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Deepwater Horizon decision serves as wake-up call for corporate counsel

Since the contract did not make Transocean liable for subsurface pollution, Transocean was not "obliged" to insure BP against that risk

By Christopher C. Loeber, Craig Dashiell

BACKGROUND

In April 2010, the Deepwater Horizon mobile offshore drilling unit exploded and sank, killing eleven people and leaking millions of gallons of oil into the Gulf of Mexico. The disaster triggered a dispute between BP p.l.c. (the oilfield developer), Transocean Ltd. (the rig owner) and Transocean's insurers over the interplay between an indemnity provision in the parties' commercial contract and the coverage provided by Transocean's insurance policies. Because the policies in question provided $750 million in coverage, the determination of BP's status as an additional insured under the Transocean policies was critical for both sides.

The Texas Supreme Court recently ruled on the extent of BP's coverage as an additional insured. That ruling serves as a wake-up call for corporate counsel charged with negotiating commercial contracts.

THE ISSUE

BP leased the Deepwater Horizon rig from Transocean to drill exploratory oil wells, and the BP/Transocean relationship was governed by a drilling contract. The drilling contract allocated liability for pollution-related events: BP was liable for any subsurface pollution events; Transocean was liable for such events occurring above the water. The drilling contract also mandated that BP was to be an "additional insured" under Transocean's insurance policies.

Transocean's policies did not explicitly name BP as an additional insured. Rather, the policies extended insured status to "[a]ny person or entity to whom [Transocean] is obliged by oral or written 'Insured Contract' . . . to provide insurance such as afforded by [the] Policy." The policies also specified that additional insured status would automatically be granted "where required by written contract."

Because the disaster involved subsurface pollution, the drilling contract provided BP with no direct recourse against Transocean. Consequently, BP pursued Transocean's insurance policies. BP argued that, although the drilling contract insulated Transocean against claims related to subsurface pollution, BP's "additional insured" status was not so limited — and BP was, therefore, entitled to the full benefit of Transocean's $750 million tower of coverage.

PROCEDURAL HISTORY

Transocean and its insurers denied BP's claims and sought a declaration that BP was not entitled to coverage for subsurface pollution. The District Court for the Eastern District of Louisiana ruled against BP, holding that Transocean was not required to insure BP for risks that Transocean did not assume under the drilling contract. BP appealed.

In March 2013, the 5th Circuit Court of Appeals reversed the district court's decision, finding that the scope of BP's coverage should have been determined solely from the four corners of Transocean's policies. In the 5th Circuit's view, the policy language alone governed the extent of BP's coverage because the insurance provision in the drilling contract was "separate and independent" from the contract's indemnity clause. And, because the policy language did not limit the insurance to which BP was entitled, the 5th Circuit held that BP's claims were covered. Transocean requested a rehearing.

In August 2013, the 5th Circuit withdrew its initial opinion, noted that the case turned on questions of Texas law as to which there was no controlling precedent, and certified the coverage questions the Texas Supreme Court. The essential issue was whether the language of the insurance policies alone could determine the extent of BP's coverage as an additional insured.

TEXAS SUPREME COURT OPINION

On Feb. 13, 2015, the Texas Supreme Court issued its decision. The court began by noting that an insurance policy can incorporate limitations on coverage that are contained in an extrinsic contract. The court observed that there are no "magic words" that will incorporate such restrictions into the policy, but that the policy must "clearly manifest an intent" to include the contractual terms as a part of the policy.

Turning to the policies at issue, the court found that BP's status as an additional insured could be determined only by reference to the underlying drilling contract. The court observed that BP was not specifically identified in any of Transocean's policies. Rather, the policies conferred BP coverage by referencing an "insured contract" that required Transocean to provide the insurance. Additionally, the court found that the policies incorporated extrinsic limitations on the scope of BP's coverage because the policies extended additional-insured status only as "obliged" and "where required" by the "insured contract."

In short, because the drilling contract made BP an additional insured, the drilling contract determined the scope of BP's coverage. And, since the contract did not make Transocean liable for subsurface pollution, Transocean was not "obliged" to insure BP against that risk.

THE LESSON FOR CORPORATE COUNSEL

This very high profile coverage dispute highlights two important points. First, commercial contracts and insurance policies are inextricably intertwined documents that cannot be read in a vacuum. Second, simple drafting oversights can have devastating consequences.

Despite their business acumen and legal sophistication, it appears that neither BP nor Transocean ever had their drilling contract reviewed by their insurance coverage counsel. Had they done so, the inconsistencies between the indemnification and insurance provisions would have been quickly identified and remedied. Instead, the parties spent millions of dollars litigating the issue. And, in the end, BP was denied access to a nine-figure insurance tower, while Transocean was one court decision away from forfeiting $750M of its own desperately needed coverage.

Although few situations mirror the scale of Deepwater Horizon, BP and Transocean are by no means unique. Thousands of times a day, commercial entities across the United States agree to indemnify one another for losses arising out of their joint business operations. And it is equally common for such entities to insert themselves as "additional insureds" under one another's policies. Yet, very few companies actually analyze the interplay between their underlying commercial agreements and the insurance that backs them.

In-house law departments should enlist the assistance of experienced coverage counsel in the negotiation/drafting of indemnity contracts. Whether you are the company seeking broad indemnification and "additional insured" status, or the party conferring those terms, it is essential that you involve insurance lawyers. As BP learned the hard way, the failure to do so can cost hundreds of millions of dollars.

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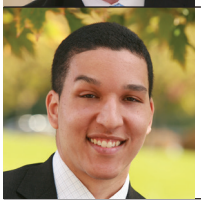

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