JUNE 2022
VOL. 22-6

PRATT'S

ENERGY LAW REPORT

LexisNexis

Pratt's Energy Law Report

VOLUME 22 **NUMBER 6** **June 2022**

LexisNexis®

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please email:
Jessica Carnevale, Esq. at ..... (212) 229-4942
Email: ..... jessica.carnevale@lexisnexis.com
Outside the United States and Canada, please call . . . . . (973) 820-2000

For assistance with replacement pages, shipments, billing or other customer service matters, please call:
Customer Services Department at . . . . . (800) 833-9844
Outside the United States and Canada, please call . . . . . (518) 487-3385
Fax Number . . . . . (800) 828-8341
Customer Service Website . . . . . http://www.lexisnexis.com/custserv/

For information on other Matthew Bender publications, please call
Your account manager or . . . . . (800) 223-1940
Outside the United States and Canada, please call . . . . . (937) 247-0293

ISBN: 978-1-6328-0836-3 (print)
ISBN: 978-1-6328-0837-0 (ebook)
ISSN: 2374-3395 (print)
ISSN: 2374-3409 (online)

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT'S ENERGY LAW REPORT [page number] (LexisNexis A.S. Pratt);
Ian Coles, *Rare Earth Elements: Deep Sea Mining and the Law of the Sea*, 14 PRATT'S ENERGY LAW REPORT 4 (LexisNexis A.S. Pratt)

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

MATTHEW BENDER

(2022–Pub.1898)

Editor-in-Chief, Editor & Board of Editors

Hydraulic Fracturing Developments
Eric Rothenberg
Partner, O'Melveny & Myers LLP

Pratt's Energy Law Report is published 10 times a year by Matthew Bender & Company, Inc.

POSTMASTER: Send address changes to *Pratt's Energy Law Report*, LexisNexis Matthew Bender, 230 Park Ave. 7th Floor, New York NY 10169.

Common "Knock-for-Knock" Indemnity Agreements May Not Limit Exposure as Parties Intended, Fifth Circuit Court of Appeals Rules

By Thomas A. Donaho*

In this article, the author explains that a decision by the U.S. Court of Appeals for the Fifth Circuit will require oil and gas companies throughout the oil patch to review their form contracts, preexisting agreements and liability policies to determine the extent of their indemnity exposure.

Oil and gas companies frequently enter into master service agreements ("MSAs") and other oilfield contracts wherein the parties agree to support their indemnity obligations with a "minimum" amount of insurance. These companies often believe that the minimum amount of insurance they agree to obtain in support of their indemnity obligations will limit their ultimate indemnity exposure under the Texas Oilfield Anti-Indemnity Act ("TOAIA") to that minimum amount of insurance.

The ruling by the Fifth Circuit in *Cimarex Energy Company, et al. v. CP Well Testing, L.L.C.*,[1] indicates otherwise. Any party to a mutual indemnity agreement supported by minimum amounts of insurance will need to read its contract and general liability policies in combination to determine the extent of its indemnity exposure under Texas law.

BACKGROUND

Throughout the United States, natural gas exploration and production is a multiparty endeavor. Oilfield operators enter into form drilling contracts (i.e., International Association of Drilling Contractors onshore drilling contracts) or MSAs with contractors under which the contractors agree to provide services and materials for the operators. Owners of mineral leases enter into farmout agreements that provide for the provision of services in exchange for a percentage ownership in the lease. Parties with mineral lease interests enter into joint exploration and development agreements. All of these agreements can include indemnity provisions that dramatically shift the risks and liabilities of the parties.

---

* Thomas A. Donaho, a partner in the Houston office of Baker & Hostetler LLP, focuses his practice on complex commercial disputes in both state and federal court. He may be contacted at tdonaho@bakerlaw.com.

[1] *Cimarex Energy Company, et al. v. CP Well Testing, L.L.C.*, No. 20-50892 (5th Cir. Feb. 15, 2022).

For those companies operating in the state of Texas, oilfield indemnity agreements must be tailored to satisfy Texas' anti-indemnity statute: TOAIA.

HOW TOAIA LIMITS A PARTY'S INDEMNITY EXPOSURE

In its current form, TOAIA provides that agreements pertaining to a well for oil, gas or water, or to a mine for a mineral, are void as a matter of public policy if they purport to indemnify a party against liability for its own negligence.[2]

However, TOAIA offers a loophole. TOAIA will not operate to void indemnity agreements that purport to indemnify parties against liability for their own negligence if the parties agree in writing that the "indemnity obligation will be supported by liability insurance coverage to be furnished by the indemnitor. . . ."[3] Where two parties agree to support their mutual indemnity obligations with liability insurance, those obligations are "limited to the extent of the coverage and dollar limits of insurance or qualified self-insurance each party as indemnitor has agreed to obtain for the benefit of the other party as indemnitee."[4]

Thus, a mutual indemnity provision in Texas will be limited by TOAIA to the lowest level of insurance both parties contractually agree to obtain in support of their indemnity obligations.[5] This is sometimes called the "lowest-common-denominator" rule.

Practical Example

Consider the following example:

> An operator and a drilling contractor enter into an MSA, which contains mutual indemnity provisions. A provision on insurance states as follows:
>
> "In support of its indemnity obligations contained herein, OPERATOR agrees to obtain insurance coverage in an amount equal to $5,000,000. . . .
>
> "In support of its indemnity obligations contained herein, CONTRACTOR agrees to obtain insurance coverage in an amount equal to $3,000,000. . . ."
>
> Since the parties agreed to provide differing amounts of coverage in support of their mutual indemnity obligations, the obligations are

---

[2] Tex. Civ. Prac. & Rem. Code § 127.003.

[3] Tex. Civ. Prac. & Rem. Code § 127.005(a).

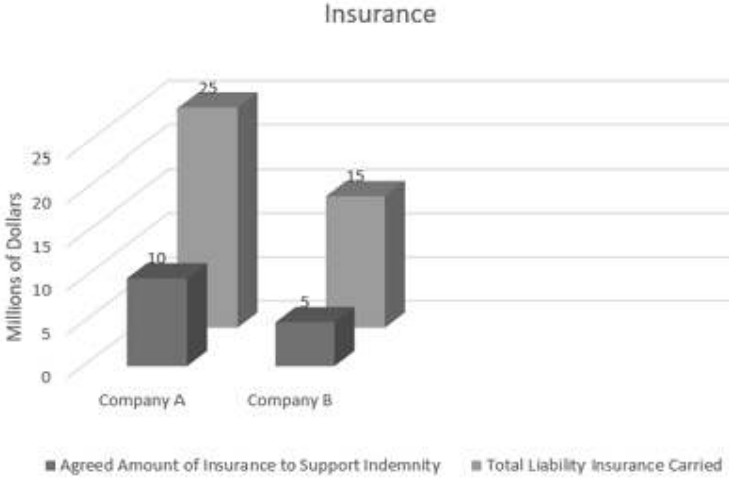
[4] Tex. Civ. Prac. & Rem. Code § 127.005(b).

[5] *Ken Petroleum Corp. v. Questor Drilling Corp.*, 24 S.W.3d 344 (Tex. 2000).

limited to the lower amount of insurance under TOAIA. Here, the parties' indemnity obligations would be capped at $3 million.

The rationale for the lowest-common-denominator rule adopted by the Texas Supreme Court is that oilfield companies do not purchase insurance for specific contracts but instead "purchase blanket insurance policies and umbrella policies that will provide coverage for a multitude of contracts."[6]

For example, a company that enters into an oilfield contract may purchase $25 million in liability insurance coverage each year but only agree to obtain $10 million in coverage in support of its mutual indemnity obligations under the contract because of risk-management guidelines or other contractual obligations. Meanwhile, the other party to the oilfield contract may purchase $15 million in liability insurance but only agree to obtain $5 million in coverage in support of its mutual indemnity obligations under the same contract.



In such circumstances, both parties' indemnity obligation is capped at $5 million under the lowest-common-denominator rule, even though both parties have additional coverage available. Still, parties to oilfield contracts do not always agree to support their indemnity obligation with an exact amount of insurance.

---

[6] *Id.* at 350.

WHERE PARTIES FAIL TO ESTABLISH INSURANCE LIMITS, INDEMNITY OBLIGATIONS MAY EXTEND TO THE AMOUNT OF INSURANCE ACTUALLY CARRIED

The Texas Supreme Court has held that where the express provisions of a contract do not limit a party's insurance obligation to a set dollar amount, that party has contractually agreed to fully insure or self-insure its indemnity obligation.[7] Thus, where the parties fail to contractually establish the limits of insurance that support their indemnity obligations, TOAIA will limit the parties' indemnity obligation to the amount of insurance carried by both parties.

For example, in *Liberty Mutual Fire Ins. Co. v. Axis Surplus Ins. Co.*, a U.S. district court in Austin held that where parties simply agreed to "carry adequate insurance limits [ ] in support" of their mutual indemnity agreement, the parties' indemnity obligations were capped under TOAIA at the lesser amount of insurance actually "carried" in support of the indemnity obligation.

PARTIES FREQUENTLY AGREE TO OBTAIN A MINIMUM AMOUNT OF INSURANCE TO SUPPORT INDEMNITY

It has become common within the industry for parties to use form contracts under which they agree to support their indemnity obligations with a minimum amount of insurance.

Examples

Here are some examples:

> "Contractor shall, during the term of this Agreement, carry at its own expense the following minimum insurance coverage. . . ."
>
> "In support of the mutual indemnity obligations contained in Section X below, Contractor and Company shall provide, each for the benefit of the other, coverage and amounts of liability insurance which in no event shall be less than the minimum set out in Exhibit Y. . . ."
>
> "Except as otherwise provided herein, Contractor and Company shall procure and maintain in force at all times during the term hereof sufficient insurance or self-insurance as may be required by law to protect Contractor and Company from third party claims arising out of or connected with the performance of Services hereunder. All such insurance shall be of the types and in at least the amounts specified in Exhibit Y. . . ."

---

[7] *Id.*

Yet, when parties agree to obtain a minimum amount of insurance in support of their indemnity obligations, neither has agreed to "dollar limits" of insurance that will serve as a cap on their indemnity obligations under TOAIA.[8]

FIFTH CIRCUIT RULES THAT INDEMNITY OBLIGATIONS CAN EXTEND BEYOND THE CONTRACTUALLY AGREED MINIMUM AMOUNTS OF INSURANCE

On February 15, 2022, the Fifth Circuit issued an opinion that finally confronted the question of how to interpret language in an oilfield contract requiring that the parties support their indemnity obligations with specified minimum amounts of insurance.

The case, *Cimarex Energy Company, et al. v. CP Well Testing, L.L.C.*,[9] concerns an MSA executed by Cimarex, the owner and operator of a well in Oklahoma, and a contractor, CP Well Testing, retained to perform flowback services at the well. The MSA contained a mutual indemnity provision requiring Cimarex and CP Well to indemnify the other against claims for personal injury, illness or death of any member of their "group" as defined in the MSA, and it further required both parties to obtain the minimum amounts of insurance specified in the MSA.[10]

Under the MSA, Cimarex was required to obtain a minimum of $1 million in general liability coverage and $25 million in excess liability coverage ($26 million in total) to support its indemnity obligation, while CP Well was required to obtain a minimum of $1 million in general liability coverage and $2 million in excess liability coverage ($3 million in total) to support its indemnity obligation.[11]

Subsequent to execution of the MSA, a member of CP Well's group was injured while working at the wellsite and brought suit against Cimarex, among others.[12] Cimarex settled the lawsuit for $4.5 million and turned to CP Well for the full settlement amount.[13] When CP Well refused to indemnify Cimarex under the MSA for more than $3 million, Cimarex's insurer, St. Paul Fire and Insurance Company, covered the remaining $1.5 million and brought suit

---

[8] *See* Tex. Civ. Prac. & Rem. Code § 127.005(b).

[9] *Cimarex Energy Company, supra* n.1.

[10] *Id.*

[11] *Id.*

[12] *Id.*

[13] *Id.*

against CP Well on Cimarex's behalf in the U.S. District Court for the Western District of Texas to recover the difference and moved for summary judgment.[14]

The gravamen of Cimarex's argument to the district court was that CP Well's indemnity obligation was not limited under TOAIA to the $3 million minimum set forth in the MSA because a minimum does not limit the amount of coverage the parties agreed to obtain in support of their indemnity obligations.[15] Instead, Cimarex argued, CP Well's indemnity obligation extends to the amount of insurance CP Well actually carried—$11 million.[16]

The district court agreed with Cimarex that the parties' agreement to obtain minimum amounts of insurance in support of their indemnity obligations under the MSA did not limit the amount of coverage the parties agreed to obtain to support their indemnity obligations.[17] Instead, the district court reasoned, "the parties merely agreed to a floor" of indemnity insurance.[18]

However, the district court did not agree with Cimarex that CP Well had necessarily agreed to maintain $11 million in liability insurance to support its indemnity obligation under the MSA simply because CP Well carried insurance in that amount.[19] Instead, the district court looked to extrinsic evidence in the form of CP Well's excess liability insurance policy, which stated:

> [T]he most [the insurer] will pay for damages under this policy on behalf of any person or organization to whom [CP Well] [is] obligated by written Insured Contract to provide insurance such as is afforded by this policy is the lesser of the Limits of Insurance shown in Item 3. of the Declarations [i.e., $10 million], or the minimum Limits of Insurance [CP Well] agreed to procure in such written Insured Contract.[20]

The policy defined "Insured Contract" as "any contract or agreement pertaining to [CP Well's] business under which any Insured assumes the tort liability of another party to pay for Bodily Injury or Property Damage to a third person or organization," which included the subject MSA.[21] Because the "lesser of the Limits of Insurance . . . or the minimum Limits of Insurance" CP Well

---

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] *Id.*

[18] *Id.*

[19] *Id.*

[20] *Id.*

[21] *Id.*

agreed to procure under the MSA was the $3 million minimum, the district court held that CP Well did not breach the MSA when it refused to indemnify Cimarex beyond $3 million.[22]

On appeal, the Fifth Circuit agreed with the district court that the plain language of the MSA established a floor and not a ceiling for insurance coverage.[23] Writing for the panel, Judge Cory Wilson then framed the central question before the court as follows:

> Given the MSA's silence on this issue, the operative question is how to determine how much of CP Well's additional $8 million in excess liability coverage was "for the benefit of [Cimarex] as indemnitee."[24]

After dismissing Cimarex's argument that the Texas Supreme Court's opinion in *Ken Petroleum* precludes courts from looking beyond the coverage limits, the panel endorsed the district court's decision to look to extrinsic evidence, stating that "[t]he district court's approach is not just logical; it is consistent with our precedent that, applying Texas law, courts in this circuit routinely consider the terms of insurance policies to determine whether a party is entitled to coverage."[25]

Ultimately, the panel concluded that CP Well's excess liability policy effectively set the indemnity coverage ceiling at the same level as the floor expressed in the MSA: $3 million.[26] The remaining $8 million of CP Well's excess liability was not "obtained for the benefit of" Cimarex, and thus application of TOAIA to the parties' MSA could not result in $11 million of indemnity exposure for CP Well.[27] The district court's decision was affirmed.[28]

IS IT TIME TO REVISE YOUR FORM OILFIELD CONTRACTS?

The Fifth Circuit's opinion in *Cimarex* explicitly states what other courts have only posited by implication—TOAIA does not limit a party's indemnity obligation to any minimum amount of insurance that parties agree to obtain in support of their mutual indemnity obligation.

---

[22] *Id.*

[23] *Id.*

[24] *Id.* (*citing* Tex. Civ. Prac. & Rem. Code § 127.005(b)).

[25] *Id.* (*citing Ironshore Specialty Ins. Co. v. Aspen Underwriting,* 788 F.3d 456 (5th Cir. 2015); *Forest Oil Corp. v. Strata Energy, Inc*., 929 F.2d 1039, 1044–45 (5th Cir. 1991); *Musgrove v. Southland Corp*., 898 F.2d 1041, 1043 (5th Cir. 1990); and *In re Deepwater Horizon*, 470 S.W.3d 452, 459–60 (Tex. 2015)).

[26] *Id.*

[27] *Id.*

[28] *Id.*

If your form oilfield contract contains mutual indemnity provisions and language requiring that the parties obtain minimum amounts of liability insurance in support, it is important to review your liability policies to determine the extent of indemnity exposure and consider whether a revision would better serve your risk-management objectives.

Many parties in the oilfield currently use form contracts with the minimum insurance language discussed throughout this article, and they mistakenly believe that their indemnity exposure is limited to that minimum amount of insurance. This mistake can be costly.

KEY TAKEAWAYS

1. When parties contractually agree to support their mutual indemnity obligations with a "minimum" amount of insurance, they set a floor—not a ceiling—on their indemnity obligations under Texas law.
2. To determine the ceiling on a party's contractual indemnity obligation, courts may look to the party's liability insurance policies for guidance.
3. Where a party's insurance policy limits coverage to the minimum limits of insurance the insured party agreed to procure under an insured contract, the minimum limits of insurance identified in that contract will be both the floor and the ceiling for indemnity obligations under TOAIA.