Why the BP Macondo Gulf Blowout is Important …and It's Not What You Think

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On the morning of April 20th, 2010, multiple safety equipment and procedural failures in the Macondo oil well allowed the escape of high pressure methane gas, causing a massive explosion on the *Deepwater Horizon* drilling rig (Letourneau, 2014). This explosion led to the largest oil spill disaster in U.S. history, but it is neither the environmental impact nor the 11 lives lost that caused many insurance professionals to anxiously await a Texas Supreme Court decision. These professionals knew the outcome would determine if additional insureds have full access to the policy or if their status can be restricted by the underlying contract (Letourneau, 2014).

Companies involved with the oil industry can sustain losses exceeding billions of dollars—losses that the admitted insurance market steers clear from ("AAMGA FAQ's", n.d.). Oil industry professionals rely on excess and surplus wholesalers to secure coverage for their unique risks. Because the oil industry's close relationship with excess and surplus wholesalers, anything that affects oil industry practice will have a substantial impact on the excess and surplus wholesalers that work with the industry. Until the Texas Supreme Court decision on Friday, February 13th, whether or not extending additional insured status in oil service contracts would be able to continue as common industry practice was in the air.

In normal contracting practice, the indemnity section allocates risk between the contracting parties, while the insurance section determines how those losses will be paid (Stanovich, n.d.). Typically, companies are proportionally responsible based on negligence; however, usually, one company's insurance policies are assigned as primary. The issue brought to question in the BP vs. Transocean case is, if a party is given additional insured status, does it have access to the full policy, or is their access limited to the extent that indemnities are assumed under the contract? In other words, when determining the extent of additional insured coverage, should only the insurance policy language be considered, or should the underlying drilling contract be taken into account (Scott & Krasner, 2014)? In the case of Macondo, the indemnity section of the Drilling Rig Contract between BP (Operator) and Transocean (Contractor) assigned BP responsibility for damages caused by subsurface pollution, and assigned Transocean responsibility for pollution originating on or above the water's surface. Under the insurance section of the contract, Transocean named BP as an additional insured on all insurance policies (Letourneau, 2014).

Following the incident, BP sought to collect as an additional insured under Transocean's policies but was denied coverage because the pollution was subsurface. BP appealed the decision, claiming that its additional insured status has no limitations in the insurance policy; essentially, that coverage should be determined based on insurance policy itself, not on drilling contract terms (Letourneau, 2014). The Texas Fifth Circuit court overruled the original decision based on precedent set in by Evanston Insurance Co. vs. ATOFINA Petrochemicals, in which the insurance policy rather than the service contract was used to determine the existence of additional insured coverage (Letourneau, 2014). However, the court withdrew the decision, asking the Texas Supreme Court to weigh in and consider two questions: First, does ATOFINA hold precedence given the marked differences between the service contracts in the two cases? Second, does the doctrine of *contra proferentem,* which holds that ambiguous terms be interpreted against the interests of the party who wrote the contract, apply? The doctrine was created to protect parties who have unequal bargaining power (Scott & Krasner, 2014). In this situation, however, both parties are considered subject matter experts.

This leads to the issue of whether it possible to restrict additional insured status through the drilling contract. Insurance policies customarily allow insureds to grant additional insured status as long as it is done in writing prior a loss. It is generally assumed that the additional insured status is restricted to the extent of the indemnity section of the underlying drilling contract, regardless of whether the limits are added to the insurance policy itself. This is because it is too administratively burdensome to endorse a policy every time additional insured status is granted. Regarding the BP case, a contract review lawyer in the oil industry explains that "depending on the outcome of the case, [companies like] Transocean will tell [companies like] BP, '[I]t doesn't look like there's any good contractual remedy for limiting your additional insured status, so you have the potential to exhaust our policy limits, leaving nothing for us…[so] we're not going to name you as an additional insured." Because both parties' intent is made clear in the indemnity section of the underlying contract, the situation illustrated here would force common industry practice to be replaced with the administrative inefficiency of endorsing each policy to the limits of contractual indemnity, all because of a technicality.

However, on Friday, February 13th, the Texas Supreme Court weighed in and determined that standard industry practice will stand (Dolon, 2015). The court claimed that no insurance contract would exist without the underlying drilling contract, so the two "are inextricably intertwined" and must be interpreted together (Fisk & Calkins, 2015). Oil industry professionals and the excess and surplus wholesalers that service them can rest easy for now…but not for long. Some professionals question whether contractual indemnity, and in extent, additional insured status, should even be legal. Four states now have anti-indemnity statues that specifically address the oilfield services industry: Texas, Louisiana, New Mexico, and Wyoming (Collura & Kelly, 2013). Anti-indemnity acts arise from the perceived inequalities in bargaining power of parties. Their purpose is to encourage fairness and limit the extent to which operators of oil and gas can transfer their own negligence to those with inferior bargaining power, which many view as an unfair burden on the little guy—it leaves the services company responsible for its own negligence as well as the negligence of the operator (Robertson & Palmer, 2013). From this point of view, covering an additional insured is, in effect, buying insurance coverage for someone else (NRLRC, n.d.).

Most insurance companies, however, do not charge extra premium for additional insureds. As an insurance company, it is too costly and time consuming to review every single contract that the insured enters into. Instead, most rely on loss history, meaning that there is no direct additional cost to the named insured.

Furthermore, according to a risk manager in the oil industry, the contractor includes a markup for insurance in their price. "Under the contract, we pay a specific line item for insurance. Since we are paying for the policy, we think it's fair that we should have the ability to collect from that policy." The purpose of having one party's insurance as primary is to deal with the small, nuisance claims. "We don't want to rely on lawyers to determine who is responsible every time there is a loss, so we seek additional insured status on the policy so that it will respond to all claims until it is exhausted." The contractor is the primary presence on site, actively doing the work, which is why their insurance policy is usually primary.

Many professionals claim that contractual indemnity and additional insured status that favors a larger operating company is not an unfair burden on the often smaller services company. No one is forcing the smaller company to name anyone as an additional insured. If terms are too unfavorable for the service company, the contracting company would have trouble finding willing partners and would have to reconsider their demands. In addition, the smaller companies work the insurance costs into the price of the contract. They are obviously making money on the deal if they are willing to do business with the operator. If they cannot agree to the terms of the contract, they always retain the right to walk away from the deal. This is no burden—it is the beauty of the free market.

Regardless of one's feelings about additional insured status and contractual indemnity, it is not difficult to see the issues that could have arose if the Texas Supreme court had granted BP unrestricted coverage as an additional insured on Transocean's policies. But even with this victory for the oil industry as a whole, the future of contractual indemnity and, in extent, additional insured status, for the oil industry is still riddled with uncertainly. Will more states follow the example set by Texas, Louisiana, New Mexico, and Wyoming to deal with the confusion surrounding these topics? By trying to protect smaller companies from a threat that, according to many oil industry professionals, may not actually exist, the states risk limiting those smaller companies' options in a free market system. Unfortunately, the waiting game will continue for those involved with the oil industry as only time will tell whether more limitations will be placed on contractual indemnity and additional insured status. With all of the confusion surrounding contractual indemnity and additional insured status, one thing remains clear: this is no longer an issue that can be brushed over without a second thought.

***The people quoted in this article asked to have their names left out to protect their identity.**

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