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Maximizing Insurance Recovery For Energy Companies

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The scale and impact of risks faced by the energy industry — and, thus, the importance of insurance coverage — is unique. Insurance programs in the oil and gas industry reflect this unique complexity, for example, in the fact that no single insurer is able to issue a policy for a large petrochemical complex solely on its own.

The economic, political and societal pressures which have expanded potential liabilities in the industry make it all the more important for energy companies to carefully craft those insurance programs and maximize their insurance recovery.

Emerging Risks

Criminal Liabilities for Environmental Violations

In recent years, government regulators and agencies are taking a more active role in policing various industries, including the energy industry. In particular, there has been a notable increase in criminal sanctions issued against companies, as well as criminal charges against individual executives for alleged violations of federal and state regulations and environmental protection laws. A recent federal Texas district court ruling addressing insurance coverage issues arising from such criminal charges shows the special coverage issues that arise in addressing such potential criminal liability.

In Waste Management. Inc. v. AIG Specialty Insurance Co.,[1] the U.S. District Court for the Southern District of Texas dealt with liabilities that result from torrential rainstorms that hit Oahu in late 2010 and early 2011, and the resulting flooding at a landfill operated by the insured. The flooding, in turn, caused medical waste at the company landfill to flow into the Pacific Ocean and wash up on the Hawaiian shoreline.

The company complied with a U.S. Environmental Protection Agency administrative order to remove the waste. It also notified AIG, which had sold the company a pollution liability policy, about the order, but did not seek coverage for the cleanup costs because they did not exceed the company's $5 million self-insured retention.

However, when the U.S. Department of Justice later filed a civil action against the company for violations under the Clean Water Act and a separate indictment alleging that individual employees' actions, amounted to criminal violations of the company's discharge permit, the company did demand that AIG pay the costs of defense of the action and indictment.

AIG agreed to cover the DOJ's civil action but denied coverage for the criminal suit. The company sued AIG, arguing that the defense costs in the criminal proceeding fell within the pollution liability policy's coverage of losses that the company was "legally obligated to pay as a result of a claim for cleanup costs resulting from a pollution condition." The Texas federal district court granted summary judgment to AIG, holding that the indictment did not constitute a claim for clean-up costs covered by the pollution insurance policy.

However, while the court ruled in favor of AIG, its reasoning suggests that there can be circumstances in which the costs of defending against a criminal proceeding would be deemed to fall within the coverage of a similar policy. In particular, the court highlighted both that the company completed its removal of the waste in compliance with the EPA order before the DOJ filed the criminal charges, and that the indictment made no mention of compensation or pollution cleanup and did not seek an order of restitution or remediation.

That suggests that an indictment for environmental crimes may be covered under such a pollution policy where the indictment includes either a demand for remediation costs or mentions that the charging authority will be seeking a remediation or restitution order.

As this case suggests, a court's determination of insurance coverage is fact-intensive and will turn on the application of the specific jurisdiction's rules of interpretation to the language of both the insurance policy and the indictment. Accordingly, a company faced with a criminal indictment for environmental violations, should not assume that the indictment and related defense costs are not covered by insurance. To maximize coverage, policyholders can work with their advisers to ensure that policies are worded so as to enhance the prospects for obtaining insurance protection for claims alleging criminal violations.

Decommissioning

As global oil and gas fields mature, aging structures must be removed, plugged and/or reclaimed. With the average lifetime of an offshore oil and gas field in the range of 25 to 40 years, many offshore installations are or will be in need of decommissioning.

Decommissioning projects are highly complex and expensive; the process involves many stages and can take more than a decade to complete. The decommissioning market is set to drastically increase, raising questions and concerns for energy industry policyholders regarding insurance coverage of decommissioning risks and liabilities.

The decommissioning process is somewhat comparable to the construction process in that there are many contractors involved, with different roles and contractual obligations. However, in a construction all risk policy, a key component is the insurance and replacement of the project works following an insured event, as the insured seeks to protect physical damage to a profit-generating asset.

Decommissioning is fundamentally different: the intended result of the project is to leave the site in the condition it was in before construction and installation, and thus, there are no "insured works." Rather, what will be important to the operator is coverage of damage to third-party property and liability exposures.

Additional risks that stakeholders in decommissioning of onshore and offshore projects should consider in evaluating coverage include:

- Liabilities and abandonment requirements under international conventions or U.S. federal or state law;

- The methods of removal of installations or equipment and plugging of wells;

- Damage to lost property or to property being removed (where that property or equipment has salvage value); and

- Damage to existing property not intended for removal and/or damage to neighboring third-party property.

The risk profile of decommissioning construction or operation of offshore and onshore oil and gas installations is still evolving. The associated development of insurance coverage to manage the complex and unique risks in decommissioning is an area that requires close attention by stakeholders and operators for the foreseeable future and beyond.

Renewable Energy

The availability of production tax credits has driven a dramatic increase in the development and installation of new renewable energy facilities by traditional E&P companies. The economic viability of these facilities depends on the reliability of wind turbine blades, gearboxes, solar cells and other fast - developing technology.

Over the last few years, the frequency and severity of insurance claims in the U.S. renewable energy market have significantly increased. A number of factors have contributed to the increase in claims, including: component vulnerability, defective designs, changing original equipment manufacturer, or OEM, warranties, and extreme weather damage.

In an increasingly competitive market, construction firms are under pressure to build projects more efficiently and in shorter timeframes, some would say contributing to the frequency of equipment malfunctions and design defects. A focus on cost-cutting and efficiency has also led to diminished OEM warranty strength, meaning that asset owners may end up without sufficient OEM support when equipment fails. These challenges have been further exacerbated by extreme weather, including wildfires, hurricanes and tornadoes now occurring out of season.

Insurance coverage is a critical element to managing a successful renewable energy project and maintaining its economic viability. Asset owners, and in particular new players in the renewable energy market, could be proactive in this regard, not only by understanding the applicable insurance policies, but also in ensuring that they recover the full benefit of insurance coverage of renewable energy assets.

Protection Against The Costs of Defense

As Waste Management makes clear, liability policies provide protection against more than the ultimate liability incurred in connection with a cleanup order, judgment or settlement. Often, the far more important coverage they provide is the payment of an effective defense that can reduce or eliminate that ultimate liability.

Earlier this year energy companies landed a significant win in the protection of their right to the payment of defense costs from the Texas Supreme Court. In Anadarko Petroleum Corporation v. Houston Casualty Co.,[2] the court ruled that an energy industry-standard "Joint Venture Provision" in Anadarko's $150 million excess liability policy held with a group of underwriters at Lloyd's of London did not limit coverage for Anadarko's defense costs in the Deepwater Horizon litigation. Anadarko was a minority partner in the offshore well that blew out, causing the largest accidental marine oil spill in U.S. history.

Anadarko's excess liability policy provided for $150 million in coverage for its "Ultimate Net Loss." The policy also contained a "Joint Venture Provision" that capped Anadarko's "liability" arising from joint-venture operations at 25% of the $150 million in coverage — that is, $37.5 million. While the insurers agreed to pay Anadarko the $37.5 million to cover various Deepwater Horizon-related liabilities to third parties, they denied coverage for more than $100 million in Anadarko's defense costs, claiming that the costs of defense were subject to the limit on joint venture liability.

Anadarko challenged the coverage determination in Texas state court on the ground that the joint venture provision only capped excess coverage for liabilities to third parties, not defense costs. While Anadarko prevailed in the trial court, the decision permitting recovery of defense costs was overturned by the Texas intermediate appellate court, which held that because the dictionary definition of "liability" includes defense expenses, such costs were a liability subject to the Joint Venture Provision limit.

The Texas Supreme Court reversed, and reinstated the award of coverage for Anadarko's defense cost. The court refused to base its analysis solely on the dictionary definition of "liability," instead, taking into account how the term was used in the context of the policy as a whole. While the policy did not define "liability," the policy "consistently distinguishe[d]" between liabilities and expenses, "us[ing] the terms liability, damages, and defense expenses consistent with their common legal meanings."

Notably, the joint venture provision did not contain the term "defense expenses." On this basis, the court concluded the limit within the joint venture provision applied only to substantive liabilities, not to costs of defense.

The Anadarko decision provides much needed guidance for energy companies assessing the availability and extent of coverage of defense costs under policies with joint venture provisions similar to the provision in Anadarko's policy. Going forward, the joint venture provision limitation common in energy industry policies should not be interpreted as limiting coverage for defense costs unless it contains explicit language to that effect.

Step to Maximize Insurance Recovery

The following steps are important considerations in maximizing an energy company's insurance recovery.

Understanding the Scope of Your Coverage

A company should not assume a loss is uninsured, nor should it assume that a denial letter from an insurance company in the wake of a loss resolves the question of coverage.. Policy terms vary and are subject to different interpretations by courts, depending on the specific jurisdiction. If you are unsure whether your company has a claim or the nature of the claim, counsel may assist in evaluating coverage and assess whether filing suit will maximize recovery.

One of the best strategies for responding to a claim, or a claim denial, is to understand the scope of coverage long before any loss occurs. In light of the various emerging liability issues in the area, you should make sure that your broker is aware when purchasing coverage that you expect it to provide protection against the costs of defending against criminal charges, decommissioning or special liabilities faced in connection with renewable energy. Coverage counsel can also be useful prior to a loss by reviewing and identifying potential “gaps” in coverage on these or other issues.

Notice of All Potential Claims

Policies often require policyholders to notify the insurer “immediately,” “as soon as possible” or “as soon as practicable” after the insured becomes aware of a potential claim. Failure to comply with notice provisions may present a significant hurdle to recovery and may even preclude coverage. Uncertainty on whether an insured has sustained coverable losses should not delay notification of all insurers of any possible losses.

Again, preparation and knowledge of your coverage is the best way to avoid problems in this area. The better you understand what is or may be covered under your insurance program the less likely you are to fail to provide notice of a claim for which you otherwise could have been entitled to insurance.

In addition, particularly in the case of large organizations, you will want your notice obligation to be “triggered” only when certain people have specified knowledge — for example, when corporate counsel or corporate risk manager is provided with notice of a governmental investigation or a lawsuit.

Limiting your obligation to give notice to such circumstances can prevent a low-level employee’s knowledge of a nascent problem from costing you coverage before anyone responsible for giving notice to insurers is even aware of the problem. It will also allow you to institute policies and procedures — such as requirements that the corporate risk management department receive regularly scheduled reports of lawsuits or claims — that will help ensure that the issues requiring notice to insurers are brought to the attention of the appropriate people in the organization.

Preservation of Evidence of Business Losses and Damages

Take measures to record all costs, expenses and damages for which the company may want to seek coverage, including photos and videos of property damage and business interruptions. For business interruptions (e.g., facility or pipeline shutdown), it is important to document losses by maintaining records of business performance or oil/gas production prior to, during and following the interruption event. Policies may also provide coverage for expenses associated with clean-up or other claim-related activities. All such expenses should be tracked to the extent possible.

Monitoring and Limiting Outside Communications Regarding Potential Losses

Communicating with brokers and insurers concerning any potential losses is not always protected from discovery. In litigation over insurance coverage, insurers may gain access in discovery to internal communications about the business’s coverage claim.

In addition, how a loss is characterized and described in internal communications may be used by the insurer as a basis for denying coverage. Engaging and involving counsel in these communications may protect the communications as privileged, but copying counsel on an email is no guarantee of protection from disclosure.

As a general rule, no internal communication should ever comment definitively that a given loss is "not covered" or "uninsured." Too often, such statements are based on a misunderstanding of the law or self-serving advice from a triggered insurer. Where someone in the organization needs to communicate how an insurance company has responded to a claim or a potential loss, the communication should make clear that the opinions set forth are those of the insurance company, and are not being endorsed or adopted.

To limit and appropriately monitor communications, designating a single point of contact or spokesperson for communications with insurers and third-parties regarding potential losses is a helpful step. For especially large or otherwise significant losses, coverage analyses should be conducted by either in-house or outside counsel, to preserve any applicable privileges.

Engaging Experienced Advisers

Venue selection can be the key to transforming what may be a losing coverage case into a winner. Engaging counsel early gives a company the opportunity to file coverage litigation in the most favorable venue available. It is important that coverage counsel not only have a track record of trying and winning coverage disputes but also have energy industry knowledge and experience to understand the priorities energy companies face in deciding whether to pursue coverage and to maximize a company's insurance recovery for losses.

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[1] Waste Mgmt. Inc. v. AIG Specialty Insurance Co., 4:16-CV-03676, 2019 WL 1409661 (S.D. Tex. Mar. 28, 2019)

[2] Anadarko Petroleum Corporation v. Houston Casualty Co., No.16-1013, 2019 WL 321921 (Tex. Jan. 25, 2019)