CRISIS MANAGEMENT IN THE GAS PATCH (PART 2): HANDLING WELL CONTROL CLAIMS

Date: 14 September 2016

Oil & Gas and Insurance Coverage Alert

By: Paul C. Fuener, Justin T.Waddell, Justin T. Waddell, Nicholas Ranjan

In a challenging business climate, such as when oil and gas are selling at low prices, exploration and production companies are not only increasingly selective with their drilling programs and capital expenditures, but are also taking measures to limit unnecessary expenses and protect critical investments through insurance and other cost-recovery mechanisms. Among these measures, companies need to consider advanced preparation to minimize costs in the event of a crisis, such as a well blowout, which may jeopardize valuable revenue streams and lead to significant costs incurred to bring a well under control and to ensure regulatory compliance.

This alert is the second in a series addressing various legal issues that exploration and production companies should carefully consider with respect to crisis management practices in a challenging market environment. This alert focuses on practical steps to preserve and maximize potential cost recovery for an out-of-control well.

INCIDENT COMMAND: BOOTS ON THE GROUND

Well control incidents require immediate action. While the priority must be establishing control and ensuring the safety of human life and property, it is good practice to have counsel involved in incident command. Local authorities and emergency services responding to an incident will usually be followed by state and federal officials from agencies governing, among other things, environmental protection, natural resources management, and general or industry-specific occupational health and safety. Early involvement of counsel with experience in crisis management is a critical part of an effective well control response. Counsel can assist in the preservation of evidence and the early retention of technical experts, facilitate the review and production of information to interested stakeholders, and provide counsel to and participate in the interviews of company employees during on-site interviews by regulators and other interested stakeholders.

Additionally, and as discussed below, early involvement of counsel at the site of the incident or at incident command can be helpful in the review of potential sources of cost recovery (e.g., insurance policies and service contracts), as well as ensuring that all of the appropriate notices are timely prepared and sent to insurers and indemnitors to preserve the right to pursue financial recovery for the costs associated with the incident.

IDENTIFYING POTENTIAL SOURCES OF RECOVERY

An important early step when faced with a well control incident or other crisis is the careful evaluation of all potential sources of recovery. These include well control insurance (*see* Control of Well Insurance, the first alert in this series), other types of potentially applicable insurance policies, and contractual indemnity.

Insurance

When attempting to identify relevant types of insurance coverage, the insurance policies containing these coverages may take a variety of different forms and may be termed in different ways. Some insurance policies provide much broader coverage, by means of endorsements or extensions, than the overall policy description might suggest. Where a company has a global insurance program, it is particularly important to check the company's "master" policy, which can include difference-in-conditions and difference-in-limits clauses designed to "plug any gaps" in the coverage provided by the relevant "local" policy.

Many businesses have insurance that responds to losses suffered to the policyholder's own property or profits. These policies cover both tangible property (e.g., equipment and inventory) and intangible property (e.g., business interruption coverage insuring against a policyholder's lost revenue). The insurance instruments containing these types of coverages may take a variety of different forms. Potentially relevant coverages include:

- **Property damage coverage.** Property insurance typically covers "physical loss of or damage to" insured property resulting from a covered cause of loss. "Insured property" often is broadly defined by the policy or applicable law. In addition to the insured's building or structure, policies typically expressly cover "business personal property", such as machinery and equipment and leased property. Policies also typically provide coverage for the property of third parties that is in the insured's "care, custody or control." As to the cause of loss, a business may have "all risk" coverage, which broadly covers all causes of loss that are not expressly excluded. Alternatively, the business may have "named peril" coverage, which covers against loss caused by various listed "perils" or causes of loss.
- **Business interruption coverage.** A policy covering property damage also typically reimburses the insured for its loss of earnings or revenue resulting from covered property damage. Note, however, that losses related to lost production of an oil or gas well may be excluded, depending on the language of the policy.
- **Contingent business interruption.** A policy including this coverage extends business interruption coverage to losses resulting from damage, not to the insured's own property, but to the property of an insured's supplier, customer, or some other business partner or entity, which damage renders that entity unable to conduct normal business operations. A business may have coverage, for example, if it suffers lost earnings or extra expense because a third-party's specialized equipment was damaged or destroyed in a well control incident.
- **Service interruption coverage.** Service interruption coverage provides coverage for business interruption attributable to the disruption of electric, telecommunication, and other critical services.
- **Claim preparation expenses.** This coverage generally provides coverage for expenses incurred by an insured to prepare, support, and certify a claim.

These coverages, which are found in many property insurance policies, may serve as a significant additional source of recovery for a business affected by a well control incident.

Contractual Indemnity

Some losses, however, may be difficult to recover from insurance, depending on the particular types of coverage and their terms and conditions. For example, well control policies may exclude loss or damage to property, whether that property is owned by the insured or a third party. Liability policies may exclude coverage for "owned property" or property in the "care, custody, and control of the insured." And first-party commercial property insurance, assuming that it is triggered by a well control incident, may not cover damage to a third party's property. Contractual indemnity may fill these and other potential "gaps" in insurance coverage available to respond to a well control incident.

Contractual indemnity is particularly important in the context of a well control incident. Oil and gas service contracts often include "knock for knock" indemnities. A knock for knock indemnity, in general, provides that both parties agree to indemnify the other for: death or injury to a party's employees; loss of, or damage to, the party's own property; and any pollution emanating from a party's property. Importantly, and subject to applicable law, these indemnities may be enforceable regardless of whether a party's own negligence may have caused or contributed to the loss in question.

COST TRACKING AND PRESENTING A CLAIM

Things are going to happen fast after a loss of well control. Keeping track of activities and costs at the site will be critical to later cost recovery efforts. Insurance policies often have various exclusions, sublimits, or deductibles that may apply depending on the particular circumstances of the loss. The manner in which the policyholder characterizes a loss and presents its claim may impact upon whether these limiting features of a policy are applied to its claim.

For example, insurance policies may exclude any employee-related costs, including overtime, travel, etc., and may state that in cases where both covered and noncovered liabilities are implicated, the insurer will pay only those costs associated with the covered portion of the claim. If the policyholder engages a law firm for a number of tasks associated with its crisis response, separate accounting and billing for defense costs associated with different claims and issues may improve a policyholder's ability to recoup those costs. The same goes for specialist well control firms and consultants and related equipment rental and service providers. It is recommended that a policyholder create a separate internal account for all costs of response and require that external service providers separately account for costs and fees associated with different aspects of the incident.

In addition, a policyholder is advised to consider retaining a third-party claims adjuster. Some well control and other policies may cover the cost of a third-party adjuster under a coverage extension for reimbursement of costs related to claims handling. Third party claims adjusters can help to properly present a claim, as well as to respond to insurer inquiries regarding the nature and reasonableness of response costs. This is particularly true in the well control context, where certain policy language may permit the insurer to argue that the policyholder could have brought the well under control earlier than it did, or that it did not use the "most prudent and economical means" while attempting to restore a damaged well.

CONCLUSION

It is important to have an understanding of available sources of recovery in the event of a well control incident. Counsel with insurance and crisis management experience can help assess the viability and strength of a potential claim, deal with insurer loss adjusters, maximize the policyholder's potential insurance recovery, and identify other potential sources of cost recovery.

KEY CONTACTS

PAUL C. FUENER
PARTNER
PITTSBURGH
+1.412.355.6327
PAUL.FUENER@KLGATES.COM

