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A professional services firm specializing in IT and business services contracts, outsourcing, on demand, e-contracting, contracts processes, and contracts management staffing

Newsletter

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Feature Article

Transocean-BP Deepwater Horizon Lease: The Mother of All Indemnification and Liability Clauses, and What Business Can Learn From the Consequences

Given the horrific damage to ocean life and coast lines, the loss of livelihood for thousands, and the possible end of an entire way of life in the Gulf States, it might seem unthinkable that anyone could or would dare try to make money out of the Deepwater Horizon oil spill disaster. Unlike the wetlands in Louisiana, though, our world is not so delicate. Investment analysts monitoring the stock of the companies involved are advising that Transocean, the owner of the rig and the drilling contractor, might make just as much revenue from insurance claims and legal maneuvering as it would had the explosion never happened and the remaining 3 years of its contract with British Petroleum (BP) completed. Absent any finding of liability, analysts say that Transocean stock has been oversold in reaction to the spill and can be bought at a bargain.

Before continuing, let's understand who is who in the Deepwater Horizon drilling project. BP, along with some minor partners, leased drilling rights at a particular location in the sea bed (MC252). Separately, BP contracted with Transocean, the owner of the drilling rig, to lease the rig and to drill the well. As fate would have it, Halliburton provided additional drilling services, as did Smith International. Cameron International manufactured the failed blow out preventer. It is still unclear how much direction BP exercised over the other companies and what knowledge workers had that a blow out was imminent. Total liability between the companies, based on loss of market capitalization, could reach \$30 billion.

The reason for analyst optimism about Transocean's financial condition in the wake of the disaster is largely based on the terms of indemnification and liability in Transocean's contract with BP. In its 10-Q statement to the SEC, Transocean states that under the Transocean-BP contract, BP assumes full

responsibility for, and defends, releases and indemnifies Transocean from, any loss, expense, claim, fine, penalty or liability for pollution or contamination, including control and removal thereof—in other words, the cleanup. Further, under the contract BP releases and indemnifies Transocean against loss or damage to the underground reservoir of oil, BP's loss of property rights to the oil, and the cost of bringing the well under control in the event of a blowout. In turn, Transocean agrees to indemnify BP for personal injury to or death of Transocean employees (it should not be lost on us that 11 men died in the explosion). It is considered standard language in oil drilling contracts for the operator (BP) to indemnify and hold the contractor (Transocean) harmless for blowouts, even if the contractor acted with gross negligence. This last provision prevents BP from using Transocean's own negligence as a defense against Transocean's bringing claims under the indemnification clause.

Indemnifications and releases in contracts are methods of controlling exposure to risk. In most circumstances these clauses are the final word on the liability of the respective parties. In the case of Deepwater Horizon, however, because the work involved deep sea oil drilling, Federal laws outside the contracting power of the parties also determine BP's and Transocean's liability including criminal restitution. BP and Transocean lawyers are attempting to enforce caps under these laws.

Insurance is another common method of controlling risk exposure in contracts. As would be expected, a number of very high dollar insurance policies covering the work were taken out by Transocean; BP self-insured through a captive insurer. Although not the insured party, BP claims that it is entitled to funds for cleanup under Transocean's insurance. Lloyd's of London, representing the insurers, has filed suit to block BP's claim, citing language in the Transocean-BP contract limiting insurers' liability to the amount of damage to the rig alone.

Deepwater Horizon represents the most deep seated fear of anyone responsible for negotiating

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About James River

James River Consulting specializes in the development, negotiation, and management of IT and business services contracts with emphasis on IT and business outsourcing and on software-as-a-service/cloud computing/managed services. James River's offerings range from short-term staffing of contracts personnel, to sales contract processes, to e-Contracts, to competitive bidding, to SaaS and BPO contracts negotiation and management. James River's president, Eric Esperne, has over 15 years experience as an in-house legal counsel and director of contracts for both large and small IT companies.

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Feature Article continued

contracts: exposure to liability under a contract (worth x dollars) sufficient to bankrupt the company. In the case of Deepwater Horizon, \$30 billion in potential liability will be decided by a paragraph or two in a contract, easily \$5-10 million a word.

Let's take Deepwater Horizon and recast it in another business context, say information technology services. Oil becomes data. BP is the data controller or party responsible for safekeeping the data. Transocean is the data center owner from which BP leases equipment and managed services personnel. Cameron is the firewall manufacturer and maintenance provider. Let's carry the scenario further. Instead of drilling 5,000 feet under the ocean, BP is receiving and storing huge amounts of credit card and personal identification data in facilities all over the world including Russia. Let's say that 30 million ID's are hacked by the Russian mob but the breach of security isn't reported until several weeks later.

Drafting good indemnification and liability clauses in any business situation is important. But indemnification, liability and insurance clauses may still fall short of protecting a company against financial doom. Negotiation of risk control clauses in contracts needs to be approached as part of an overall transaction risk management strategy. Acceptable levels of risk exposure can only be determined by identifying

risks that are particular to each transaction and then weighing the probability and likelihood of those risks against the opportunity.

Indemnification, insurance and other standard contract language should be viewed as just some of many techniques available for managing transaction risk. Some causes of catastrophic risk can be detected beforehand if parties to a contract are legally obligated to follow risk mitigation procedures and decision making authority is clearly defined, before moving forward with the work. John O'Leary, a research fellow at the Kennedy School of Government's Ash Center, recently wrote an article in Governing magazine on the failure of organization's to recognize warning signs. O'Leary advises that organizations ask "What if?" and to welcome bad news. We can add a third piece of advice: plan for risk and write the plan into the contract.

Contract-mandated risk management should also include crisis management. One of the most costly risks that companies face in disasters is damage to reputation. Having procedures for responding to crisis that are tied to liability under the contract is an effective approach to eliminating finger pointing and poor early response.

For more, contact Eric Esperne, President at 703-850-7061 or email him at eesperne@jamesriverllc.com.

Company News

Recent Client Work James River Consulting continues to provide a wide range of professional contracts management services (our client list is kept confidential). In addition to writing several Software-as-a-Service (SaaS) license agreements, James River has consulted a large corporation on establishing a model contract management function where no formal supply contract policies or procedures exist. James River is also continuing to support government contractors in subcontract management.

IACCM Book of Knowledge Working with contract management professionals from around the world, Eric Esperne, President of James River Consulting, is developing a book of knowledge (BoK) for the International Association of Contract and Commercial Management. Specifically, Eric has principally authored the chapter on implementing and communicating post-signature contract management. The BoK is due out at the end of 2010.



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