

THE RHA REVIEW

ROUTE TO:

Vol. 13, No. 2, First Quarter 2007

A publication of Robert Hughes Associates, Inc., an international litigation support, actuarial, risk management and insurance consulting company.



Watch Your Back

By Robert L. Carson, Jr., CPCU, ARM

Do you remember watching *Starsky and Hutch* on TV, and when they would raid some den of iniquity, one would say to the other, “I’ve got your back”? Those need to be by-words for writing insurance specifications; i.e., “Watch your back.” The worst kinds of claims are those that come in the back door — at least that is the case in the energy industry.

Take, for example, the International Association of Drilling Contractors’ (IADC) standard drilling contract. In it the drilling contractor indemnifies, releases from liability and holds the operator (the owner of the well) harmless for damage to the drilling contractor’s drilling rig, except for damage caused by an unsound location or by environmental damage. [The former means damage caused by the ground giving way and the rig collapsing into the hole. The latter involves extra wear and tear to the rig caused by some corrosive or caustic materials (such as H₂S) getting into the mud (the circulating fluid) and causing unusual damage to the equipment.] Such an indemnification protects the operator from having to pay for the rig if, for instance, there is a blowout (for which the operator always assumes liability).

As further protection, at another point in the contract both parties agree to waive their insurer’s right of subrogation against the other party in areas where each has indemnified the other. What this appears to mean is that, among other things, the drilling contractor has waived his rig insurer’s subrogation right for damage

“The worst kinds of claims are those that come in the back door — at least that is the case in the energy industry.”

to the rig. An alert risk manager will recognize that there is a hole in the dike, and, in a present-day impersonation of the little Dutch boy, he will stick his finger in it; i.e., he requests that the contract be changed to say that his obligation to pay for a rig damaged by an unsound location is excess of any insurance carried by the drilling contractor. (Actually, until 2003, that is what the contract itself said.) This saves the day. Almost.

Remember that subrogation has been waived when one party has indemnified the other. The drilling contractor has indemnified the operator for damage to the rig *except for unsound location*. So if there is no indemnification for sound location claims, then there is no waiver of subrogation (as required later in the contract). And although the contractor has subsequently agreed to go to his insurance first, the insurer can subrogate against the operator. The back door has been left open. (This, by the way, is not the only instance in the drilling contract in which you can feel a draft.)

The moral of this entire story is that when you ask to have subrogation waived, do not ask that it be waived only on a certain policy or on just the

(Watch, continued inside)

IN THIS ISSUE:

- ***Watch Your Back***
- ***From Near and Far***
- ***Celebrating 50 Issues***

(Watch, continued from cover)

insurance specified or just where someone has held you harmless. ASK THAT INSURANCE BE WAIVED ON ALL INSURANCE CARRIED, WHETHER OR NOT SUCH INSURANCE IS REQUIRED BY THE CONTRACT. You never know which policy is going to pay. In the oil and gas industry, it could be a liability policy, a control-of-well policy, a drilling rig policy, a platform policy, or a workers' compensation or employer's liability policy. In the construction business there are an equal number of places in which a

“The answer is to just have subrogation waived on all insurance carried. Make insurance be the end of the claim.”

subrogation suit can arise. I imagine that in all other businesses, there are just as many back doors. *The answer is to just have subrogation waived on all insurance carried.* Make insurance be the end of the claim.

Here is another chapter in the indemnification protocol. Many times you will see contracts that call for three layers of protection from claims. Initially, one party indemnifies the other from liability for injury. Next, the indemnitee is added as an additional insured to the insurance policy; last, subrogation is waived. (The last two are usually referred to as “Naming and

Waiving”). This action is akin to wearing a belt and suspenders with coveralls. Let's analyze what all this means.

If you are held harmless, you do not have to be named as an additional insured or have subrogation waived. There is no subrogation available for the insurer because the indemnitor has waived his rights to go against the indemnitee. (You have to be very careful, however, that there is not an anti-indemnity law on the books in your state. Texas, Louisiana, New Mexico and Wyoming have such that applies directly to the oil and gas business. Other states have ones that apply to the construction industry, while other states just flat reject indemnification for sole negligence as being against public policy.) Some parties will be hesitant to fully indemnify another party but see no harm in “Naming and Waiving.”

Therefore, to back up the indemnification or to replace it if there is a statutory problem or if the other party has just refused to do so, you need to be named as an additional insured. The insurance carrier cannot subrogate against its own insured (except in rare instances). In the case of being named an additional insured on a property policy, some brokers/agents may balk at the idea, saying that there is no insurable interest. The response to such a denial is to state that if one has the vulnerability to be held liable, he has an insurable interest.

The last item, waiving subrogation, should just about close all the vents. However, if only subrogation is waived without either of the other two

actions (indemnification and/or naming), you still have an exposure. The other party, i.e., the one that waived only subrogation, has just waived his insurer's rights. He has not waived his own, so the waivee is not totally off the hook (unless he has used wording in the agreement that forces the other party to go first to his insurance). He can come back against you for the loss. Why would he do that? There are several reasons. One is that claims on his policy make his premiums go up, he may carry a big deductible, or he may not have enough limit and needs you to fill in the shortfall. (Side note: on the flip side of the coin, don't let the

“There is one last thing that needs to be tended to. Have the other party's insurance certificate verify that insurance has been waived.”

other party say that he would never let the insurer subrogate against you because you are such a great customer, or because you are a valued contractor, etc. The facts are that this party will have nothing to say about it. When the insurer pays the claim, it has full right to go against whomever caused the loss, and you are not a valued customer of the insurance company.)

To make a final check, let's review what we have done: (a) make certain that you are indemnified, check

(Watch, continued opposite)

FROM NEAR AND FAR



Chicago – According to an article published in the *Insurance Journal*, the Chicago Mercantile Exchange announced that it is going to offer contracts that allow insurers to hedge against hurricane damage. CME is joining forces with Carvill Group, a reinsurance intermediary.



USA – Travelers has launched a new policy that covers weddings. The Wedding Protector Plan offers coverage for many occurrences that result in the cancellation of a wedding. This plan can cover events in the U.S., Puerto Rico, Canada, the UK, Mexico and most of the Caribbean. To learn more, you can go to www.protectmywedding.com.



Mississippi – In February, State Farm announced that it would stop writing new homeowners' and commercial property coverage in Mississippi. It will continue to serve its current customers and also write new auto business. According to a State Farm press release, it wrote 29,000 new homeowners' policies in 2006. It also said that State Farm had handled more than 84,000 non-auto property claims in Mississippi related to Hurricane Katrina.



Berlin – On January 18, a powerful windstorm rocked Europe with hurricane-force winds that lasted for two days. Estimates by the German insurance association state that insured property damage losses could be as high as \$2.4 billion.

(Watch, continued from opposite)


the laws of your state to make certain that indemnities are not prohibited; (b) be named an additional insured on the policies in question, including property policies; (c) have insurance waived on all policies carried.

Okay, are we all finished? Not quite yet. There is one last thing that needs to be tended to. Have the other party's insurance certificate verify that insurance has been waived. Even though you have said such in the contract, if the insurer has not granted permission in the insurance policy for the insured to waive the insurer's rights without notification (which the policy usually does), and if the insured has

not subsequently notified or asked permission, the insurer may still subrogate. This leaves you with a

“So when you think that you have covered all the bases, when all of your ducks are in a row, when you check and double-check, you'd still better make certain that your back is covered, because that's where you can get a big surprise.”

breach-of-contract suit against the other party, and that can take years to settle.

So when you think that you have covered all the bases, when all of your ducks are in a row, when you check and double-check, you'd still better make certain that your back is covered, because that's where you can get a big surprise. 

Robert L. Carson, Jr., is an associate of RHA, Inc., and vice president of the energy division of Higginbotham & Associates, Inc. His field of expertise includes risk allocation in oilfield contracts; coverage analysis and interpretation of well control, general liability, excess (umbrella) liability, platform and related policies; marketing these coverages to underwriters; and claims handling in these areas.

ROBERT HUGHES ASSOCIATES INC.

508 TWILIGHT TRAIL, SUITE 200
RICHARDSON, TEXAS 75080
(972) 980-0088 FAX (972) 233-1548

PRSR STD
U.S. POSTAGE
PAID
RICHARDSON, TX
PERMIT NO. 1380

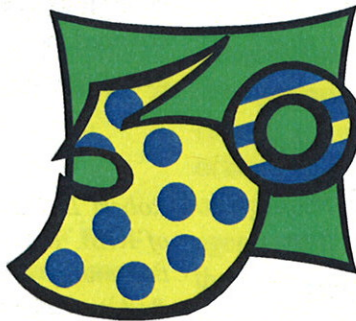
ADDRESS SERVICE REQUESTED

CONGRATULATIONS TO US!

This is the 50th issue of our free quarterly publication, *The RHA Review*. Who knew back in November 1994 that we'd still be putting out what we think is a quality newsletter in February 2007? A lot has happened in the world in the last 12 ½ years. Soft insurance markets, hard insurance markets, a climb in insurance-related litigation, tort reform, terrorist attacks around the world and on home soil, catastrophic weather-related events and many other newsworthy and not-so-newsworthy happenings.


Throughout this time we hope that you have enjoyed receiving and reading *The RHA Review*. We have grown

from publishing and mailing about 500 copies of the first issue to regularly writing, editing, printing and mailing close to 2,500 copies each quarter. We are read, hopefully, in the United Kingdom, Canada, the Virgin Islands, Bermuda and here at home.



We hope that we can continue to do this for another 50 issues and are currently forming a peer review board in order to further our

credibility.

As an aside, if you have not done so already, you should go to www.roberthughes.com and check out our totally redesigned website. 

THE RHA REVIEW

Publisher Robert N. Hughes
Editor John R. Oakley
Assistant Editor Alice H. Oakley

The RHA Review is published quarterly by Robert Hughes Associates, Inc. — an independent international litigation support, actuarial, risk management and insurance consulting company based near Dallas, Texas, with offices in Houston, Texas, and London, England. The purpose of this publication is to offer insurance-related information and critical comment pertinent to the clients, friends and fellow professionals of Robert Hughes Associates, Inc. This publication is available free to interested parties. The information contained in this publication is intended to be general in nature; readers should obtain professional counsel before taking any action on the basis of this material.

For more information, contact
John R. Oakley, Editor
508 Twilight Trail, Suite 200
Richardson, TX 75080
Tel. (972) 980-0088.

Copyright © Robert Hughes Associates, Inc.,
2007. All rights reserved.