

**Testimony of Ron Baron  
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**Energy Insurance Market Capacity for Third Party Pollution Liability and Control  
of Well Risks in Respect of Offshore Exploration and Production Activities**

**Before the Senate Committee on Environment and Public Works  
June 9, 2010**

Good morning Chairman Boxer, Ranking Member Inhofe, and Members of the Committee. My name is Ron Baron and I have over 39 years of work experience in the insurance industry. I am currently an Executive Vice President of Willis' Global Energy Practice. On behalf of Willis, I would like to thank the Committee for inviting me here to testify today. Willis is a major global risk management and insurance intermediary with an integrated network of about 400 offices in over 120 countries. Our Global Energy Practice services hundreds of energy client programs worldwide and those clients include Integrated Oil companies as well as Exploration and Production companies. My testimony is focused on the energy insurance market capacity for control of well risks and third party pollution liability in respect of offshore exploration and production activities.

**Testimony**

There is a worldwide insurance market for offshore energy risks with the traditional leading market being Lloyds of London. I would advise that there is a finite amount of capacity available from the market which varies depending on the type of insurance cover being provided as well as other factors. Generally speaking, third party liability (TPL) insurance provides coverage for property damage and bodily injury liability arising from a company's operations. Control of well (COW) insurance provides coverage for costs and expenses in controlling a well that is out of control as well as redrill, restoration, recompletion, pollution clean up and containment. Another insurance product offered by the market is Oil Spill Financial Responsibility Certification but they typically are backed up by indemnity agreements from the assured (Operator) and/or by evidence of TPL and/or COW insurance. A summary of these types of insurance covers can be found in the Appendix.

When talking about capacity I will use two descriptive words being theoretical and working. Theoretical capacity is the maximum dollar amount that an insurer can commit to any single risk. Working capacity is the dollar amount that an insurer will typically commit to any single risk as insurers seldom commit their maximum capacity to any single risk.

The working capacity for third party liability (TPL) including pollution coverage offshore the United States is in the range of \$1.25 billion to \$1.5 billion. Theoretical capacity for TPL is closer to \$1.9 billion and for risks not subject to U.S. jurisdiction the theoretical

capacity is closer to \$2.4 billion. A number of insurance companies either do not entertain risks subject to U.S. jurisdiction or offer less capacity for same.

The working capacity for control of well (COW) risks is in the range of \$600 million to \$750 million on a stand alone basis. Theoretical capacity for stand alone COW is closer to \$1 billion.

It is important to note that there is a standard provision in both the TPL and COW covers that actually reduces the limits of coverage provided by the insurance market. That provision scales the limit of coverage to the percentage interest that the assured may have in a well. As an example, if a company has a 50% interest in a well and their policy(ies) provides \$400 million of limit than the limit of coverage actually provided by the insurers for that well would scale down to a \$200 million limit.

The working capacity for Oil Spill Financial Responsibility Certification is even more limited and I would estimate the top range to be no more than \$200 million.

As a consequence of the Macondo well incident we initially saw a contraction of the capacity being offered by the insurance market for TPL and COW coverage. The insurance market is also quoting higher premiums for these products since the incident. The magnitude of increased premiums has and will vary dramatically depending on the profile of the particular assured which would include their exposures, operating areas and loss experience.

More recently, due to the increased premium that is being charged for certain of these risks we have seen some insurance companies considering offering more capacity. In particular, we know of one insurance company who has provided pricing indications to a number of interested buyers for additional limits of excess third party liability in the amounts of \$500 million and alternatively \$1 billion (a portion of this "additional" limit already formed a part of the theoretical capacity noted above). Also, we are aware of an insurance buyer who is looking to purchase overall limits of \$1 billion for their control of well coverage but to date that placement has not been completed.

In addition to the capacity available from the commercial insurance market there is an oil industry mutual insurance company domiciled in Bermuda called Oil Insurance Limited (OIL). As of January 1, 2010 there were 54 member companies of which about half were engaged in exploration & production activities. OIL provides a limit of \$250 million per occurrence to it's members. The coverage provided by OIL includes property damage or loss, control of well and sudden & accidental pollution risks. Although this cover is typically used to cover property damage loss to the extent the limit of cover is not exhausted by a single event the balance of the limit would be available to fund costs and expenses arising from a control of well event and or a sudden and accidental pollution event. However, OIL membership is restricted to companies with a minimum of \$1 billion of gross assets and a number of companies are not comfortable with the mutual concept, which requires sharing losses of the group amongst the members.

The actual working capacity available in the insurance market as of today is in a state of flux and although increased premiums should attract additional capacity over a period of time it will not be sufficient to satisfy the liability/financial responsibility limits being proposed under S. 3305.

## **Appendix**

### **A. Third Party (Excess) Liability Policy - Summary**

#### **General Information:**

- This summary is based on XL-004 which is a stand-alone indemnity Excess Liability Policy which is not subject to the terms and conditions of any other insurance.
- Coverage applies, subject to the terms, conditions and exclusions of the policy, only if Notice of Occurrence is first given to the Company during the policy period.
- Defense costs are included within and are not in addition to the limits of liability.

#### **Insuring Agreements - Coverage:**

- Indemnifies the Insured for Ultimate Net Loss the Insured pays by reason of liability imposed by law, or of a person or party who is not an Insured assumed by the Insured under contract or agreement,
- For Damages on account of Personal Injury, Property Damage, Advertising Liability,
- Encompassed by an Occurrence, provided, notice of the Occurrence is first given by the Insured during the Policy Period in accordance with the Notice provisions of the policy.

#### **Limits of Liability:**

- Limits available on this policy form are in the area of \$1 billion to \$1.25 billion per Occurrence and in the annual aggregate. However, in joint venture situations these limits will usually scale down (be reduced) based on the percentage interest of the Insured in the liability of the joint venture.

- The limits of this policy are excess of the greater of the amounts indicated as the limits of the underlying insurances or the per Occurrence retention amount.

**Pertinent Definitions (Including but not limited to):**

- **“Personal Injury”** means Bodily Injury, mental injury, mental anguish, shock, sickness, disease, disability, false arrest, false imprisonment, wrongful eviction, detention, malicious prosecution, discrimination, humiliation, and libel, slander or defamation of character or invasion of rights of privacy.
- **“Bodily Injury”** means physical injury to the body of a person including death at any time resulting there from.
- **“Property Damage”** means:
  - (1) physical damage to or destruction of tangible property, including the loss of use thereof at any time resulting there from;
  - (2) loss of use of tangible property which has not been physically damaged or destroyed arising from physical damage to or destruction of other tangible property; or
  - (3) losses consequent upon evacuation arising from actual or threatened Bodily Injury or destruction of tangible property.
- An **“Occurrence”** exists if, and only if:
  - (a) except with respect to actual or alleged Personal Injury or Property Damage arising from the Insured’s Products, there is an event or continuous, intermittent or repeated exposure to conditions which event or conditions commence on or subsequent to the Inception Date, or the Retroactive Coverage Date, if applicable, and before the Termination Date of Coverage A, and which cause actual or alleged Personal Injury, Property Damage or Advertising Liability.
  - (b) actual or alleged Personal Injury to any individual person, or actual or alleged Property Damage to any specific property, arising from the Insured’s Products takes place on or subsequent to the Inception Date, or the Retroactive Coverage Date, if applicable, and before the Termination Date of Coverage A.
- **“Ultimate Net Loss”** means the total sum which the insured shall become obligated to pay for Damages on account of Personal Injury, Property Damage and/or Advertising Liability which is, and/or but for the amount thereof would be, covered under this Policy less any salvages or recoveries.

- **“Discharge”** means discharge, emission, dispersal, migration, release or escape (or any series of such of a similar nature at the same site) but does not include any discharge, emission, dispersal, migration, release or escape to the extent that the Pollutants involved remain confined within the building or other man-made structure in which they initially were located.
- **“Pollutant”** means any solid, liquid, gaseous or thermal irritant, contaminant or toxic or hazardous substance or any substance which may, does, or is alleged to affect adversely the environment, property, persons or animals, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and Waste.

**Pollution Exclusion and Limited Give Back:**

This Policy does not apply to actual or alleged:-

**POLLUTION**

- (1) (a) liability for Personal Injury, Property Damage or Advertising Liability arising out of the Discharge of Pollutants into or upon land or real estate, the atmosphere, or any watercourse or body of water whether above or below ground or otherwise into the environment; or
- (b) liability, loss, cost or expense of any Insured or others arising out of any direction or request, whether governmental or otherwise, that any Insured or other test for, monitor, clean up, remove, contain, treat, detoxify or neutralize Pollutants.

This Exclusion applies whether or not such Discharge of such Pollutants:

- (i) results from the Insured’s activities or the activities of any other person or entity;
- (ii) is sudden, gradual, accidental, unexpected or unintended; or
- (iii) arises out of or relates to industrial operations or the Waste or by-products thereof.
- (2) Paragraph (1) of this Exclusion does not apply to:
- (a) Product Pollution Liability; or
- (b) (i) liability of the Insured for Personal Injury or Property Damage caused by an intentional Discharge of Pollutants solely for the purpose of mitigating or avoiding Personal Injury or Property Damage which would be covered by this Policy; or

- (ii) liability of the Insured for Personal Injury or Property Damage caused by a Discharge of Pollutants which is not Expected or Intended, but only if the Insured becomes aware of the commencement of such Discharge within seven (7) days of such commencement;

provided that the Insured gives the Company written notice in accordance with Section D of Article V of this Policy of such commencement of the Discharge under Subparagraphs (2)(b)(i) or (ii) of this Exclusion within forty (40) days of such commencement. Such notice must be provided irrespective of whether notice as soon as practicable otherwise would be required pursuant to Section A of Article V of this Policy.

## **B. CONTROL OF WELL INSURANCE**

1. Combined Single Limit over three (3) main coverage sections:
  - A) Control of Well
  - B) Redrill / Restoration / Recompletion
  - C) Pollution Clean-up and Containment
2. Limit typically “scales to interest”
3. A brief description of the basic coverages provided by this policy follows below:

### **Control of Well**

Reimburses costs and expenses incurred for attempting to regain control of any well insured which gets out of control, including any other well that gets out of control as a direct result of a well insured getting out of control. Subject always to the combined single limit provided under the policy.

### **Redrilling/Restoration/Extra Expense**

Reimburses costs and expenses incurred to restore or redrill a well which has been lost or otherwise damaged as a result of an occurrence which would be recoverable under the Control of Well section of the policy. Coverage can be extended to cover a well which has been lost or damaged as a result of physical loss of or damage to the drilling and/or work-over and/or production equipment resulting from specific named perils.

In respect of drilling wells, Underwriters liability ceases when the well is restored to a condition comparable to that existing prior to the occurrence, subject to the combined single limit provided under the policy.

## **Seepage and Pollution/Clean-up and Contamination**

This section indemnifies the insured against:

All sums which the insured shall be liable to pay for the cost of remedial measures and/or as damages for bodily injury or damage to property caused directly by pollution above the surface of the ground and arising from a well insured;

The cost of, or attempt at, removing or cleaning up pollution emanating from a well insured including the cost of containing and/or diverting and/or preventing the pollution from reaching the shore;

Costs and expenses incurred in the defense of any claim resulting from actual or alleged pollution arising from a well insured.

The pollution incident must meet the sudden and accidental definition of the policy. Subject always to the combined single limit provided under the policy.

### **C. OIL SPILL FINANCIAL RESPONSIBILITY**

The operator is required under OPA to maintain financial responsibility either in the form of self-insurance, bonds, letters of credit or stand-alone pollution insurance with liability limits that are adequate to meet its maximum statutory liability.

The pollution insurance liability coverage offered by the insurance market is not true risk transfer as the operator typically agrees to indemnify the insurer for claims paid out under such covers. These indemnifications are backed up by a guarantee letter from the corporation as well as evidence of control of well insurance and/or third party liability insurance.