

ClientAlert

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Insurers and Reinsurers Must Prepare For Complex And Costly Issues From Gulf Coast Oil Spill

At the time of this writing — seven weeks after the April 20 explosion and fire aboard the Deepwater Horizon drilling platform that killed 11 people, injured at least 17 more, and unleashed a torrent of oil into the Gulf of Mexico — progress is for the first time being announced in restraining the underwater gusher.

Yet, this is far from the end for this crisis. Substantial uncertainty remains, bringing it with a number of challenges for insurers and reinsurers.

The Ultimate Outcome Remains Volatile.

Despite the recent success in placing a “cap” on the blown-out well, the situation remains extremely volatile:

- **The Spill is Likely Far From Over.** The device, which some have called a “cap,” is actually more of a siphon. It has not stopped, and will not stop, the flow of oil from the well. It is merely taking a portion of the oil to surface ships for capture or flaring. The relief wells that are currently being drilled are the only (hopefully) permanent solution now being attempted, and they will not be completed until at least August, assuming they are successful.
- **The Containment Operation Will Continue Well Into Hurricane Season.** Assuming the relief wells are on time and are successful, the current large containment operation will continue until at least August. That operation will therefore continue well into the Atlantic hurricane season, which is anticipated to be unusually active. If a hurricane were to move into the spill region, it would likely halt the relief well drilling (and possibly damage equipment). A hurricane would likely require the abandonment of the siphoning operation currently in place. It could also move the oil now reaching the shore further inland, causing even more damage.
- **Even Without A Hurricane, Major Setbacks Could Occur.** At the ocean floor, technology is being used, at tremendous depths and pressures, to do things never before attempted. The “cut” portion of the most recent “cut and cap” procedure actually increased the flow from the well, and if the “cap” had failed would have simply added as much as 20% to the volume of oil being spilled. Other efforts being made at the site of the well likely have potential to make matters worse, and possibly much worse.

At and above the ocean surface, more than 3500 ships (including skimmers, tugs, barges, tankers, recovery vessels and drilling units), as well as dozens of aircraft and remotely-operated vehicles are involved in the response effort. The sheer size of the operation, and the numbers involved, carries the potential for collisions or other mishaps. Approximately 1.12 million gallons of chemical dispersants have been used. Among other things, these dispersants

are alleged to have toxic properties and to have sickened response personnel. At least 24,000 people are working on the spill response, in various employment relationships, some of whose legal status may not be entirely clear (e.g., are they employees or independent contractors?).

- **Even Without Further Setbacks, The Economic and Ecological Costs Will Be Massive.** Early high-end estimates of the likely costs of the Deepwater Horizon spill speculated that the total costs “could” exceed \$1 billion. Seven weeks later, with the flow still not stopped, BP p.l.c. (“BP”) has announced that it has already spent in excess of \$1 billion. Some analysts are now predicting costs of up to \$40 billion or beyond for cleanup and damages. As we write, oil has already reached the shores of Louisiana — including ecologically sensitive marshlands — as well as parts of Mississippi, Alabama, and coastal Florida. This suggests that even the current upper-end “worst-case” estimates of costs the spill could be overtaken by events because the spill could very well impact the ecology and economy of the entire Gulf Coast (where tourism and fishing alone are valued at over \$100 billion annually). There are at least some scenarios in which ocean currents sweep oil around the entirety of Florida, up the eastern seaboard by late summer or fall, and then out into the Atlantic. Under some scenarios, “tar balls” could reach as far as the British Isles.

Complicated Factual and Liability Issues.

Even just the initial explosion and fire has raised complex factual and liability issues. The rig, owned by Switzerland-based Transocean, was operating under contract to BP. Shortly before the blow out, Halliburton Energy Service Inc. had completed “cementing” the well, an operation that, when not completed correctly, has resulted in previous blowouts. Cameron International Corp. manufactured the “blow out preventer” device, which may have been modified from Cameron’s design. The widely-publicized appearance before Congress of representatives of BP, Transocean, Cameron and Halliburton can be seen as confirmation that these facts alone will lead to pitched battles amongst this group of companies regarding liability. The complexity only increases as the focus extends from that group, and as time goes on, and would obviously be affected should a hurricane or mistakes in the response operation (possibly taken at government direction) make matters worse.

To date, over 100 lawsuits have been filed in connection with the oil spill. The Oil Pollution Act could potentially limit the liability of BP and others to only \$75 million, but efforts are underway in the U.S. Senate to raise that cap. Transocean, meanwhile, has moved in court for the application of a different federal statute limiting maritime liability (46 U.S.C.A. §§ 30501 to 30512). Transocean has also asserted that its contract with BP provides Transocean with broad indemnity against liability for pollution and contamination liabilities. For its part, BP has vowed to pay all “legitimate” claims, but has already been criticized for falling short of that.

The liability situation is further complicated by the ongoing investigation into the facts surrounding the accident and the Justice Department’s criminal probe in relation to BP, Transocean, and Halliburton. Criminal charges hold the potential for huge fines and the negation of otherwise-applicable statutory liability caps, in addition to increasing the likelihood of punitive damages to civil claimants. There is also essentially strict liability for certain environmental violations and for fines for the “taking” of endangered species or migratory birds.

Uncertainty as to How Much Will Be Insured.

For insurers and reinsurers, the total damage caused by the spill, and the portion of that damage paid by the various potentially responsible parties, are obviously of great concern. Of more direct pecuniary concern, however, is the amount of insured damage.

In that regard, the liability coverage for the most-obviously-implicated parties is dwarfed by the likely total costs. Transocean, Cameron, and Halliburton reportedly have liability insurance coverage, but that coverage would undoubtedly be exhausted by liability for even a relatively small portion of the total damages, to say nothing of the amounts that will be spent on defense. For its part, BP has said that it fully self insured through captive insurer Jupiter Insurance Ltd., and that Jupiter did not purchase reinsurance. Transocean's excess insurers have also filed an action seeking a declaratory judgment as to their responsibility for BP's cleanup costs as an "additional insured."

First-party property coverage for these and other insureds will also be implicated. For example, Transocean executives have stated that they have already recovered \$481 million of the \$560 million insured value for the Deepwater Horizon itself. The wide range of other possibly-implicated coverage include: Business Interruption/Loss of Production policies; CGL policies; Environmental/Pollution Liability policies; Directors' and Officers' Liability policies; Professional Responsibility policies; Operators' Extra Expense/Control of Well policies; Workers' Comp/Employers' Liability policies; Civil Authority coverage; and Gross Earnings coverage.

A Challenge for Reinsurance Relationships.

Although the underlying facts, liabilities, and insurance coverages are subject to substantial uncertainties, it is not too early for insurers and their reinsurers to consider the implications for their reinsurance relationships. To the contrary, it will be imperative for reinsurers and cedents to establish early and effective communication as these claims develop.

Timely notices, transparent information sharing, and good-faith collaboration regarding claims handling are important for the reinsurance relationship. On the other hand, if not handled properly, they can present risks to both cedents and reinsurers, particularly in the context of high-profile and likely sharply-litigated underlying claims and coverage disputes.

Timely and substantive notices are important for the renewal process, for preserving rights under existing agreements, for reinsurer reserving and notice to retrocessionaires, and for claims handling and cooperation between insurers and reinsurers. With effort and cooperation from both sides, it is possible to achieve these goals while at the same time minimizing the risk that attorney-client privilege may be waived as against the original insured.

These efforts will help provide a needed foundation: as this massive and complicated loss develops, and as the underlying and insurance claims progress, additional strains may develop regarding claims handling, investigation, coverage defenses, litigation strategy, and settlement decisions. In the meantime, both cedents and reinsurers will need to carefully consider, among other things, how underlying payments are allocated, which reinsurance coverages apply, how losses are aggregated and allocated between reinsurance coverages, whether there are applicable exclusions, and how any territorial

limitations apply. (The Deepwater Horizon was approximately 40 miles offshore, but damages are occurring inside the territorial waters of the United States).

Experience and foresight are often crucial to effectively navigating and managing the reinsurer-
cedent relationship. Chadbourne & Parke's insurance and reinsurance practice group has been advising
clients on claims management issues for more than 20 years. With offices in Washington, D.C., New York,
and London, Chadbourne & Parke's insurance and reinsurance attorneys provide unparalleled access and
expertise, allowing clients to anticipate and control complex and costly claims.

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