development of the leased block and that the contract between Gulf Island and Agip dealt with that development. The court found that the agreement to fabricate the jacket was included in the subject matter of the Builders Risk policy, and a manager of Agip had confirmed by letter that its Builders Risk policy covered Gulf Island.

¹⁵³ The insurance policy had been issued and delivered in Texas to a Texas defendant by a Texas company.

Having decided that Gulf Island was an additional assured, the court then held that underwriters could not assert any right of subrogation. In order for an insurer to assert a right of subrogation against its own insured, such intent must be clear and unequivocal in the policy. There was no such language in this policy. Furthermore, the court found that underwriters had waived any rights of subrogation against Gulf Island under the language of the policy as either an additional assured or as a contractor of Agip.

Underwriters argued that Gulf Island's comprehensive general liability policy covered this loss; however, the court found that Builders Risk, not CGL policies, generally covered this type of loss. Gulf Island had no contractual responsibility or independent duty to obtain additional Builders Risk insurance.

Underwriters also argued that the contract between Agip and Gulf Island limited the scope of coverage afforded to Gulf Island. The contract had provided that Agip was responsible for Builders Risk insurance for work during fabrication and loadout. Despite this language, the court held that the contract did not state that Gulf Island's coverage was limited or that Gulf Island was to procure Builders Risk coverage. Any ambiguity in coverage was construed in favor of coverage for Gulf Island.

[2] Contractual Waivers

Agip brought suit for its uninsured losses against McDermott, with whom it had contracted for the transportation and installation of the jacket; Snamprogetti USA, Inc., with whom it had contracted to supervise the design and fabrication of the jacket; Gulf Island, with whom it had contracted to fabricate the jacket; and Petro-Marine Engineering of Texas, Inc.,

with whom Snamprogetti had contracted to provide design and engineering services.¹⁵⁴ Agip alleged negligence, gross negligence, products liability, breach of contract and breach of warranty, and sought recovery for compensatory damages, including lost revenue from delayed production, and punitive damages.

Choice of law was critical as to Agip's tort claims because, under maritime law, many of Agip's damages would have been precluded under the "economic loss" rule. Under Louisiana state law, which would govern under OCSLA, Agip could recover. The court ruled that maritime law applied. Although the dispute met the OCSLA situs requirement, federal maritime law applied on its own force. The court focused particularly upon McDermott. Snamprogetti, Gulf Island, and Petro-Marine's contracts with Agip were for the design and construction of a fixed platform, not traditional maritime activities. McDermott's contract, however, was for supplying vessels and providing transportation and installation services, which the court found to be maritime in nature. The requirements of locality and nexus were met and admiralty law applied. Because one of the tortfeasors met the nexus, the nexus was also satisfied as to the other tortfeasors.¹⁵⁵ The court then applied the economic loss rule to prohibit Agip's recovery of lost revenues.

The court also prevented Agip from recovering any damages arising in negligence or strict liability that were contractually limited. The contract with Snamprogetti had waived

¹⁵⁴ AGIP Petroleum Co., Inc. v. Gulf Island Fabrication, Inc., 920 F. Supp. 1330 (S.D. Tex. 1996).

¹⁵⁵ But see *Debellefeuille v. Vastar Offshore, Inc.*, 139 F. Supp.2d 821, 824 (S.D. Tex. 2001) (criticizing *Gulf Island's* use of the proximate cause rule to assert admiralty jurisdiction over platform defendants and requiring a jurisdictional inquiry for each of multiple defendants).

special, punitive, indirect, or consequential damages. The contract with McDermott had waived any warranties and consequential damages. The contract with Gulf Island had waived consequential damages. The court granted summary judgment in favor of McDermott, Snamprogetti, Gulf Island, and Petro-Marine for lost production revenues, economic losses, and all claims limited by the contract. It denied summary judgment on Agip's claims for compensatory damages resulting from gross negligence or willful misconduct.

Likewise, the court granted summary judgment for the defendants on Agip's breach of contract and breach of warranties claims to the extent these damages were contractually barred, but denied claims resulting from willful or deliberate misconduct. The court applied Louisiana law under OCSLA to claims against Snamprogetti, Gulf Island, and Petro-Marine, but maritime law to claims against McDermott. Under both bodies of law, however, the court allowed Agip to recover damages for willful or deliberate breach of contract, but not for damages limited by contractual provisions. The court also found that Snamprogetti's warranty clause limited Petro-Marine's liability to Agip. This warranty clause required Agip to defend, indemnify, and hold Snamprogetti and its subcontractors, *e.g.* Petro-Marine, harmless, and limited Petro-Marine's liability to correcting defects in service.

[3] Uninsured Losses and Risk Allocation

Subsequently, Gulf Island, Petro-Marine and McDermott demanded coverage from Agip's underwriters for Agip's claims for uninsured consequential losses brought against them.¹⁵⁶ The contractors also wanted the underwriters to cover them for property damage. The court recognized that if the underwriters indemnified the contractors, Agip would be recovering

¹⁵⁶ Agip Petroleum Co., Inc. v. Gulf Island Fabrication, Inc., 3 F. Supp.2d 754, 755 (S.D. Tex. 1997).

from its insurers for excluded risks. Similarly, if the underwriters were to indemnify the contractors for the property damage, then the underwriters would be paying twice the coverage underwritten for the platform.

The court held that the underwriters were not responsible to Gulf Island, Petro-Marine and McDermott. Agip chose to not insure loss for delayed production and kept the risk for consequential damages. Thus, the underwriters were not required to cover those losses for Agip or the contractors. Even though the contractors were other assureds, the policy did not cover delay damages involving the insured property. The contractors also chose not to insure against a risk of loss of use and could not shift that loss to the underwriters.

[4] Choice of Law and Economic Damages

In subsequent litigation,¹⁵⁷ the court determined that maritime law governed the contract between Agip and McDermott that required McDermott to transport and install the platform. Agip's uninsured losses were estimated to be over \$47,000,000.00. Agip fought hard for the application of Louisiana law, which would have allowed recovery of its purely economic losses.

The contract between Agip and McDermott specified that maritime law would apply, and the court honored that choice. The court reasoned that McDermott was a sophisticated entity that had allocated the risk among itself and its insurers. Agip's loss was a risk that it chose to bear by not insuring and not excusing McDermott from bearing the loss. Had Agip selected Louisiana law, McDermott would have bid the job based on its potential liability under that law rather than maritime law. The court correctly recognized that allowing a party to change a choice of law raises the other party's costs.

¹⁵⁷ Agip Petroleum Co., Inc. v. Gulf Island Fabrication, Inc., 17 F. Supp.2d 658 (S.D. Tex. 1998).

The court also found that Agip's contract with McDermott was maritime. The contract required McDermott to load the platform on its boat, carry it to the gas field, and to use the boat to erect the platform, "quintessential maritime activities."

The following year, the court revisited the consequential damages claim brought against McDermott.¹⁵⁸ Although its contract with McDermott specifically excluded consequential damages, Agip argued that it could recover if it proved gross negligence. The court disagreed, finding that Agip had negotiated for a blanket ban to consequential damages. Agip therefore saved costs by limiting McDermott's liability and had made a choice to exclude these damages from its remedies. Agip's attempt to circumvent the contract by making a tort claim was actually a claim for breach of the implied warranty of workmanlike performance. Again, the court found that the waiver of the contract precluded recovery.

[5] Lessons to be Learned

The results in the *Gulf Island* case illustrate the importance of anticipating how the parties intend certain issues to be resolved. In the offshore construction business, risks have to be taken, but it is important to try to understand and plan for those risks in advance to the maximum extent possible.

§ 1.09 Conclusion

There are a variety of other issues relating to deepwater construction contracts that have not been discussed in this paper. To begin with, any offshore construction must comply with the myriad of applicable federal regulations, MMS Notices to Lessees, Letters to Lessees, and

¹⁵⁸ Agip Petroleum Co., Inc. v. Gulf Island Fabrication, Inc., 56 F. Supp.2d 776 (S.D. Tex. 1999).

similar agency requirements.¹⁵⁹ In addition, there can be U.S. Coast Guard and customs issues if any of the vessels involved are foreign flagged or any portion of the facility is being constructed overseas. There will also be environmental issues and many other concerns. In many instances, however, the most important issues relate to liability risk allocation, allocation of risk of loss to the work itself, and allocating the contractual risk between the parties as to what happens if something goes wrong from a performance standpoint. Recognizing these key considerations, and anticipating and addressing the potential problems, is where foresight and preparation is critical.

¹⁵⁹ See, *e.g.*, 30 CFR Part 250.900 et seq. (MMS regulations); 33 CFR Part 67 (Coast Guard regulations); 33 CFR Part 322 (Corps of Engineers regulations); NTL No. 2006-N06 (crane load tests on fixed platforms); NTL No. 2001-G08 (structure removal).