

Presented:  
18<sup>th</sup> Annual Insurance Law Institute

November 7-8, 2013  
Houston, Texas

## **DOWNHOLE, OFFSHORE AND BLOWOUTS**

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### **A PRIMER ON OIL AND GAS COVERAGE: THE OFFSHORE ENERGY PACKAGE POLICY**

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## **I. INTRODUCTION: The Offshore Energy Package Policy**

### **A. The Offshore Energy Package Policy**

The Offshore Energy Package Policy is an essential necessity for offshore drilling.<sup>1</sup> Developed by the London Insurance Market and having at its core Control of Well Insurance, the package bundles together a series of complimentary policies and endorsements which each provide separate coverage. Taken together, the Offshore Energy Package Policy addresses a wide array of interlocked operational and property risks.<sup>2</sup> The Offshore Energy Package Policy has become so ubiquitous and of such long standing that relationships among the Assureds, their Brokers, and given Underwriters have effectively turned certain packages into well known “Market brands.”<sup>3</sup>

While it comes in many forms and its various bespoke wordings are the subject of a constant to and fro among Underwriters, Assureds, and Brokers, the Offshore Energy Package Policy can and typically does include some or all of the following policies or endorsements and perhaps others as the Market continuously evolves:

1. Operator’s Extra Expense (“OEE”) or Energy Exploration and Development (“EED”)<sup>4</sup> which themselves aggregate a number of related covers into a harmonious whole:
  - Control of Well which itself includes:
    - Section A: Control of Well
    - Section B: Redrilling/Extra Expense
    - Section C: Seepage and Pollution, Cleanup and Contamination
  - Underground Control of Well
  - Extended Redrill and Restoration
  - Making Well Safe
  - Care Custody and Control
  - OPA Endorsement
  - OPOL Endorsement
  - Resultant Plugging and Abandonment Endorsement
  - Evacuation Expenses
  - Deliberate Well Firing

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<sup>1</sup> There are exceptions to every rule. A major player in the Macondo blowout did not have such a package.

<sup>2</sup> Particularly as to contractors and service providers (as opposed to owners and operators), marine exposures must be considered.

<sup>3</sup> See DAVID SHARP, UPSTREAM AND OFFSHORE ENERGY INSURANCE at 339 (Witherbys Insurance 2009)(“Sharp II”)(“by developing its own operating package the oil company is able to focus its market relationship with a chosen panel of leaders and following markets, creating continuity with these markets and a ‘brand’ or identity in the market. The package approach is now universal practice ... .”) and at 395-96 (“The rationale for this approach was explained in terms of creating bulk buying capability and brand image[.]”) See the discussion of the “Wellsure” Energy Package Policy in *Prime Natural Resources, Inc. v. Certain Underwriters at Lloyd’s London*, No. 01-11-00995-CV (Tex. App. – Houston [1<sup>st</sup> Dist.] 2012) (briefs only). This mechanism can be compared to a similar quota share arrangement in Onshore Energy Package Policies.

<sup>4</sup> As will be seen, the present and predominant EED form is the EED (8/86) Policy which supplanted and replaced the EED (9/85) Policy. **All references to “EED”, unless otherwise stated, will be to the EED (8/86) form.** The OEE Policy in its original pure form is rarely, if ever, seen in the Market today. Variations of it survive and, to be sure, the name lives on. See **Preliminary Word of Caution** in Section II.A.1 at 4, *infra*.



- Contingent Joint Ventures
  - Turnkey Wells Endorsement
  - Farmout Wells Endorsement
  - Developmental Drilling Wells Endorsement
  - Wild Well Contractor Endorsement
  - No Claims Return of Premium Endorsement
  - Priority of Payments Endorsement
  - Various Excess Cover Endorsements
  - Windstorm Endorsement
2. Physical Damage (“PD”)
- Physical Damage
  - Removal of Debris (Removal of Wreck) (“ROD”, “ROW”)
  - Sue and Labor
  - Oil in Line
  - Property in Transit
  - Oil & Gas Well Drilling Tools Floater/All Risks
3. Pollution<sup>5</sup>
4. Business Interruption (“BI”) including:
- Contingent Business Interruption (“CBI”)
  - Loss of Production Income (“LOPI”)
  - Loss of Hire
  - Delay of Start Up
5. Third Party Liability
6. Construction Risk
7. Charterer’s Liability
8. Windstorm
9. Crude Oil Storage
10. Political Risk<sup>6</sup>
11. War and Related Risks

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<sup>5</sup> As will be seen, the OEE and EED Policies contain a seepage and pollution cover but it is restricted to a control of well event as the operative trigger so a broader third party liability pollution cover must be included in the Offshore Energy Package Policy.

<sup>6</sup> There may be different markets for confiscation and expropriation.

## 12. Contingent OEE/EED

### **B. Focus of the Paper: Control of Well and, to a lesser extent, Physical Damage**

This paper will focus on the EED Policy and, to a lesser extent, on the PD cover. The EED Policy's core is the Control of Well section to which various endorsements have been added over time to result in the EED Policy.<sup>7</sup> This mini-package policy then provides the core to which the full panoply of coverages outlined in Nos. 2-12 above attach to form the complete Offshore Energy Package Policy.<sup>8</sup> The numerous sections under the Offshore Energy Package Policy are too broad to be covered in detail in one paper. However, there will be broad brush information provided about the other sections to provide a starting point for research.

The discussions of EED and PD will contain extensive quotations to sometimes difficult to find sources in an effort to make the paper a more user friendly, comprehensive working research tool. A working bibliography will also be included. However, bear in mind any cited case must be read with great care since policy language has evolved over time with sometimes startling ultimate effect on the holdings of what at first blush would appear to have been on point cases. Secondary authorities will be provided to support further explanation and research. Note, however, there is a dearth of on point case law interpretation.<sup>9</sup> A final goal of this paper will be to, at least in a very broad stroke sense, suggest how the various risks encountered by an offshore operator/contractor are structured into the various components of the Offshore Energy Package Policy.<sup>10</sup>

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<sup>7</sup> As will be seen, the EED Policy is a specialized cover essentially corresponding to the contractual risk allocation in the oilfield that generally places responsibility for a blowout on the well operator.

<sup>8</sup> Bear in mind that physical damage was not available through the London Market for offshore property until the 1960s. See section on Physical Damage II.B., *infra*. This situation is true even though the first control of well policies per se were themselves ironically add-ons to onshore physical damage policies.

<sup>9</sup> The leading treatise on the topic is David Sharp's Upstream and Offshore Energy Insurance, today's "Energy Insurance Bible" ("Sharp II"), which superseded his earlier classic OFFSHORE OIL AND GAS INSURANCE (Witherby & Co. Ltd. 1994) ("Sharp I"). His views have also recently been summarized and updated in Lloyd's Energy Drilling in Extreme Environments (2011) ("Sharp III"). The leading article in this area is J. Clifton Hall III, *Offshore Energy Insurance*, 83 Tul. L. Rev. 1303 (2008-2009) ("Hall I") recently supplemented by his article presented in connection with a panel presentation "Offshore Industry in the 21<sup>st</sup> Century, Practice, Procedure and Liability", entitled *Offshore Energy Insurance: Building a Program*, Maritime Law Association (Fall 2013) ("Hall II"). This paper is indebted beyond measure to and largely built on their excellent foundation. The paper will cite as yet undecided, pending cases in the nature of a "watch this space" since typically in Federal Court, at least, pleadings and briefings irrespective of a final reported decision are generally now available with electronic research, shed some light on the current "state of play" and provide some forecast of potential rulings on pertinent issues.

<sup>10</sup> See Theresa M. Fadul, Maximizing Insurance Protection as part of contractual risk allocation, 2004 No. 2 RMMLF-Inst. Paper No. 12 Rocky Mountain Mineral Law Foundation (2004) for an excellent discussion in a contract context of various coverages and their workings under an Offshore Energy Package Policy.

## II. LOOKING AT THE PACKAGE

### A. Operators Extra Expense (“OEE”) or Energy Exploration and Development (8/86) (“EED”) Policies

#### 1. Overview

Beginning in the 1940s, the London Market began offering Control Of Well policies (“COW”) as an add on to onshore physical (property) damage policies. A **preliminary word of caution** on confusion in terms is warranted. The original policy began simply as “control of well”. As will be seen, this control of well policy began to attract add-ons such as redrilling and seepage and pollution like a super magnet. By the 1970s the predominant form of this conglomerate control of well package was the Operators Extra Expense (“OEE”).<sup>11</sup> Later the OEE was eclipsed in the late 1980s by the Energy Exploration and Development Policy (“EED (8/86)”) – which itself had quickly eclipsed the short lived EED (9/85) form. However, one must be aware that many EED form policies are generically referred to in the same way that all copiers are “Xerox machines” as an “OEE Policy” or sometimes even just “Control of Well” as an all-inclusive term. Technically, the Control of Well policy now is simply Section A of either the EED or OEE Policy. While a bit confusing, this linguistic looseness must be kept in mind when reading the policies, cases and secondary authorities. Our focus is the Market dominant EED (8/86) form.

As the industry grew and Spindletop gushers and fabled wild wells lost their adventuresome allure, it was becoming apparent that the costs of controlling a well blowout were substantial and growing. The somewhat tortured history of the development of today’s predominant control of well wording over the past 70 years is a classic study in the London Market’s creative adaptation of policy language to match practical and judicial interpretation realities so that the risks in drilling could be realistically and actuarially insured.<sup>12</sup> As will be seen in the development of the policy language, there is (1) an ever present tension between ordinary expected kicks encountered in drilling and the development of incipient and actual blowouts when a necessary balance between upward and downward pressures is lost and the well becomes out of control and, (2) inherent linguistic difficulties in striking that balance unambiguously on paper.

An in-depth review of the evolution in language will not only probe the underlying geoscience and dangers inherent in drilling but also underscore and explain how today’s COW language expresses in writing the blend of risks which can be feasibly insured. While nothing is perfect and language is fluid, the resulting EED (8/86) Policy is, by any fair measure, a splendid work of underwriting art. However, it is interesting to note as we go through the history that contemporaneous commentators on the EED (8/86) Policy when it first emerged were concerned about its perhaps overly restrictive nature - a concern which, over time, has proved largely unwarranted in the Market place. At the conclusion of reviewing the history, we will briefly

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<sup>11</sup> See discussion of David Sharp’s description of the original OEE Policy at II.A.3.c., *infra*.

<sup>12</sup> There are, of course, other significant, secondary Markets, e.g., Norwegian, Scandinavian and American.

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First appeared as part of the conference materials for the  
18<sup>th</sup> Annual Insurance Law Institute session

"Downhole, Offshore and Blowouts: Primer on Oil and Gas Coverage"