Determining the scope of coverage for additional insureds: US Fifth Circuit Appeal Court decision in the Deepwater Horizon litigation

Ursula O'Donnell, Offshore Claims Director

+44 20 3320 8813
ursula.odonnell@ctplc.com

The below article considers a recent important Appeal Court decision, which held that under Texas law the rights of an additional insured named on an insurance policy are governed by the language of the policy and not by the indemnity provisions in the underlying contract.

Background facts

In April 2010, the Deepwater Horizon drilling rig sank in the Gulf of Mexico as a result of the blowout of the Macondo well, which led to the death of 11 workers and set off the worst offshore oil spill in US history. At the time of the incident, the rig was engaged in exploratory drilling at the Macondo well under a Drilling Contract between Transocean and BP. Under the terms of the contract, Transocean, which was the owner of the rig, was obliged to indemnify BP against liabilities for pollution originating on or above the surface of the water, whereas BP was obliged to indemnify Transocean against all other pollution, which included pollution from the well.

The Drilling Contract required Transocean to maintain various insurances and provided that "*BP, its subsidiaries and affiliated companies... shall be named as additional insureds in each of Transocean's policies... for liabilities assumed by Transocean under the terms of this contract*". Transocean maintained primary and excess liability insurance policies in the amount of $750m.

Claim

In 2011, BP filed a claim against Transocean's insurers in the Texas District Court (Texas law being the applicable law of the insurance policies) seeking access as an additional insured to the insurances to cover their pollution liabilities. BP argued that the

insurance policies alone and not the indemnities detailed in the Drilling Contract governed the scope of their coverage rights as an additional insured. Transocean's insurers argued that BP was only entitled to coverage for liabilities that Transocean had assumed under the Drilling Contract and that BP did not have access to the insurances with respect to liabilities that BP had assumed under the contract.

On 15 November 2011, the Texas District Court held that the additional insurance coverage was only as broad as the indemnity in the underlying Drilling Contract and therefore denied BP coverage and issued judgment in favour of the insurers. BP appealed against this decision.

Appeal

In March 2013, the Fifth Circuit Court of Appeals[1] reversed the District Court's decision. It relied upon the case of ATOFINA (2005)[2] in which the Texas Supreme Court held that under Texas law only the terms of the insurance policy itself and not the provisions of the indemnities in the underlying contract determine the scope of coverage afforded to the additional insured, providing the additional insured provision and the indemnity provisions in the underlying contract are separate and independent of one another. The Appeal Court found that the insurance and indemnity provisions in the Drilling Contract were "separate and independent" and on this basis decided that they were only bound to look to the policy terms to determine the scope of additional insured coverage. The Appeal Court held that since the Transocean policies did not contain any limitation on additional insurance coverage or incorporate the limits from the Drilling Contract (i.e. that BP was only entitled to coverage for liabilities assumed by Transocean under the contract), BP was entitled to full coverage for its pollution liabilities under the policies.

The case has not yet reached resolution. The Appeal court has recently decided to withdraw its own opinion, and has referred the case back to the Texas Supreme Court. At the time of the writing the initial decision of Judge Barbier stands.

Conclusion

The principal lesson that can be learned from this decision is that members should contract on terms that expressly limit access to their insurance policies by additional insureds so that coverage is restricted to liabilities that have been assumed by the member under the contract and they should ensure that the wording of their insurance policies reflects this fact.

Members should not be exposed to this particular risk under the terms of their P&I cover with the club, as the contract of insurance between the member and the club is governed by and construed in accordance with English law. Furthermore we only provide P&I cover to co-assureds on a 'misdirected arrow' basis (in accordance with rule 13.6). This means that cover is limited to liabilities which are properly the responsibility of the member under the terms of their contract with the co-assured. It does not cover liabilities assumed by the co-assured under the contract.

1 In Re: Deepwater Horizon No. 12-30230, 2013 WL 776354 (5TH Cir. Mar 1, 2013)
2 Evanston Insurance Co v ATOFINA Petrochemicals, Inc, 256 S.W. 3rd 660 (Tex. 2008)