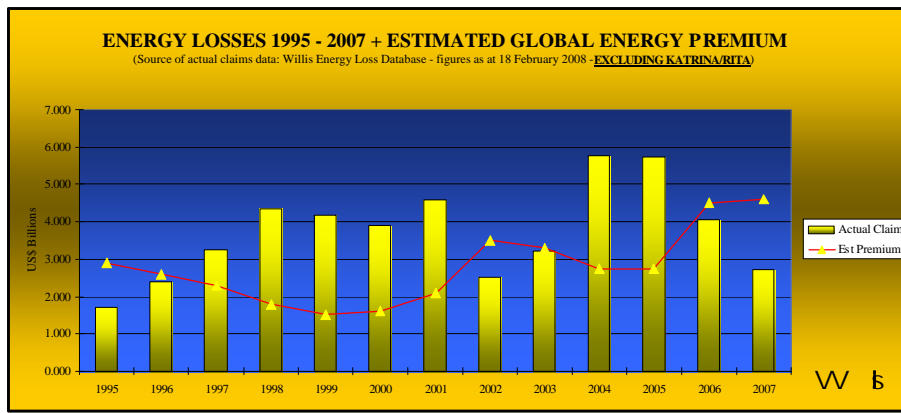


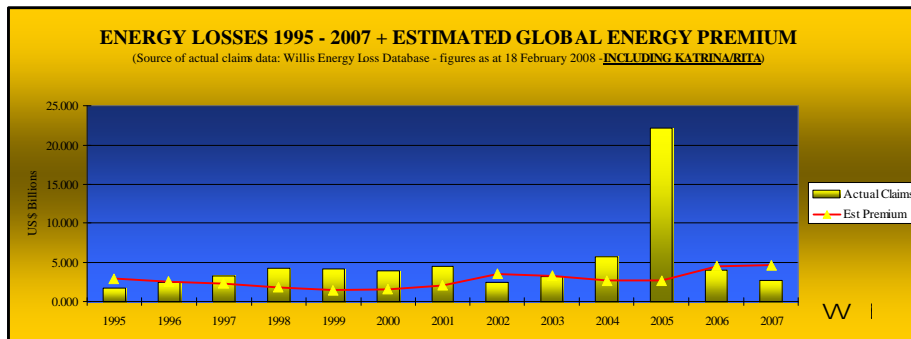
Presentation given by Andrew Jackson, Managing Director of Energy Property & Casualty Claims, Willis Limited at the Lillehammer Energy Claims Conference on Thursday 28<sup>th</sup> February 2008.

## KATRINA & RITA – THE MAIN ISSUES

I believe that Hurricanes Katrina and Rita changed the energy insurance market in the same way that 9/11 changed air travel. Some of these changes have been identified and discussed this morning. A number of these issues were also highlighted by Bryan Johnson and Rodney Winkler at last year's conference but with the aim of producing a complete picture I will include these again. But before I do that let us have a quick reminder of the financial impact these hurricanes had on the energy industry



*Energy Losses 1995 – 2007 + est. premium EXCLUDING Katrina & Rita*



*Energy Losses 1995 – 2007 + est. premium INCLUDING Katrina & Rita*

- ✓ There have been a number of settlements made for claims arising out of these two events but in the majority of cases these have included unallocated costs.
- ✓ Consequently, whilst both the client and the insurers may have found the level of settlement acceptable, in these days of contract certainty is it
  - ✓ acceptable that the client is not aware of precisely what cover they have purchased?
  - ✓ Similarly is it acceptable that that the insurer is not aware of precisely what cover they are providing?

- ✓ It does need to be recognised of course that to some clients there was value in not having to put together a detailed claim.

Why is this the case? In the next 30 minutes I am going to try to outline a number of issues that have arisen out of Katrina and Rita which, whilst they may not be specific to hurricanes, have nevertheless been magnified with these two storms simply because of the frequency and value of the problems.

As I am aware that some of these issues are still under debate, discussion or even litigation, it is not my intention to give any opinion one way or the other but to identify, hopefully for the benefit of all, why we as a market find ourselves in this area of uncertainty and why so many property claims remain unsettled two and a half years after the event. If my opinion does creep into this presentation I retract it in advance and apologise.

Lastly before I get going, I would like to thank a great number of you who are here today and many others who were unable to attend this conference for their valuable input into my understanding of the key issues involving Katrina and Rita.

### **VALUATIONS:**

The nature of the energy industry is one of shifting ownership and valuations. It is not uncommon for valuations to be out of date and incomplete and this is not necessarily reflective of poor management within the oil companies. Trying to keep fully on top of all sales and acquisitions and report these in a timely manner is recognised as a significant activity and doesn't always get the highest priority. This is nothing new. What was new was the sheer scale of the properties affected by Katrina and Rita and the impact that these incomplete and out of date schedules had on the ability to properly formulate the insurance claims. This aspect on its own was responsible for some quite considerable delays in the presenting of claims to the market.

- ✓ When was the last valuation exercise carried out? – this has varied significantly from company to company for a number of reasons, not least being the number of mergers and acquisitions that have been seen in the energy industry in the last few years.
  - Additional problems following mergers and acquisitions include not knowing what is part of who's portfolio and consequently where the insurance belongs.
  - This can be exacerbated if key operations people from the purchased company do not continue their employment in the new company thus losing valuable knowledge.
  - What became clear was that the longer it was left post-acquisition, the more difficult it became to carry out the exercise.
- ✓ What was the correct valuation? - the availability of resource for rebuilding and repairing property after Katrina and Rita created a surge in demand and pricing for these activities.
  - This meant that the pre-hurricane valuation may have been correct but the sum insured was unrealistic and inadequate post-hurricane. Under-insurance also existed simply because there hadn't been a re-valuation of assets for a number of years

- ✓ Absence of properties from schedules – this has long been regarded as inevitable as any active oil company will be changing their asset base on an ongoing basis and any schedule is pretty much out of date as soon as it is completed. Mergers & acquisitions don't help
- ✓ This is recognised by the market by the inclusion of Errors and Omissions clauses in policies however the scale of Katrina and Rita raised a lot of questions as to whether these E&O clauses were being stretched beyond their original intent.
- ✓ Incorrectly scheduled properties – inadequate or incomplete descriptions contributes towards confusion and delay
- ✓ Percentage interests on ownership – most of us are familiar with how rapidly these can change and how it is not always that easy to ascertain the status at the time of the loss particularly if you are a co-venturer. However, the claim cannot be properly adjusted without this information so it has to be obtained

### **REPAIRS:**

There were and still are a number of issues that made assessing the proper cost of repairs difficult

- ✓ Contractors being sent to work repairs on structures that were damaged by different storms in different locations on the same AFE and submitting joint invoices without sufficient information to enable a proper breakdown
- ✓ Tracking costs – accommodation on a single property (such as a platform) damaged by a storm being used as the base for multiple repairs to surrounding properties. Unless the record keeping is good it may be that the host property runs out of available limit due to the insured value because all accommodation costs have been allocated to that property rather than being shared out amongst all involved properties. Transport logs do help overcome this problem but it is still a problem.
- ✓ Other projects – particularly at large facilities it was not unusual for repairs to be carried out concurrently with other projects. Accurate recording for labour and materials in these instances was very important
- ✓ Which hurricane was it that caused the damage? – sometimes it is necessary for a view or test of reasonableness to be taken by the parties involved
- ✓ Damage from a previous storm/incident paid for but not repaired - this can be particularly difficult if the prior damage occurred whilst the property was in different ownership
- ✓ Generality of Joint Interest Billings (these are billings from the operators to the co-venturers for their 'share' of the costs associated with the operation) – these can often lack detail and include non-related costs. This is a problem for non-operators. A solution has been to agree to a percentage acceptance of these costs if a more detailed breakdown is not available. This is often used at the end of the adjustment to enable wrap-up of the claim
- ✓ Lack of available information from the Operator – if the operator has no insurance interests due to lack of insurance, higher level insurance or have exhausted their limits or even already completed a wrap-up deal with their insurers, the incentive to provide further detailed information for non-operating interests is diminished.
- ✓ Change of mind over whether to effect repairs or not – many factors can influence this decision not least the price of oil but having advised insurers that repairs are not going to be carried out and then reversing that decision does have significant impact on all involved

- ✓ E-payables – the practice whereby contractors enter their billing directly into the accounting system of a facility may be beneficial to the running of the asset but if the information captured is inadequate (which in some cases it has been) it is very difficult to break down between activities at a later date. The contractor, having been paid, is naturally not going to put any request for further information at the top of his priority list.

### **REMOVAL OF WRECK/DEBRIS:**

- ✓ What constitutes a wreck? - what constitutes debris? Is there coverage for non-insured property cleanup? Some platforms were covered in sea debris/weed which was clearly not insured property so does the cleanup of this fall for consideration under the ROW/D coverage?
- ✓ Lack of limit under the ROW/D coverage may result in costs being re-packaged as Physical Damage – and maybe some of this should more correctly be recognised as PD. Rarely is 25% of scheduled value sufficient to remove property from the seabed
- ✓ Clash with Making Wells Safe – is clearing access to the wells ROW/D or part of the costs associated with MWS
- ✓ If the costs of ROW/D exceeds the value of the remaining field reserves, it may be decided to cease any further production but the terms of the lease will require that the clear seabed policy is complied with. Does this trigger the ROW/D coverage or is this regarded as a financial consideration particularly if the extent of the removal is increased beyond the level that would have otherwise be required
- ✓ Rigs to Reef – this is difficult to get governmental agreement to. If the property is not in or near a designated reef site then it either needs to be moved to a designated reef site or a Special Artificial Reef Site (SARS) approval needs to be applied for. Apart from the costs associated with creating the reef (and removing undesirable parts such as topsides and any other possible sources of contamination), 50% of the delta between clear removal and reef creation costs is contributed to the State as a fee. Insurers have responded favourably to these costs but is it clear in the policy that this is covered?
- ✓ Liability for removal – does this constitute a first or third party liability if the property is on other property and/or a navigational hazard?
  - ✓ ROW coverage appended to a liability policy typically responds where an insured has a legal or contractual liability to remove wreckage to someone who can bring a suit against you.
  - ✓ The MMS requirement to remove wreckage on first party property may not trigger ROW coverage under a liability policy if coverage under the PD policy has been exhausted
- ✓ Aggregate sub limits – these can be available for removal of non-scheduled/insured properties that have no real residual value but will still incur a cost to remove if they suffer a loss. These coverages were not intended for multiple properties being impacted at the same time as the amount available will inevitably be inadequate. This has turned out to be the case for more than one insured.

### **MAKING WELLS SAFE:**

This has been referred to as an ‘unfortunately named endorsement’

- ✓ Plug and Abandonment - OIL and the commercial markets are generally considering paying the extraordinary P&A costs i.e. those costs over and above the amount that would have been incurred in the eventual normal P&A of the well AND only if coverage for P&A exists in the policy
- ✓ Configuration/Status of wells – it is not always easy to determine the configuration or status of the wells forming part of the claim, without which determining what would have been the normal P&A costs is very difficult to establish
- ✓ What constitutes an unsafe well?
- ✓ Who pays to determine whether a well was unsafe or not?
- ✓ Redrills – if a redrill is required, there have been instances where the operator has changed their mind on conducting a redrill more than 540 days after the event. This would normally preclude coverage under most OEE policies.

### **ONSHORE:**

- ✓ Flood vs. Windstorm – deciding the dominant cause was important particularly as there were different restrictions and limits applicable to each.
  - ✓ Similarly for flood, it was necessary to determine what was Zone A (river flood 1:100 year) or Zone V (storm surge from sea 1:100 year)
- ✓ CBI – what is covered?
  - ✓ Exclusion for offshore structures can negate a claim under a supplier’s policy.
  - ✓ Different limits between named suppliers and general suppliers
  - ✓ Katrina & Rita demonstrated how CBI exposures could be generated that were clearly not foreseeable by either the client or the carriers
- ✓ Pre-landfall costs – the costs involved in shutting down the plant in preparation for the hurricane impact and the associated BI for this period. What happens if it doesn’t hit? Some wordings appeared to envisage no damage being sustained.
- ✓ Price spiking – what was the loss? Hurricane or damage? One point of view was that without PD there was no trigger so if the policy is triggered why should the hurricane be the loss? [Not expecting an answer to this]. Does additional impact on prices due to the outage of the damaged facility form part of the BI claim?
- ✓ Workforce stabilisation – employees displaced. Need to get back in business and carry out the repairs.
  - ✓ Carriers seemed surprised this was a head of claim to this extent. Also necessary as part of preventative measures both for minimising BI and restricting further PD deterioration.
- ✓ Some carriers asked about an audit to see if any employees’ householders policies also responded for displacement with a view to contribution towards any payments made
- ✓ Temporary accommodation

### **OIL INSURANCE LIMITED:**

- ✓ Having declared aggregation limit (not once but twice) for the first time in their history, OIL cannot finalise claims until they have all of them adjusted – this has already taken over 2 years and may take another 4-5 years unless some alternative methodology is considered
- ✓ Some of the commercial market policies ‘drop down’ for any OIL shortfall and where this is the case it is usually quite clear that it IS the case. However, none of

the policies state WHEN this will happen. One school of thought has been that until such time as OIL actually make their final payment, there is no liability under the 'drop down' coverage. Needless to say this has been challenged and mostly with success although time value of money often enters into the negotiations

- ✓ Currently OIL are anticipating paying 50% of adjusted Katrina losses and 70% of adjusted Rita losses
- ✓ Any payment by the commercial market providing 'drop down', wrap or DIC coverage has to be done on a negotiated basis with both the client and commercial market having to take a view and agree on a potential final amount from OIL
- ✓ Questions are being asked as to whether the adjustments that will make up the erosion of the available \$1,000,000,000 limits are correct. Most affected are those OIL members who have no 'drop down' or excess coverage and of course the carriers who are providing any 'drop down' or excess coverage

### **GENERAL:**

- ✓ Lack of available resource is a common theme often mentioned in the issues arising out of these storms. These range from availability of labour and materials to effect repairs to the availability of personnel within the insureds risk management and operations areas. On top of this it was necessary to contend with lack of available flights, taxis, rental cars, or hotels for contractors and adjusters. On many occasions adjusters advised that even if they could get a flight to an affected area, there was no further transport or accommodation available to get them to site
- ✓ Lack of clarity and consistency from the different markets as to what is recoverable or not has been a frustration for all involved including the markets themselves
- ✓ Insureds without a risk manager have to embark on a very steep learning curve to understand the issues they may be facing and also to be persuaded that they are not being treated any differently to other insureds. Without any prior knowledge of the people or entities you are dealing with in our world of insurance, it can be a pretty daunting and challenging task to determine who is best to listen to and dare I say it, trust
- ✓ It has been suggested that coverage under the policy for imposed level 2 surveys costs irrespective of whether damage is discovered or not is something that should be considered
- ✓ Information sharing between operators and non-operators and their adjusters was required on an unprecedented scale
- ✓ Difficulties in establishing accurate estimates was detrimental for clients (renewals and shareholder reporting), insurers (reserving) and adjusters (reputation)
- ✓ CBI – unscheduled contingent properties in the supply and delivery chain. These may be unscheduable as the client may not have known about them.
- ✓ BI – non operators having inadequate information from operators

\*\*\*\*\* END \*\*\*\*\*