Key Insurance Coverage Issues for Offshore Operations and Construction Projects
Our Speakers

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An overview of key areas of dispute: hurricanes and blowouts
Overview of Key Areas of Dispute: Hurricanes and Blowouts

I. Windstorms

– Prior to Macondo, windstorm claims for Ike, Ivan and Katrina in the Gulf rocked the offshore producers and insurers
  • 80+ downed platforms in Gulf from Katrina
– Large claim exposures from catastrophic events inevitably expose tensions in policy language and coverages which creates disputes.
A. Wreck removal / decommissioning ("ROWD")

- Traditionally part of Energy Package Policy, first party, 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.”
three (3) triggers (1) compulsory by law, (ii) liable under contract (e.g., Insured contract) or (iii) interferes with operations (e.g. voluntary)

- Additional or Excess ROWD within Energy Package
- Excess ROWD
- Stand alone excess ROWD
- 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* (5th Cir. 1983)
  - *Danos Marine v. Curole Marine* (5th Cir. 2010)
- *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
  - Policyholders contend that MMS order or directive is imposed by law or legal liability
B. 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

– 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.]
Fact Pattern

- Policyholders with sub-limits for Section IIC instead of combined single limit for Sections II, A, B and C.
- Wells drilled to control seepage after Section II A and Section III (OPA) limits exhausted
- Insureds looking for coverage for relief well activities under more than one section, including Section C, due to separate sub-limits
Expected Insurer Arguments

– Efforts already covered under Control of Well
  - Section C not available for relief wells, but rather for activities such as use of dispersants and collection efforts
– Prove pollution is emanating from covered wells
– Efforts to drill relief wells do not constitute “remedial measures”
  - Remedial measures undefined
  - “nullify” requires escaped oil; Section C does not apply to oil in bore or reservoir
– 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”

C. Control of Well
II. Blowouts: *Macondo*

A. Additional Insured (Indemnification)

- 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

– 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
– Transocean excess policy language is similar to JL 2003/006


– The policy form defines “Insured” to include:

\[(c) \text{ any person or entity to whom the “Insured” is obliged by written “Insured Contract” entered into before any relevant “Occurrence” to provide insurance such as is afforded by this Policy}\]
– The policy form defines “Insured Contract” as:

[ANY]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.
– 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 to limit BP’s status or coverage
B. 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
    - Waiver required by written contract
C. Civil Fines/ Penalties and Punitive Damages

1. Incidents such as *Deepwater Horizon* create potential for fines and/or penalties.

2. Certain policies explicitly exclude civil or criminal fines or penalties.

- Coverage grant obligates insurer to “indemnify Insured for Ultimate Net Loss…by reason of liability imposed by law for “*Damages*” on account of…”

- “*Damages*” defined as follows:
“Damages” means all forms of compensatory damages, monetary damages and statutory damages, punitive or exemplary damages and costs of compliance with equitable relief, other than governmental (civil or criminal) fines or penalties, which the Insured shall be obligated to pay by reason of judgment or settlement for liability on account of Personal Injury, Property Damages and/or Advertising Liability covered by this Policy, and shall include Defense Costs.
3. Policy language which does not explicitly exclude fines and penalties.

…Underwriters will indemnify the Insured for the amount of the Ultimate Net Sum Payable which the Insured shall be obligated to pay by reason of the liability:

(a) imposed upon the Insured by law, or

(b) assumed by the Insured under contract or agreement, for damages on account of:-
(i) **Personal Injuries**;

(ii) **Property Damage**,

(iii) **Advertising Injury**,

resulting from each Loss.
“Ultimate Net Sum Payable” is defined as “the total sum the Insured is obligated to pay, either through adjudication or compromise, as damages in respect of any Loss…” and “Loss” is defined as “an accident, including continuous or repeated exposure to the same general harmful conditions.”

The term “damages” is not defined.

Even when term “damages” not defined, underwriters argue that term does not include fines or penalties.

Issue may turn on applicable law and whether the fine or penalty is compensatory (as opposed to punitive) in nature.
Current trends in market capacity for offshore applications
## Overall Capacity

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<th>Realistic</th>
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Sources - AAA Market Data Base - January 2011
Willis Energy Market Review April 2011
### Recent Losses

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<td>January</td>
<td>Canada</td>
<td>Fire at Oil Sands Plant</td>
<td>$1,000,000,000</td>
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<tr>
<td>February</td>
<td>North Sea</td>
<td>Storm damage to FPSO</td>
<td>$800,000,000</td>
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<tr>
<td>April</td>
<td>Mexico</td>
<td>Sinking of Accom. Unit</td>
<td>$150,000,000</td>
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Impact of recent earthquakes
Market Reaction

- No discernible pattern as yet
- Will halt any potential softening
- Higher premiums on OEE and pollution interests maintained
- Benign windstorm season?
Likely Coverage Trends

• Tighter survey requirements
• Clarification of breach of warranty provisions
• New wordings:
  – WELCAR
  – New pollution form
• Continued review of existing coverages
Risk allocation and insurance provisions in offshore construction and drilling/well services contracts
Inherent risks of offshore activities

“Operations to exploit … oil and natural gas resources … have two prominent features relevant for the present purposes. First, such operations are potentially hazardous … It is plain beyond doubt that an Oil Platform is a dangerous place unless careful and proper safety precautions are taken … the platform holds contained under pressure large quantities of gas and liquid hydrocarbon material which is explosive, very flammable and most dangerous if control of it is lost… The second feature worthy of note is the involvement of many contractors and subcontractors…” (Judgement of Lord Bingham in Caldeonia North Sea Ltd v. London Bridge Engineering Ltd [2002] 1 Lloyd’s Rep 553, HL)
Risks in offshore operations and construction projects

• Risk of owner/operator and contractor/subcontractor own personnel and own property damage
• Risk of liability to third parties for their personal injury or property damage
• Risk of consequential losses
• Risk of pollution or contamination from the parties’ equipment or the reservoir
Contractual allocation of risk in offshore operations/construction

- Risk of injury to own personnel and own property is allocated on a ‘knock for knock’ or mutual hold harmless basis.
- Risk of liability to third parties as a result of the operator’s or contractor’s conduct is allocated on a traditional fault basis (i.e. each party indemnifies the other for liabilities to third parties caused by its own fault).
- Usually, the risk of each party’s own consequential loss is allocated on a ‘knock for knock’ or mutual hold harmless basis; and
- Risk of pollution is often allocated on a knock for knock basis with each party assuming the risks of pollution emanating from its own property (including, in the case of the owner/operator, the reservoir itself).
What is knock for knock?

- In its purest form it is designed so that each party assumes responsibility for injury to its own personnel or damage to its own property regardless of fault.
- Achieved by way of mutual and reciprocal indemnities.
- Most IOCs and NOCs and even some larger contractors will have their own contract form.
- A common approach to risk allocation can be found in the LOGIC (Leading Oil and Gas Industry Competitiveness) suite of contracts.
Basic knock for knock provision (1)


*Indemnity and hold harmless from the Contractor to the Project Owner/Operator:*

“Clause 22.1(a): The CONTRACTOR shall be responsible for and shall save, indemnify and hold harmless the COMPANY GROUP from and against all claims, losses, damages, costs (including legal costs) expenses and liabilities in respect of … loss of or damage to property of the CONTRACTOR GROUP arising from, relating to or in connection with the performance or non-performance of the CONTRACT …”
Basic knock for knock provision

**Operator to Contractor:**

“Clause 22.2(a): The COMPANY shall be responsible for and shall save, indemnify and hold harmless the CONTRACTOR GROUP from and against all claims, losses, damages, costs (including legal costs) expenses and liabilities in respect of … loss of or damage to property of the COMPANY GROUP … which is located at the WORKSITE arising from, relating to or in connection with the performance or non-performance of the CONTRACT, but excluding the PERMANENT WORK …”
Advantages of knock for knock

• Makes the risk allocation clear and predictable
• Reduces insurance costs in the offshore sector
• Encourages an open exchange of information
• Recognises that each party is best able to manage the risk of injury to its own employees and damage to its own property
• Enables disputes to be resolved and compensation paid (relatively!) quickly
Issue 1: Extent of the parties’ respective groups

• Common for the KFK regime to be extended not only to each party’s losses but also to the losses of each party’s “group” as defined in the contract

• Under LOGIC contracts, the groups are:
  – “Company Group” (the Operator and its co-venturers, plus their affiliates and their employees)
  – “Contractor Group” (the Contractor and subcontractors of any tier and their employees)
Example: Injury to an employee of subcontractor caused by the Operator during offshore operations
Extent of the parties’ respective groups

• Contracts (Rights of Third Parties) Act 1999
• A key issue is whether the owner/operator group is broadly or narrowly defined
• LOGIC contracts define the owner/operator group narrowly and exclude the Company’s other contractors from the Company Group (the “small family” concept)
• This leaves the Contractor with residual exposure to the operator’s other contractors
• Industry Mutual Hold Harmless Scheme (“IMHH”)
Issue 2: “Carve out” of gross negligence and wilful misconduct

• In an ideal world, KFK should apply irrespective of fault
• E.g. LOGIC KFK indemnities for own personnel and own property damage apply “irrespective of cause and notwithstanding the negligence of breach of duty (whether statutory or otherwise) of the indemnified party or any other entity and shall apply irrespective of any claim in tort, under contract or at law”
• However, it is increasingly common to “carve out” gross negligence/wilful misconduct from the KFK indemnities
• This is partly to ensure enforceability of KFK in some jurisdictions
Issue 2: “Carve out” of gross negligence/wilful misconduct

• What is gross negligence?
  – Approach under English law
  – Tradigrain S.A. v Intertek [2007] EWCA Civ 154
  – Red Sea Tankers Ltd v Papachristides (The “Hellespont Ardent”) [1997] 2 Lloyds Rep 547
  – Mance J: Gross negligence would be “conduct which a reasonable person would perceive to entail a high degree of risk of injury to others, coupled with heedlessness or indifference to or disregard of the consequences”
Issue 2: “Carve out” of gross negligence/wilful misconduct


“Gross negligence” is defined in the AIPN forms as “such an entire lack of care as to indicate a conscious indifference and reckless disregard for the safety of people and property and includes wilful misconduct”
Issue 2: “Carve out” of gross negligence/wilful misconduct

- What is wilful misconduct?
  - Much higher threshold than gross negligence
  - Requires that the party knew he was doing wrong or was reckless, not caring whether it was right or wrong (*Horabin v BOAC* [1952] 2 Lloyd’s Rep 450)
  - *Lewis v Great Western Railway* [1877] 3 QBD 195 “misconduct to which the will is a party, something opposed to accident or negligence, the misconduct, not the conduct, must be wilful … perhaps one condition of “wilful misconduct” must be that the person guilty of it should know that mischief will result from it”
“Carve out of gross negligence/wilful misconduct

- Other definitions: “reckless disregard of good and prudent oil and gas field practice”
- The gross negligence/wilful misconduct carve out is often qualified so that it only applies to acts committed at senior levels within the corporate structure of the parties (and not, for example, a foreman on a drilling operation who has a grievance or has become mentally disturbed)
- Bespoke drilling contract:
  - “Gross negligence shall mean any act or failure to act by managerial or senior supervisory personnel which constitutes wanton and reckless conduct, with utter disregard for harmful, avoidable or reasonably foreseeable consequences”
Issue 3: Exemption clauses are interpreted strictly under English law

- Judicial recognition of KFK
  - *Smit International (Deutschland) GmbH v Joseph Mobius* (unreported) “a blunt and crude regime”
  - *Caledonia North Sea Ltd v London Bridge Engineering Ltd* [2002] Lloyd’s Rep 552 “a market practice” which had “developed to take account of the peculiar features of offshore operations”
Issue 3: Exemption clauses are interpreted strictly under English law

• General principle of English law that a party will not be relieved of the consequences of its own negligence without clear words showing that was the parties’ intention

• *Smith v South Wales Switchgear Ltd* [1978] I WLR165HL “when considering the meaning of an indemnity clause one must, I think, regard it as even more improbable that one party should agree to discharge the liability of the other party for acts for which he is responsible”
Issue 3: Exemption clauses are interpreted strictly

- However, where the clause is expressed clearly and unambiguously, there is no justification for placing on the language of the clause a strained and artificial meaning to avoid the exclusion or restriction of liability (*Chitty on Contracts* 30\textsuperscript{th} Edition)
Issue 3: Exemption clauses are interpreted strictly

- If the clause does not expressly exempt a party for negligence, there is a risk that the English courts will not construe it in this way (*Canada Streamship Co Ltd v The King* [1952] AC 192)
- *EE Caledonia Ltd v OrbitValve* [1994] 1 WLR (CA)
Issue 3: Exemption clauses are interpreted strictly

- Tension between KFK provision and express obligations in an oil and gas construction or operations contract
- *Super Scorpio II* (*Smedvig v Elf Exploration UK Plc* [1998] 2 Lloyd’s Rep 659)
- *Deepak v ICI* [1999] Lloyd’s Rep 387 CA
Issue 3: Exemption clauses are interpreted strictly

- *Seadrill Management Services Ltd v OAO Gazprom* [2010] EWCA 691
  - International Association of Drilling Contractors (IADC) standard daywork form
  - English governing law
  - KFK provision not sufficiently clear to exclude contractor’s liability for breach of implied warranty
Specific issues in Drilling/Well Services Contracts

The following specific risks are often defined in the contract and allocated to the operator (LOGIC Model Drilling Contract 1997):

- Pollution or contamination emanating from the reservoir or the property of the Company Group
- Loss of or damage to property, materials or equipment whilst “in hole” below the rotary table, except if caused by the negligence of the contractor or subcontractors used to provide specified equipment and personnel
Specific issues in Drilling/Well Services Contracts

• Loss of or damage to any well or hole
• Blowout, fire or explosion, cratering or any uncontrolled well condition (including the costs to control a wild well and the removal of debris)
• Damage to the reservoir or geological formation
Issues specific to Drilling/Well Services Contracts

AIPN 2002 International Well Services Contract

- KFK subject to gross negligence/wilful misconduct
- Same general ‘carve outs’ borne by operator – e.g. spills emanating from Company Group equipment, equipment damaged Down Hole, well control, damage to the subsurface and reservoir
Pollution

• Typical approach is that the drilling contractor is responsible for pollution emanating from its above surface equipment and the operator bears ultimate liability for pollution and contamination.
Deepwater Horizon

- Drilling Contract between BP and Transocean Ltd
- SEC Filing by Transocean August 2010: “Under our drilling contract for Deepwater Horizon, the operator has agreed, among other things, to defend, release and indemnify us from any loss, expense, claim, fine, penalty or liability for pollution or contamination, including control and removal thereof, arising out of or connected with operations under the contract other than for pollution or contamination originating on or above the surface of the water …”
Deepwater Horizon

• Considerable attention now focussed on KFK indemnities in drilling contracts and enforceability issues

• May see a greater number of carve outs to KFK provisions and more qualified definitions of gross negligence
Closing remarks

• Risk allocation must be reviewed in relation to each specific project rather than relying upon standard oil and gas forms
• Remains critical to draft indemnities and exclusions precisely
• Verify whether risks assumed by indemnity obligations are passed to others by way of back-to-back indemnities or covered by insurance
The new offshore construction wording
The Future WELCAR

Some thoughts as to its likely shape and scope

May 2011

David Sharp

Senior Consultant, INDECS
Offshore Construction All Risks Insurance
Contractual and Coverage Issues
Risk of damage to the works during construction

• Usually borne by the contractor and carved out of the KFK indemnity
• LOGIC Marine Construction Contract Clause 24.1:
  “… the CONTRACTOR shall be responsible for the PERMANENT WORK from the EFFECTIVE DATE OF COMMENCEMENT OF THE CONTRACT until the COMPLETION DATE of the relevant part of the PERMANENT WORK, at which date or dates responsibility shall pass to the COMPANY”
Responsibility to insure

“The COMPANY shall arrange Construction All Risks insurance … Liability for deductibles is payable under such insurance relative to the WORK shall be for the account of the CONTRACTOR but the size of such deductibles shall not be increased without the prior consent of the CONTRACTOR. The COMPANY agrees that the insurance shall be properly placed and be maintained on the same terms for the benefit of all parties mentioned as assureds for the period set out in Appendix 1 to Section 1 – Form of Agreement”
LOGIC

• Clause 24.5 allows the Company to self insure and provide the contractor with an indemnity in lieu of the policy

• Liability for deductible
WELCAR – coverage issues

QA/QC Clause

- As a condition precedent to coverage as an additional insured, contractor must have carried out the works in compliance with a Quality Assurance/Quality Control ("QA/QC") programme
- Also a condition precedent to the waiver of subrogation
- QA/QC clause is often deleted
- Where it is used it will need to be reflected by a corresponding provision in the offshore construction contract
WELCAR – coverage issues

- What level of QA/QC programme is required?
- May not be immediately clear that there has been a failure to comply with the QA/QC programme
Issues with Other Assureds

• *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd’s Rep 582
  – Davy’s obligation was to “insure on an All Risks basis the work and materials in the course of manufacture until the time of delivery”
  – National Oilwell (the subcontractor) was held not to be insured in respect of matters arising after delivery
  – No insurable interest beyond delivery
  – Waiver of contribution clause similarly limited
Issues with Other Assureds

- **BP Oil Exploration v Kvaerner Oilfield Products Ltd** [2004] All ER 87
  - National Oilwell applied but the Court decided that, construing the contract as a whole, Kvaerner was entitled to the benefit of the policy to the full extent available to BP
BP v Kvaerner

Colman J:

“whilst it is widespread practice in the field of oil and gas Construction All Risks Contracts for provision to be made for main contractors to have the benefit of cover for property damage under the Operator’s policy which correspond to that given to the Principal Insured … this is by no means an invariable practice. A particular operator might have particular commercial reasons for wishing to provide a main contractor with less than co-extensive cover”
Issues with Other Assureds

- *Hopewell Project Management Ltd v Ewbank Preece* [1998] 1 Lloyd’s Rep 448
  - Held that engineers were not “subcontractors” and therefore were not insured under CAR policy
  - Cases underline the importance of checking the underlying contract to verify the extent to which the contractor, subcontractors and subconsultants are afforded the benefit of the CAR policy
“Defective parts

The insurance afforded by Section I covers physical loss and/or physical damage to the property insured herein occurring during the Policy Period resulting from a Defective Part, faulty design, faulty materials, faulty or defective workmanship or latent defect even though the fault in design may have occurred prior to the attachment date of the Policy. Section I, however, does not provide coverage for loss or damage to (including the cost of modifying, replacing or repairing) any Defective Part itself unless all of the following is satisfied:
Exclusion of Defective Part 2001 WELCAR Policy

(a) such Defective Part has suffered physical loss or physical damage during the Policy Period;

(b) such physical loss or physical damage was caused by an insured peril external to that part; and

(c) the defect did not cause or contribute to the physical loss or physical damage"
Exclusion of Defective Parts

- Difficulty in identifying what is actually a “part”
- *The Nukila* [1977] 2 Lloyd’s Rep 146 CA
  - High Court:
    “a part … was one which was physically separable and performed a separate function”
  - Court of Appeal:
    “The word part is capable of being used in a whole variety of ways depending upon the context … The weld is a part just as much as a bracket or bulkhead or plate or the totality of the leg structure”
Latent Defects

- Latent Defect or Physical Damage?
- *Pilkington UK v CGU Insurance* [2004] All ER 272
  
  “damage requires some altered state, the relevant alteration being harmful in the commercial context”

- *Seele Austria GmbH & Co v Tokio Marine Europe Insurance Ltd* [2007] BLR 337
Physical Damage

• **Seele Austria** (cont’d)
  Field J:
  “*damage means here not a defect in the works but an adverse physical affect on the state of the physical state of the works as a result of the defect … there is no damaging within the insuring clause and therefore no cover under an unbespoke Contractor’s All Risks policy for the cost of rectification where a defect is discovered which has not yet physically affected the insured property but will do so unless it is rectified*”

• **Quorum v Schramm** [2002] 2 All ER Comm
  – Sub-molecular damage
Offshore pollution insurance – the inconsistent approach in the oil and gas market
Offshore Pollution Insurance
The Inconsistent approach in the Oil and Gas Market

Paul King, Director,
Indecs Consulting Limited
Who am I?

- An ex risk manager with RTZ, Mobil and Enterprise Oil
- Director of Indecs
What I want to talk about

• What a loss does to test your insurance product
  – Reaction
  – Expectation
• The inconsistency in buyers and sellers of pollution insurance
• Not a blame game
Deepwater Horizon

- 20\textsuperscript{th} April 2010
- Fire burned for 36 hours
- 11 people died
- Rig sank
- Hydrocarbons leaked into the Gulf of Mexico for 87 days.
- As of 31\textsuperscript{st} December 2010, BP has spent USD17.7 billion on “response” activities
Reactions

- Regulators (in the US)
- Industry
- OPOL (in the UK)
- Insurance Buyers
- Insurance Sellers
Regulators

- **Big Oil Bailout Prevention Act**
  - “Section 1004(a)(3) of the OPA 90 Act to be amended by striking USD75,000,000 and inserting USD10,000,000,000”
  - There was a genuine fear that no one, other than “Big Oil” would be able to work in the Gulf again

- **Other Bills**
  - Mandated mutual insurance

- **All deep water drilling stopped**
Regulators cont’d

• EC proposed more work needed re environmental liability directive
  – Damages for biodiversity and ecosystems
• D.E.C.C. in the UK questioned whether OPOL was adequate
• Compulsory Insurance mentioned
Industry

- Well capping
- Well examination
- National Contingency Plan
- Shared resources
- OSPRAG formed
- Status quo not an option
- A much closer look at what operators have in their insurance programme
OPOL

- Limit increased to USD250 million (USD500 million in the aggregate)
- Two categories of claim:
  - Reimbursement of remedial measures
  - Compensation to third parties
- 50/50 but unexhausted part can be used
- Claimants must make a claim within 12 months
- NOT a limit of liability
OPOL cont’d

• Direct damages
• Changes Caused confusion all round
  • What’s the size of the fund?
  • What do you mean it applies to property – not just wells!
  • A standalone limit
  • The Operator must insure for everyone
    – Some underwriters were looking at this for the first time
Buyers

• What does “I want pollution coverage” mean?
  – Clean-up v Liability
• “My excess liability insurance sits above my OEE cover for pollution”
• Indecs undertook a number of reviews
  – Not always (usually) true
  – Yes, but not from wells
  – Excluded clean-up
Sellers

- Not possible to transfer the risk fully to insurers
- On the one hand there is pollution coverage provided through the OEE section….
- …on the other there is pollution coverage in the third party section
- Two sets of underwriters from the same company reviewing things in a very different way
- First Party v Third Party
- Agreement v Exclusion
Policy Forms

- EED 8/86
- JL2003/006
- LSW245
- WELCAR
EED 8/86 Insuring Agreement

a) all sums which the Assured shall by law or under the terms of any oil and/or gas and/or thermal energy lease and/or license be liable to pay for the cost of remedial measures and/or as damages for bodily injury (fatal or non-fatal) and/or loss of, damage to or loss of use of property caused directly by seepage, pollution or contamination arising from wells insured herein;

b) the cost of, or of any attempt at, removing, nullifying or cleaning up seeping, polluting or contaminating substances emanating from wells insured herein, including the cost of containing and/or diverting the substances and/or preventing the substances reaching the shore;

c) costs and expenses incurred in the defence of any claim or claims resulting from actual or alleged seepage, pollution or contamination arising from wells insured herein, including Defence Costs and costs and expenses of litigation awarded to any claimant against the Assured, provided, however, that the inclusion of the above costs (and expenses) shall in no way extend the Combined Single Limit of Liability of Underwriters over all Sections of this Policy.
JL2003/006 - Exclusions

- for “Bodily Injury”, “Personal Injury”, “Property Damage” and/or “Advertising Injury” directly or indirectly caused by or arising out of seepage, pollution or contamination however caused whenever or wherever happening

UNLESS

(a) the seepage, pollution or contamination was caused by an “Occurrence”; and,
(b) the “Occurrence” first commenced on an identified specific date during the period set out in Item 5 of the Declarations; and,
(c) the “Occurrence” was first discovered by the “Insured” within fourteen (14) days of such first commencement; and,
(d) written notification of the “Occurrence” was first received from the “Insured” by Underwriters within ninety (90) days of the “Insured’s” first discovery of the “Occurrence”; and,
(e) the “Occurrence” did not result from the “Insured’s” intentional violation of any statute, rule, ordinance or regulation.
JL2003/006 - Exclusions

• **BUT NEVER** for any actual or alleged liability:

  (i) to evaluate, monitor, control, remove, nullify and/or clean-up seeping, polluting or contaminating substances to the extent such liability **arises solely** from any obligations imposed by or on behalf of a governmental authority;

  (ii) to abate or investigate any threat of seepage onto or pollution or contamination of the property of a “Third Party”;

  (iii) for seepage, pollution or contamination of property which is or was, at any time, owned, leased, rented or occupied by any “Insured”, or which is or was, at any time, in the care, custody or control of any “Insured” (including the soil, minerals water or any other substance on, in or under such owned, leased, rented, occupied or controlled property or property in such care, custody or control);

  (iv) in respect of any seepage, pollution or contamination which is directly caused by or **arises out of the drilling of, production from, servicing of, operation of or participation in wells or holes**;
LSW244 - Exclusions

• These are the same as JL2003/006
WELCAR

• Liability Section – nearly the same!

• Replaces (iv) (from wells) with:
  – arising directly out of the transportation by the Assured of oil (other than fuel or other substances used in furtherance of the Assured's operations) or other similar substances by watercraft; or
  – arising directly or indirectly from seepage, pollution or contamination which is intended from the standpoint of the Assured or any other person or organisation acting for or on behalf of the Assured;
Some Good News

- Munich Re (US$10 billion)?
- Lloyd’s (US$1 billion)
- Joint Rig and Liability Committees
  - A new Pollution policy is being developed
    - A coverage agreement for clean-up
    - A coverage agreement for liabilities arising
  - Questions
    - Price?
    - Limit?
    - Broader concept of Liabilities?
    - How does it fit in with existing arrangements?
Thank you
Political risks to offshore operations
Political Risks

- Standard & Poor’s Ratings Agency: oil and gas industry remains vulnerable to political risks
- Oil producing countries such as Venezuela, Equatorial Guinea, Tajikistan, Syria and Iraq are at the top of a global political risk table produced by Aon
- “Arab Spring”
Force majeure

- Not a term of art under English law
- Meaning will be determined by the contract
- Key issues are how broad the definition is and whether the relevant contract allows time/money
For the purposes of this CONTRACT only the following occurrences shall be force majeure:

(a) riot, war, invasion, act of foreign enemies, hostilities (whether was be declared or not), acts of terrorism, civil war, rebellion, revolution, insurrection or military or usurped power;

... 

(g) changes to any general or local statute, ordinance, decree, or other law, or any regulation or bye-law of any local or other duly constituted authority or the introduction of any statute, ordinance, decree, law, regulation or bye law"

The force majeure event must also be “beyond the control and without the fault or negligence of the party affected and which, by the exercise of reasonable diligence, the said party is unable to provide against.”
AIPN definition

“Force Majeure” means any event or circumstance (excluding the inability to pay compensation due under this Contract) beyond the reasonable control of a Party which prevents or impedes the due performance of this Contract, and which by the exercise of reasonable diligence, such Party is unable to prevent, including, without limitation, act of war, act of terrorism, riot, rebellion or civil unrest, … explosion, fire, or expropriation, nationalization, requisition or other interference by any government authority, the enactment or amendment after the effective date of any statute, order, bye-law or other rule or regulation having the force of law in the Area of Operations hereunder or promulgated by a government body claiming to have jurisdiction over a Party…”
Insurance

• War/terrorism exclusions
  – P&I/Marine
  – WELCAR
  – EED
Political Risk Insurance ("PRI")

- Public and private insurers
  - MIGA (Multilateral Investment Guarantee Agency)
  - member of the World Bank
  - Particularly active in the oil and gas sector
  - Tailored guarantees and policies for oil and gas projects (e.g. revocation of leases and concessions, tariffs, regulatory, and credit risks, contract repudiation or disputes under take-off agreements, production sharing, exploitation and drilling rights)
  - several national governments also underwrite their own scheme
  - OPIC (US) provides PRI to US companies e.g. Apache
  - Export Credit Agencies
  - Private insurers: Lloyd’s, AIG, Ace, AXIS, Chubb, Zurich, Houston Casualty
Political Risk Insurance

PRI will usually cover one or more of the following:

- Governmental expropriation or confiscation
- Governmental frustration or repudiation of contracts
- Wrongful calling of letters of credit or similar on demand bonds or guarantees
- Currency related risks such as the inability to repatriate funds
- Political violence coverage against losses resulting from damage to assets or prolonged business interruption
Political Risk Insurance

- Insurers would subrogate to the insured’s rights of recovery, e.g. against the sovereign under the relevant joint operating agreement
- Policies usually define the term “expropriation”
- Check the definition sufficiently wide – e.g. would it cover expropriation of equity in an operator’s SPV?
- Check that both SPV and the operator are insured under the policy
Political Risk Insurance

- “Non-compliance with laws of host country” exclusion
- Coverage issues – policy preconditions, notification, misrepresentation and non-disclosure
- Banks frequently obtain PRI against governments failing to honour contracts for political reasons
- Clear procedures required to notify insurers and satisfy policy preconditions
- Particularly important for lenders
- Importance of keeping accurate records
- Take advice in putting together coherent claim as proof of loss to maximise recovery
Jurisdictional issues in oil and gas claims
Governing Law and Venue for Disputes

I. Applicable Law

A. Policies without pre-determined choice of law or venue provisions

1. Typical Service of suit or venue provision:

“It is agreed that in the event of a failure of the Underwriters hereon to pay any amount claimed to be due hereunder, the Underwriters hereon, at the request of the Insured (or Reinsured), will submit to the jurisdiction of a Court of competent jurisdiction within the United States. Nothing in this Clause constitutes or should be understood to constitute a waiver of Underwriters’ rights to commence an action in any court of competent jurisdiction within the United States, to remove an action to a United States District Court, or to seek a transfer of a case to another Court as permitted by the laws of the United States or of any State in the United States.”
2. Specific venue designated with arbitration

3. Choice of law
   - U.S. state specific choice of law rules
   - Some factors influencing “interests” test: (i) place of contracting, (ii) policyholder headquarters, (iii) location of facilities
   - Significant implications:
     » Bad faith claims
     » *Contra proferentum*
     » Punitive damages
B. Bermuda Form Approach

1. Modified version of New York law
   - New York law, but Condition O purports to disapply certain pro-policyholder canons of construction adopted in New York law, specifically *contra proferentum*, and parol evidence.
   - Other underwriters adopting this approach by designating New York law with following qualification:

   “...provided, however, that the provisions, stipulations, exclusions and conditions of this Policy are to be construed in an evenhanded fashion as between **Insured** and the **Company**; without limitation, where the language of this Policy is deemed to be ambiguous or otherwise unclear, the issue shall be resolved in a..."
manner most consistent with the relevant provisions, stipulations, exclusions and conditions (without regard to the authorship of the language, without any presumption or arbitrary interpretation or construction in favor of either the **Insured** or the **Company** or reference to the “reasonable expectations” of either thereof or to contra preferentem and without reference to parol or other extrinsic evidence). To the extent that New York law is inapplicable by virtue of any exception or proviso enumerated above or otherwise, and as respects arbitration procedure pursuant to Condition N, the internal laws of England and Wales shall apply.”

2. Treatment of New York precedent decided based on application of rules of construction
II. Arbitration and Pre-determined Venue Provisions

A. Typical Bermuda Form Arbitration Provision (in part)

“Any dispute, controversy or claim arising out of or relating to this Policy or the breach, termination or invalidity thereof shall be finally and fully determined in London, England under the provisions of the Arbitration Act of 1996 (“Act”) and/or any statutory modifications or amendments thereto, for the time being in force, by a Board composed of three arbitrators to be selected for each controversy as follows: ....”
B. Challenges to Mandatory Arbitration Clause

C. Other Arbitration Provisions

“In the event of a disagreement between the Company and the Insured under this Policy, the disagreement shall be submitted to binding arbitration before a panel of three (3) arbitrators.

... The arbitration proceedings shall take place in or in the vicinity of New York, N.Y. The procedural rules applicable to this arbitration shall, except as provided otherwise herein, be in accordance with the Commercial Arbitration Rules of the American Arbitration Association.”
D. Importance of uniformity in program regarding choice of law, forum and venue provisions.
Key Insurance Coverage Issues for Offshore Operations and Construction Projects