

# **CONTRACTUAL INDEMNITY, WARRANTY AND ADDITIONAL INSURED PROVISIONS – YOURS, MINE AND OURS**

**7<sup>TH</sup> Annual Advanced Contract Risk Management  
Conference for Oil and Gas**

**May 26-27, 2010**

**Houston, Texas**

**Glenn Legge/Alexander Papandreou**

**Legge, Farrow, Kimmitt, McGrath & Brown, L.L.P.**

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# Warranties, Indemnities and Insurance

- **The interaction of contractual indemnities and warranties.**
- **The scope of “knock for knock” indemnities – who, what and where?**
- **Contractual indemnities and insurance coverage – who’s on first?**
- **Consequential damage limitations – what is being waived?**
- **Choice of law – will the courts enforce your contractual provisions?**

# Warranty and Indemnity Interaction

## Construction/Design Warranty

- Warranty/guarantee that facility will be free of defect in construction/design.
- Breach of warranty triggers obligation to timely repair/remediate defects in construction/design.
- Obligations to repair/remediate defective material/services during a Warranty/Guarantee Period.
- Warranty/Guarantee Period will be extended for period of defect and/or repair

## Contractual Indemnity

- Knock for Knock – reciprocal obligations to defend/indemnify/hold harmless the other party (indemnatee) from property damage/bodily injury to indemnitor's property/people
- Triggered by status of ownership/control of the injured property/people, not be fault of parties
- Contractual indemnity obligation will likely have an exception for injury caused by the indemnatee's gross negligence/willful misconduct

# Warranty and Indemnity Interaction

## Factual Scenario

- Contractor defectively designs/constructs hull of a offshore tension leg platform (“TLP”) causing Company damages that are discovered offshore, including:
  - Cost of repairing structure offshore
  - Delayed/deferred production.

## Issues:

1. Application/scope of Contractor’s warranty obligation.
2. Trigger of Company’s contractual indemnity obligation.
3. Extent of Company’s damages recoverable from Contractor.

# Warranty and Indemnity Interaction

1. Warranty obligation extends to repair of defective hull, including reasonable costs to support such repairs offshore.
2. Company's contractual obligation to defend/indemnify Contractor for damage to Company's property does not extend to defectively designed/constructed property. Property never existed in undamaged state to be damaged by Contractor's acts – *N. Am. Shipbuilding Inc. v. SMAU, Inc.* 930 S.W.2d 829 (Tex. App. – Houston [1<sup>st</sup> Dist.], 1996).
3. Company's damages for cost of repair of defective TLP hull are covered by Warranty obligations. Company's deferred production is arguably not within scope of Warranty clause **if** the contract contains a waiver of consequential damages clause.

If defect impacted only property within subject matter of the contract - **no independent tort claim for economic loss due to delayed/deferred production** - *East River S.S. Corp v. Transamerica Delaval*, 476 U.S. 858 (1986)

# Consequential damage limitations – what is being waived?

## Waiver of consequential damages

- Direct damages flow naturally and necessarily from wrongful act and compensate claimant for loss foreseen by parties as a consequence of wrongdoing – *Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812 (Tex. 1997)
- Consequential damages result naturally, but not necessarily, from the defendant's wrongful acts – *Stuart v. Bayless*, 964 S.W.2d 920 ( Tex. 1998)
- Standard clauses waives consequential/incidental damages, lost profits, lost production and/or loss of use. What about:
  - Project cost delays?
  - Cost overruns that would preclude a party from obtaining internal rate of return on funds that would have otherwise been invested?

# CHOICE OF LAW TO INTERPRET CONTRACTS

## Choice of Law Clauses

- Valid choice of law (“COL”) provisions have been supported by U.S. and Texas Supreme Courts - *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15 (1972); *In re AutoNation, Inc.* 228 S.W.3d 663 (Tex. 2007)
- Arms length transactions between parties should be enforced as long as no evidence of overreaching or fraud.
- Valid COL clause provides predictability of risk allocation requirements under:
  - Common law - Express Negligence (TX)/Clear and Unequivocal (Maritime)
  - Statutes (LOIA, TOIA and OCSLA/LHWCA 905(c))

# CHOICE OF LAW – CONT.

Fifth Circuit and Texas Supreme Court have conducted critical reviews of choice of law provisions with respect to contracts requiring work to be performed in Louisiana or in various locations.

## **U.S. Court of Appeals for the Fifth Circuit**

- *Roberts v. EDC*, 235, F.3d 935 (5<sup>th</sup> Cir. 2000)
  - Contract between
    - N.J. corporation with PPB in TX, and
    - LA corporation
  - COL – Maritime law or TX law.
  - Claim – LA resident killed in LA
  - COL clause invalidated by LA law

# CHOICE OF LAW – CONT.

## Texas Supreme Court

- *Sonat v. Cudd*, 271 S.W.3d 228 (Tex. 2008)
  - Contract between
    - DE corporation with PPB in LA/TX
    - DE corporation with PPB in GA/TX/LA
  - COL – Maritime law or TX law
  - Contract for work in various states
  - Claim – LA residents killed in LA
  - Restatement (Second) of Conflict of Laws 187, 188, 196
    - Location of performance prevailed

## Other factors to consider

- Impact of offshore location/vessel status

# THE SCOPE OF “KNOCK FOR KNOCK” INDEMNITIES – WHO, WHAT AND WHERE?

## Reciprocal/Mutual Contractual Indemnities

- Extra ordinary shifting of risk from one party to another regardless of fault and determined by class/ownership/responsibility for property/people
- Indemnity obligation can extend to third parties if contained in definition of indemnitee (pass through indemnities)
- Specific requirements of state and maritime law:
  - TX – TOIA -CPRC 187 – supported by insurance and mutual/unilateral limits
  - LA – LOIA - La. Rev. Stat. 9:2780 – prohibits indemnities/additional insured allowed with premium – applies to personal injury/death only.
  - Maritime law – clear and unequivocal standard for indemnity
  - OCSLA/LHWCA – 33 U.S.C. 905(c) – reciprocal indemnity between employer and vessel owner is allowed.

# CONTRACTUAL INDEMNITIES AND INSURANCE COVERAGE – WHO’S ON FIRST?

## Indemnity obligations accompanied by additional insured obligations

- Conflicting Indemnity/Insurance Obligations
  - Contractor obligated to defend/indemnify Company
  - Company obligated to provide Contractor with additional insured coverage
  - When indemnity and insurance requirements conflict:
    - Company’s liability insurance must respond first
    - Then Contractor must honor its contractual indemnity obligation.
  - *Ogea v. Loffland Bros. Company*, 622 F.2d at 186, 189-90 (5th Cir. 1980).

# CONTRACTUAL INDEMNITIES AND INSURANCE COVERAGE – CONT.

## INSURANCE COVERAGE/OBLIGATIONS SHOULD FIT INDEMNITY AGREEMENTS

- Limits of insurance should match intended limits of indemnity provision
- Liability insurance may be alternative to prohibited indemnity (LOIA)
- Limits of liability insurance policies may limit indemnities (TOIA)
- Other insurance/primary insurance obligations should be addressed
- Standard insurance exclusions should be addressed to support indemnity agreement
  - Watercraft exclusion
  - Pollution exclusions/buy back – Occurrence or Claims Made?
  - “As owner” and navigational limits clauses in P&I policies
- Additional insured/waiver of subrogation to extend to all appropriate parties

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