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# Key Insurance Coverage Issues Under “Energy Package” Policies for Offshore Operations



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# Developments in Fundamental Coverages



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# **Energy Exploration and Development (EED) Insurance**

## **Standard EED Coverages**

- A. Control of Well
- B. Redrilling/Extra Expense
- C. Seepage and Pollution, Cleanup and Containment

# EED Section A: Control of Well Insurance

## **Coverage:**

“Underwriters agree ... to reimburse the Assured for actual costs and/or expenses incurred by the Assured (a) in regaining or attempting to regain control of any and all well(s) insured hereunder which get(s) out of control, ...but only such costs and/or expenses incurred until the well(s) is (are) brought under control . . . and (b) in extinguishing or attempting to extinguish fire. . .

Relief wells are automatically held covered under this section...”

## EED Section A: Control of Well (cont'd.)

- Trigger: well “out of control” – defined
  - Unintended flow from the well of drilling fluid, oil, gas or water above the surface of the ground or water bottom, which, cannot be stopped by equipment, increase of drilling fluid or safely diverted.
- Termination of Coverage: wells “brought under control” – defined
  - Flow is stopped or can be safely stopped
  - Drilling resumed
  - Well returned to same status before occurrence
  - Flow diverted

## EED Section A: Control of Well (cont'd.)

- Expected Insurer Arguments
  - Well(s) not “out of control” under policy definition
  - Mere “P&A” activities never intended to be covered
  - Well(s) brought under control much sooner than Assured claims, or at a minimum “could have been safely stopped” earlier
  - Claimed costs are not recoverable “costs” (undefined) or “expenses” (defined)

# EED Section B: Redrilling/Extra Expense

## **Basic Coverage Grant:**

*to reimburse the Assured for actual costs and/or expenses reasonably incurred to restore or redrill a well insured hereunder, or any part thereof, which has been lost or otherwise damaged as a result of an occurrence giving rise to a claim which would be recoverable under Section A of this policy if the Assured's Retention applicable to Section A were nil.*



## EED Section B: Redrilling/Extra Expense (cont'd.)

- Coverage Elements:
  - Triggering event is an occurrence covered under Section A
  - Expenses “reasonably incurred” and with “most prudent and economical methods” employed
  - Depth limitations to point of loss or geologic zone(s) if production well
  - No coverage if flow can be safely diverted into production through relief well or otherwise
  - Standard AFE limitations of 130% of original well to depth at time of loss, plus 10% compounded per annum for production wells up to 250% of original
    - Elimination by endorsement
  - Time limitations: redrilling commenced within 540 days of date of accident or expiration of policy, whichever later

# EED Section B: Redrilling/Extra Expense (cont'd.)

- Section B: Exclusions
  - Similar to Section A
  - Loss or damage (or loss of use) to production equipment or damage to any reservoir
  - Relief well
  - Plugged and abandoned wells prior to loss event
  - Making wells safe (MWS) endorsement – if Section A applies solely by virtue of MWS

## **EED Section B: Redrilling/Extra Expense (cont'd.)**

- Extended Redrill
  - Extension to Section B for causes similar to MWS and involving (i) uninsured well lost or damaged and (ii) directly related to physical loss or damage to equipment
  - Combined single limit

# EED Section C: Seepage and Pollution, Cleanup and Containment

## Three (3) Separate Coverage Grants:

- (a) All sums assured shall by law or under terms of lease or license be liable to pay for remedial measures and/or as damages for bodily injury and/or loss of, damage to or loss of use of property caused directly by seepage, pollution or contamination arising from insured wells
- (b) The cost of or any attempt at, removing, nullifying or cleaning up seeping, polluting or contaminating substances from insured wells, including cost of containing/directing substances or preventing them from reaching shore
- (c) Defense cost for any claim or claims resulting from actual or alleged seepage, pollution or contamination arising from insured wells

# EED Section C: Seepage and Pollution (cont'd.)

## Covered circumstances:

- (a) Legal obligation to clean up seeping/polluting oil emanating from covered wells, whether by statute or under lease agreement
- (b) Costs of or attempts to remove, nullify or clean up the contamination
- (c) Defense costs: Defending against a “claim:” governmental administrative directives/orders requiring investigation and remediation (?) [Allegations alone sufficient.]

# EED Section C: Seepage and Pollution (cont'd.)

- Expected Insurer Arguments
  - Efforts already covered under Control of Well
  - Prove pollution is emanating from covered wells
  - Your efforts do not constitute “remedial measures”
  - Your activities are mere decommission activities required at every lease end
  - Underwriters did not intend to cover typical plug and abandon activities under this coverage, even if ordered by the government
  - No ‘property damage’ to soil or water on ‘international waters’
  - Government administrative actions not “claims”

# Removal of Wreck (“ROWD”)

- Traditionally part of operational physical damage coverage for additional limit of 25% of insured value
- Standard language:

*“It is hereby agreed to indemnify the Assured for all costs and expenses of or incidental to the raising, removal or destruction of the wreckage or debris of the insured property, or attempts thereat, following a peril insured hereunder, including the provision and maintenance of lights, markings and audible warnings for such wreckage or debris, when the incurring of such costs and expenses is compulsory by any law, order or regulation, or where the Assured is liable under contract, or when such wreckage or debris interferes with the Assured’s operations.”*

## Removal of Wreck (“ROWD”) (cont’d.)

- Additional or Excess ROWD within Energy Package
- Excess ROWD
  - Stand alone ROWD
  - Endorsement to excess liability policy
- Variations on language of coverage grant creates potential for disputes
  - “compulsory by law” or “imposed by law”
  - *Continental Oil v. Bonanza* (5<sup>th</sup> Cir. 1983)
  - *Danos Marine v. Curole Marine* (5<sup>th</sup> Cir. 2010)



## Removal of Wreck (“ROWD”) (cont’d.)

- *Lamar Homes* (Tex. 2007)
- “legal or contractual”
- Nature of liability: third-party, regulatory, contractual
  - MMS decommissioning regulations (30 C.F.R. §250.173)
  - Insurers argue contractually assumed under lease and not imposed by law or a legal liability

# Loss of Production Income (“LOPI”)

- Small to mid-size company market for BI coverage
- JR 2005 / 003 A Form (2005)
  - Uniform product for BI
  - Section of energy package
- Basic issues:
  - Revenue to be protected – basis of indemnity
  - Period of indemnity

# Loss of Production Income (“LOPI”) (cont’d.)

- Basis of Indemnity
  - Agreed Value – stated sum per day
    - Traditional approach
  - Indemnity basis – anticipated vs. actual production during delay period
- Indemnity Period (Recovery Period)
  - Variety of factors, including financing, cash flow, topside damage repairs, installation of temporary facilities, etc.
  - Waiting period

# Loss of Production Income (“LOPI”) (cont’d.)

- Triggers
  - Accidental physical loss to Property Insured for specified perils
  - WOC – well out of control

# Insurance Market Update Post-Macondo



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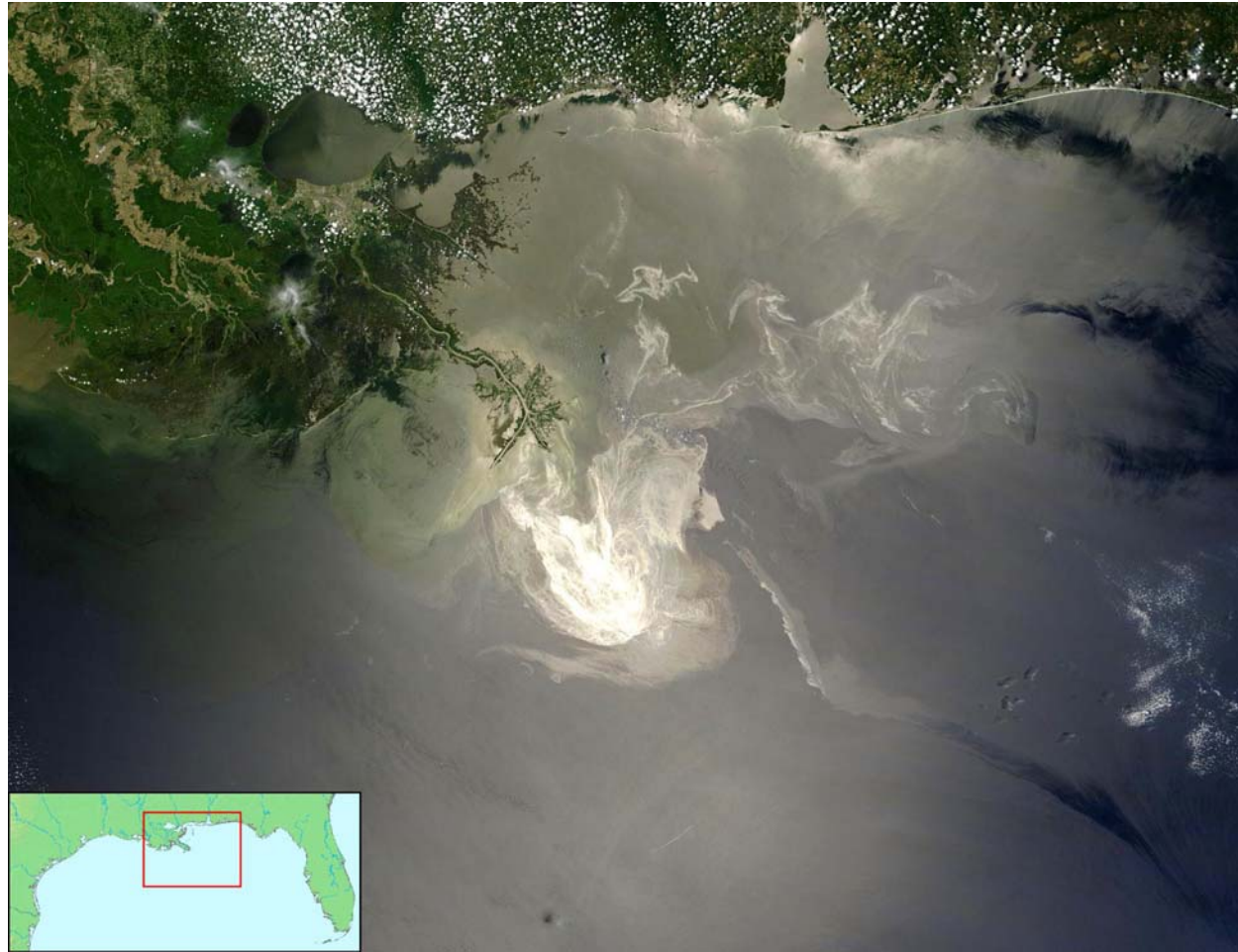
# The Macondo Loss – April 20, 2010

- The largest accidental marine oil spill in the history of the petroleum industry
- 11 fatalities
- 17 Injuries
- 4.9 million barrels of crude released
- 62,000 barrels per day estimated max discharge rate
- Well was effectively “killed” on September 19, 2010 – 5 months after the original incident



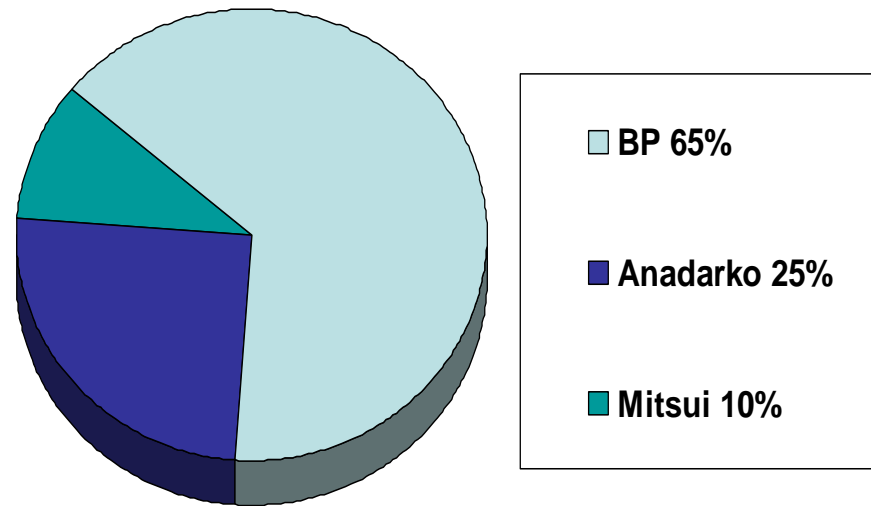
Photo: US Coast Guard

# Oil Spill Extent



**NASA image taken on May 24, 2010 – Spill estimated to cover an area in excess of 4000 square miles**

# Operating Group for Macondo Joint Venture



The cost of the response to September 29<sup>th</sup> amounts to approximately \$11.2 billion, including the cost of the spill response, containment, relief well drilling, static kill and cementing, grants to the Gulf states, claims paid and federal costs. <sup>(1)</sup>

Combined \$80 billion reduction in Market Cap of the companies directly involved (as at September 30<sup>th</sup>) <sup>(2)</sup>

(1) Source: BP PLC (2) BP, Transocean, Anadarko, Mitsui



# Insurance Coverage in Place for the Key Players

- **BP:** With a 65% interest in the Deepwater Horizon joint venture, BP says it is self-insured. BP's captive (Jupiter Insurance Ltd) has \$6 billion in capital. It is reported that Jupiter's per occurrence limit on physical damage and business interruption is \$700 million and is not expected to cover environmental clean-up costs or third party liability.
- **Anadarko Petroleum:** With a 25% interest in the Deepwater Horizon joint venture, Anadarko Petroleum publicly stated they have \$162.5M in available COW and Liability limits.
- **Mitsui Oil Exploration:** With a 10% interest in the Deepwater Horizon joint venture, Mitsui is believed to have \$175 million of coverage available.
- **Transocean:** The Deepwater Horizon was insured for \$560 million. In addition, Transocean carries some \$950 million in third party liability insurance.
- **Cameron:** The manufacturer of the blowout preventer that failed on the rig reportedly has a \$500 million liability insurance policy.
- **Halliburton:** Service provider to Deepwater Horizon has liability insurance in excess of \$1 billion.

Source: Barclays Capital research note 05/10/10; Credit Suisse research note 5/11/10

# But how much will the market actually pay?

- BP has said it will assume liability for all legitimate claims caused by the oil spill. Primary liability for clean up costs will be BP and its partners.
- Transocean has already been paid the majority of the claim for the Deepwater Horizon.
- The Energy Market will likely pay somewhere between \$1.2 and \$2.5 billion in claims.
- Litigation, D&O liability and workers comp losses will add to the loss total but will likely take many years to finalize.
- Lawsuits against equipment manufacturers, suppliers and sub-contractors will also add to the claims – even to the extent of defense costs.
- The \$20 billion fund established by BP could reduce the chances for large liability awards.

Source: Insurance Information Institute (I.I.I.) 9/1/10; Towers Watson, 08/02/10; Bank of America Merrill Lynch research note 08/20/10; Barclays Capital research note 05/10/10; Credit Suisse research note 05/11/10

# But it is more complicated than that.....

- **Other types of claims likely to be filed:**
  - Personal injury claims on behalf of families of persons suffering injury or death in initial platform explosion
  - Products liability and/or negligence claims against equipment manufacturers, suppliers etc.
  - Natural resource damage claims from states (water, air, seashore)
  - Claims by businesses and individuals for lost earnings and/or property damage, (e.g. fishermen, shrimpers, resort operators, excursion boat operators, casino operators, hotels, restaurateurs.)
  - Claims alleging lost revenues at the govt. level, (e.g. royalties, lease payments, fishing licenses, sales taxes)
  - Environmental claims (e.g. on behalf of conservationists and fishermen)
  - Health claims by workers assisting with cleanup (e.g. occupational injury due to use of dispersants) and coastal residents

Source: Credit Suisse Research Note 05/11/10; Insurance Information Institute (I.I.I.) 9/1/10

# So what does the Macondo loss mean for buyers in the Commercial Market?

- Initial Reaction Post April 20<sup>th</sup>
- Other Market Losses
- 2010 Windstorm Season
- Reinsurance Renewals
- Other Impacts of Macondo
- The Competitive Landscape
- 2011 Challenges



# Initial reaction post Macondo

- As expected the market “over reacted”
  - 1<sup>st</sup> deepwater well was drilled in 1980
  - Over 2100 deepwater GOM wells have been drilled since without incident
- Control of Well rates in deepwater immediately increased over 100%
  - Capacity also being closely looked at
- GOM Rig physical damage rates increased by more than 20%
- Liability rates for deepwater operators increased by more than 25%
  - Bermuda markets became reluctant players at attachment points of less than \$500M.
  - Casualty insurers started enquiring about the limits purchased for COW and in some cases wanted this information noted on the policy.

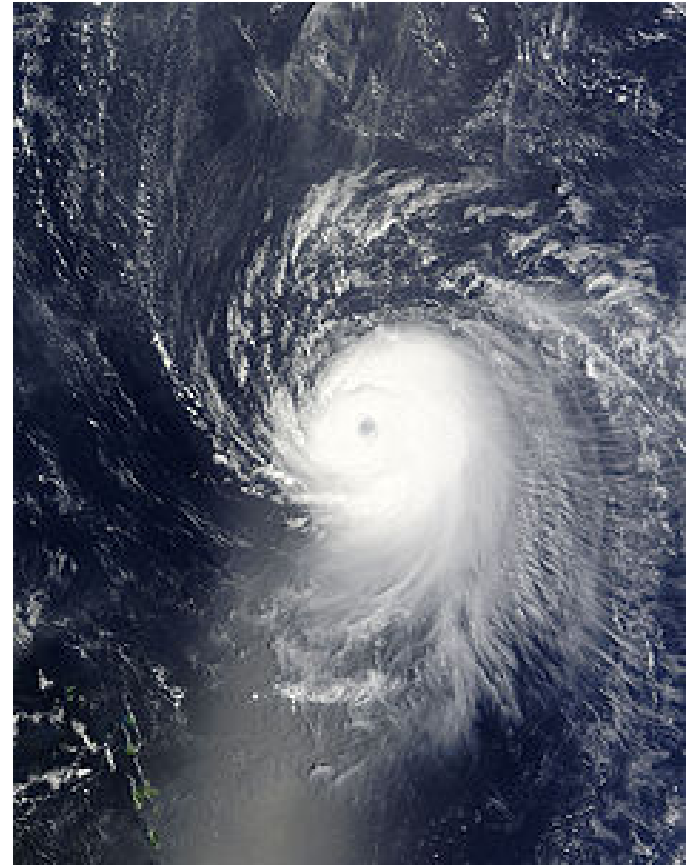
# Other Recent Market Losses

- “Alban Pearl” – sank May 13<sup>th</sup> – Market Loss \$235 million approx. <sup>(1)</sup>
- Apache – additional IKE claim for LOPI presented to the market in May – estimate \$150 million <sup>(1)</sup>
- Enbridge – July 27<sup>th</sup>, Kalamazoo Oil Spill - \$350 million <sup>(2)</sup>
- PG&E – September 9<sup>th</sup>, San Bruno Pipeline Explosion - \$ ?????

(1) Willis Energy Market report (2) Enbridge Energy Partners LP

# 2010 Windstorm Season

- Forecasters were predicting a very active season with anywhere between 15 and 23 named storms, 8 – 14 hurricanes and 3 – 7 major hurricanes (cat 3 and above)
- CSU estimated a 76% chance of a major hurricane hitting the US Coast
- As of October 14<sup>th</sup>, there have been 16 named storms, 9 hurricanes and 5 major hurricanes
- This is much closer to an average year as opposed to a “very active year”
- In addition, no hurricane actually made landfall in the USA, although Earl skirted the Eastern Seaboard as a Category 2 / 1
- **But no losses to the Energy Market.....**





# Reinsurance Renewals

- Largest single insurance claim event in 2010 to the Reinsurance market was the Chilean Earthquake
  - Approx. \$350 million to the Energy Market but;
  - \$8 - \$12 billion to the re / insurance market as a whole <sup>(1)</sup>
- This did little to move the reinsurance market for renewals at July 1<sup>st</sup> other than in areas specifically affected by the losses <sup>(2)</sup>
- Losses from the Energy Market may move prices higher but not dramatically <sup>(2)</sup>
- Reinsurers may well require much greater detail on potential clash coverage between multiple assureds' and multiple coverages on a single exposure <sup>(2)</sup>



(1) Insurance Journal Sept 2010 (2) Guy Carpenter July 2010 reinsurance review



# Other Impacts of Macondo

- US Deepwater Drilling Moratorium
- New BOEMRE requirements for all OCS properties and drilling activity
- Proposed changes to U.S. Oil Spill Legislation
- Contractual Reviews
  - between Operators and Partners
  - between Operators and Contractors



# The Competitive Landscape

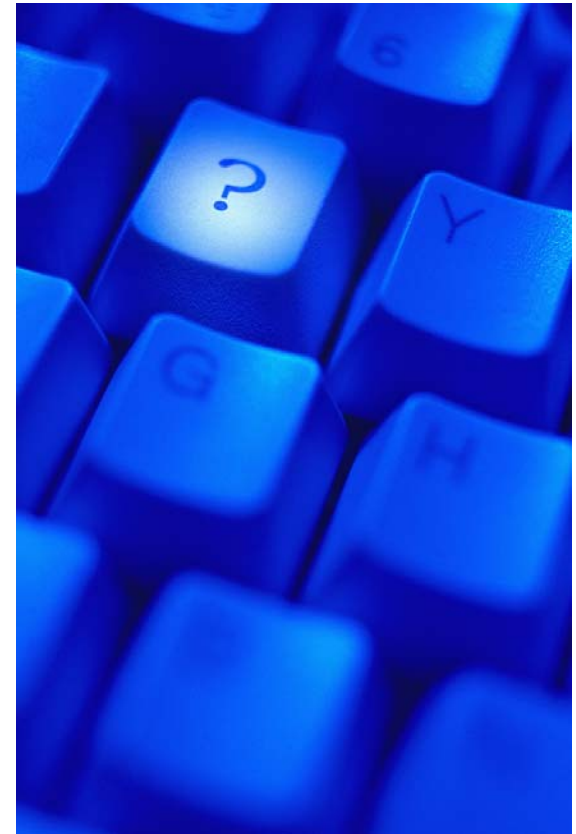
- Long term viability of Insurers requires adequate pricing,

## **BUT**

- Supply and Demand weigh heavily into the equation
- The majority of Deepwater GOM operators are either self insured or a member of OIL
- There is still more than enough capacity in the Energy Market for all but the very largest of risks
- There is evidence of some premium increases on offshore renewals – but nothing dramatic
- There is no indication from Reinsurers (yet) that capacity for 2011 will reduce dramatically or that prices will increase significantly
- Underwriters have had a further year without GOM windstorm losses

# 2011 Potential Challenges

- What effect with the EU Solvency “2” directive have on the capacity offered by European Underwriters (including Lloyd’s)?
- Will the reinsurance market for Energy Business actually harden?
- How much influence will the Lloyd’s franchise board have on the business plans of each Underwriting Syndicate or Company?
- What will the revisions to OPA 90 mean to operators?
  - Increased COFR limits?
  - Necessity of increased liability levels to meet regulations?
- How will the market respond to these?



**2011 will be a challenging year for both the Energy Industry and Insurers**

# Potential Involvement of Other Affected Parties



# Business Interruption Claims

- Business Interruption Claims can take many forms:
  - Direct: Loss of Production Revenue (Energy Package)  
Loss of Business Income (1<sup>st</sup> Party Property)
  - Indirect: Typically manuscript wordings; terms unique to each policy and situation
- Example: Refinery loses its supply ... “loss of use”?

## Business Interruption Claims (cont'd.)

- Wordings of Particular Grant of Coverage important
  - Covered peril?
  - Actual physical loss to own property or property of others upon which you rely?
  - Timing of business suspension
- Decline of general market conditions insufficient

# Additional Insured / Indemnification Issues

- Basic CAR policy risk allocation principles
  - Contractor liability for works capped by fixed limit and/or operator deductible
  - Commonality for risks other than works, e.g. own property, third-party and consequential damages
  - Role of indemnities
    - Sole, gross negligence and willful misconduct
    - *Lloyds v. BP* litigation
    - Overlapping indemnities
  - Waiver of subrogation

# Additional Insured / Indemnification Issues (cont'd.)

- Lloyd's of London v. BP Litigation
  - BP provided Transocean's excess liability insurers with notice of claims arising out of *Deepwater Horizon* incident on May 14, 2010
  - Transocean's excess insurers filed a declaratory judgment lawsuit against BP on May 21, 2010
  - Two weeks later, Transocean's captive insurer filed an almost identical declaratory judgment action against BP
    - \$750 million in liability coverage at issue
    - Venue/consolidation motions pending
  - Primary coverage issue is whether BP is entitled to coverage as an "additional insured"
    - Insurers argue that drilling contract limits "additional insured" coverage to liabilities assumed by Transocean under contract
    - BP argues that insurance policy language controls



## Lloyd's v. BP Litigation (cont'd.)

- Transocean excess policy language unknown
- London Umbrella JL 2003/006 policy form indemnifies “Insured” for “Ultimate Net Loss” by reason of liability assumed by “Insured” under an “Insured Contract”
- The policy form defines “Insured” to include:
  - (c) *any person or entity to whom the “Insured” is obliged by written “Insured Contract” entered into before any relevant “Occurrence” to provide insurance such as is afforded by this Policy but only with respect to:*
    - i) *liability arising out of operations conducted by the named “Insured” or on its behalf; or*
    - ii) *facilities owned or used by the named “Insured”;*

## Lloyd's v. BP Litigation (cont'd.)

- The policy form defines “Insured Contract” as:

*[A]ny written contract or agreement entered into by the “Insured” and pertaining to business under which the “Insured” assumes the tort liability of another party to pay for “Bodily Injury”, “Property Damage”, “Personal Injury” or “Advertising Injury” to a “Third Party” or organization.*

# Lloyd's v. BP Litigation (cont'd.)

- Under drilling contract:
  - Transocean agreed to indemnify BP for liability related to pollution originating above surface from discharge of fluids in possession and control of Transocean
  - BP agreed to indemnify Transocean for any pollution-related liabilities not assumed by Transocean
  - BP named additional insured for liabilities assumed by Transocean
- Insurers relying on these provisions

# Non-Operating Owner Liability

- “Challenges” of meeting Named Assured definition of Operator’s Policy
- “Challenges” of meeting covered peril in your own property coverage
- Operating Agreement (hopefully) will deal with division of liabilities.
- Review own insurance for possible separate cover.

# Presentation and Adjustment of Oil and Gas Claims



# How Claim Estimates Can Lead to Dispute

- The lack of information just after a loss event
- Urgent requests for an initial claim estimate
- Factors influencing claim estimates
- Allowing for contingencies

**Solution: Provide a range of best-case and worst-case estimates**

# Contingency Considerations

- Is the full extent of the loss and damage known?
- What is the necessary scope of the remediation work?
- How long before production or service is reinstated?
- How effective will the loss mitigation efforts be?
- Delays due to access restrictions, incident investigation and regulatory/statutory issues?
- Manufacturing lead times?
- Availability of contractors, vessels and equipment?
- Cost escalation and estimating inaccuracies?
- Time required for engineering and procurement?
- Weather and seasonal delays?

# Substantiating Oil & Gas Claims

- What information is required?  
(This is not just about collecting invoices)
- Level of detail required?
- Planning and organizing saves time and expense
- Set up project cost controls and adequate claim resources or you may require the services of a claim archaeologist!



## OEE Claims – When is a well safe?

When a drilling or production facility has been damaged as a result of a named peril, the Making Wells Safe Endorsement covers:

*“...the actual costs and expenses incurred in preventing the occurrence of a loss insured ...”*

*“Underwriters’ liability ... shall cease at the time that (1) operations/production can be safely resumed, or (2) the well is or can be safely plugged and abandoned, ...”*

## **“Safe” vs. “Unsafe”**

- “Safe” is not a defined term in the policy
- Oil & Gas Industry practice
- Abandoning wells on toppled platforms
- Reliance upon two pressure barriers
- Uncertain integrity of tubing/casing strings
- At what point is it safe to commence P&A operations?

# PD Claims: Rebuilding to a Different Specification

- The policy only pays up to the cost of 'like-for-like' repairs
- Detailed repair cost estimates are therefore required to determine the hypothetical 'like-for-like' repair cost
- Basis of Recovery: Actual expenditure versus Unrepaired Damage claim and RCV versus ACV
- Insurers attitude to hypothetical repair costs and 'windfall' payments

# CAR Claims: The Owner/Contractor Relationship

- In addition to its policy terms, recovery under a CAR policy is contingent upon the insurance and indemnity clauses contained in the construction contract
- The cause of failure may affect contractual issues, such as liquidated damages, as well as recovery under the policy
- The Owner may side with the insurers on some issues and with the Contractor on other issues
- The Contractor does not have direct access to the insurers and may not have the same extent of coverage

# Panel Discussion: Current Developments and Specific Challenges Unique to Offshore Coverage Claims



# Thank You for Attending



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