

Environmental Pollution Liability and Insurance Law Ramifications in Light of the Deepwater Horizon Oil Spill

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Abstract

The financial impact of the April 20th, 2010 explosion and sinking of the “Deepwater Horizon” in the Gulf of Mexico is estimated to overall eclipse the financial impact of the Exxon Valdez oil spill in 1989 - which resulted in a 3.5 billion U.S.A. dollar settlement and in 5 billion U.S.A. dollars in legal and financial settlements. In spite of having managed to contain the “Deepwater Horizon” oil spill initially in July 2010, then again in August 2010 and finally in September 2010, nevertheless, the environmental liability and insurance law ramifications of the disaster continue to loom large. Given the scope of the disaster, the claims involved will, inter alia, implicate property liability, environmental liability, marine insurance and business interruption insurance or loss of production income, comprehensive general liability, operator’s extra expenses - occurred for the control of the well, physical damage, workers compensation or employers liability. Furthermore, the insurance loss is estimated to be spread throughout the insurance and reinsurance markets in London, the U.S.A. and Bermuda. This paper examines the liability arising out of environmental pollution and the consequences it bears on insurance, in the light of the occurrence of the “Deepwater Horizon” oil spill. In doing so, it evaluates the environmental pollution liability regime and the environmental pollution insurance coverage, whilst also projecting on potential future directions in both fields.

I. Introduction

Environmental pollution is here to stay for good. The modern way of living has allowed the threat of the occurrence of environmental pollution at anytime become more than ever before apparent and part of our everyday routine. Consequent to the occurrence of environmental pollution, a liability regime also arises.

It is widely acknowledged that the globalisation of environmental risk poses a mounting challenge to policy makers and that, nevertheless, the rules of responsibility for harm production remain underdeveloped. In spite of the negotiation and implementation of numerous international environmental agreements, those agreements lack detailed provisions stipulating the responsibility of state and non-state actors for environmental damage. This lack relates to the means of estimating the

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owed liability for environmental harm across national boundaries.¹ Most multilateral environmental treaties stipulate that signatory parties should act in accordance with the principle of state responsibility for environmental damage, however the nature of liability and compensation provisions are not prescribed.²

State practice overall reveals a widespread reluctance to pursue environmental liability through inter-state claims and a preference for increasing the importance of private liability attached to operators of risk-bearing activities as the main mechanism for progressing environmental liability. This move towards a compensation regime regarding liability for environmental damage, driven by private actors has made civil liability treaties the preferred vehicle for rule development in this area.³

The civil liability regime for marine oil pollution was the first of these regimes to broaden compensation obligations beyond personal injury and property damage provisions to environmental impairment, and has served as a model for liability rule development for the carriage of dangerous goods, the maritime carriage of hazardous and noxious substances, and revisions to civil liability provisions for nuclear damage. Moreover, the method of compensation entitlement under this regime, i.e. strict liability without the need to prove negligence, has become the norm for pollution damage liability rules elsewhere. And, it has also been rationalised as an effective and equitable means of incorporating the “polluter pay” principle into the field of environmental liability.⁴

Democratic accountability for trans-national harm production requires the effective and equitable treatment of the claims of affected publics.⁵ For oil pollution

¹ Principle 13 of the 1992 Rio Declaration on Environment and Development registered this lack, calling on states to cooperate in developing liability and compensation rules for environmental damage caused by activities within and beyond their areas of territorial jurisdiction and control; See, Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69. Department of Geography and Environment, London School of Economics and Political Science, London, 2002, pp. 1-3.

² The 1972 Convention on International Liability for Damage Caused by Space Objects remains one of the few treaties with explicit state liability obligations – rules which supported a successful claim by Canada against the USSR for the clean-up of radioactive debris following the break-up of a Soviet satellite over Canadian territory in 1979 ; See, Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69. Department of Geography and Environment, London School of Economics and Political Science, London, 2002, pp. 1-3.

³ Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69. Department of Geography and Environment, London School of Economics and Political Science, London, 2002, pp. 1-3.

⁴ Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69. Department of Geography and Environment, London School of Economics and Political Science, London, 2002, pp. 1-3; See, Sandvik, B., & Suikkari, S., *Harm and Reparation in International Treaty Regimes: An Overview*, 57-71, 64-65, in Wetterstein, P. (Ed.), *Harm to the Environment: the Right to Compensation and the Assessment of Damages*, Clarendon Press, Oxford, 1997.

⁵ Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69. Department of Geography and Environment, London School of Economics and Political Science, London, 2002, pp. 1-3; See generally, Mason, M., *Transnational Environmental Obligations: Locating New Spaces of Accountability in a Post-Westphalian Global Order*, Transactions of the Institute of British Geographers, 2001, 26(4), 407-409, Renn, O., Klinke, A., *Public Participation Across Borders*, in Linnerooth-Bayer, J. et al (Eds.), *Trans-Boundary Risk Management*, Earthscan, London, 2001.

liability, this relates above all to claims for recompense. The existing changing spatialities of environmental liability are evident in the implementation of legal rules under the relevant international conventions.⁶ It is, however, doubtful whether, the currently in force environmental liability rules are sufficient to meet claims for compensation from representatives of affected publics. Moreover, the existence of international oil pollution liability rules raises the issue of the standing of state and non-state actors, not only as potential claimants but also as participants collectively shaping norm application.⁷

Given the above considerations, it remains to be explored: a) the extent to which the marine oil pollution civil liability regime is satisfactory and adequate as a vehicle for transnational environmental accountability, b) the extent to which the marine oil pollution civil liability regime's overarching framework of legal obligations serves the interests of those national and non-national publics suffering trans-boundary injury from ship-source or off-shore installation facilities' oil spills, and c) the extent to which the available insurance options can meet the demands of the assureds and other potential claimants.⁸

Following the explosion at the Deepwater Horizon drilling platform in the Gulf of Mexico on April 20th, 2010, the ruptured well was reported to have been leaking between 1.47 and 2.52 million gallons of oil a day,⁹ thus¹⁰, not only far surpassing the 1989 Exxon Valdez oil disaster, but,¹¹ making it the largest environmental disaster in U.S.A. history.¹² Businesses¹³ have suffered, and will continue to suffer, significant losses due to property damage and economic losses.¹⁴ Municipalities may also experience decreased tax revenues due to business closures. In short, the combined economic impact of oil-spill-related losses for businesses and

⁶ I.e. the 1969 International Convention on Civil Liability for Oil Pollution Damage (CLC), and the 1971 International Convention on the Establishment of an International Fund for Compensation for Oil Pollution Damage (Fund Convention), as both amended by the 1992 Protocols (United Nations International Maritime Organisation (IMO), 1996); See, Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69. Department of Geography and Environment, London School of Economics and Political Science, London, 2002, pp. 1-3.

⁷ Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69. Department of Geography and Environment, London School of Economics and Political Science, London, 2002, pp. 1-3.

⁸ Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69. Department of Geography and Environment, London School of Economics and Political Science, London, 2002, pp. 1-3.

⁹ Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

¹⁰ As per U.S.A. government estimates.

¹¹ Having also contaminated the Gulf, and the adjacent shore-lands.

¹² Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

¹³ Especially those in the tourism, fishing, and catering industries; See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

¹⁴ Business losses for the Florida tourism industry alone are projected to reach \$3 billion; See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

communities is estimated to be in the billions.¹⁵ The oil spill has also instigated short- and long- term uncertainty for residents and businesses along the Gulf Coast.¹⁶ Given the tremendous financial need expected to arise for businesses and communities trying to respond to the disaster and recover from its impact, a valuable resource available in the form of insurance can play an important role in helping them recover from this disaster. This insurance may provide coverage not only for physical damage to and loss of property, but also for financial losses arising from an inability to conduct business - either at all or at the same levels as before, the extra expenses incurred in dealing with the effects of a disaster - including expenses incurred in advance to minimize any damages and losses, and the costs incurred in establishing the extent of any losses. Several types of insurance might respond to pay for losses stemming from the oil spill, including, insurance policies for first-party property, “business interruption” and loss of production income insurance, D&O insurance, event cancellation insurance, trade disruption insurance, environmental liability insurance, marine insurance, comprehensive general liability insurance, insurance for operator’s extra expenses - occurred for the control of the well, physical damage insurance, workers compensation or employers liability insurance.¹⁷

II. Setting the Scene

II.1. The Incident

II.1.a. Facts

On 20th April, 2010, the Deepwater Horizon, a semi-submersible mobile offshore drilling rig owned and operated by Transocean Ltd., caught fire and sank in the Gulf of Mexico, off the shores of Louisiana.¹⁸ The rig was drilling a prospect known as Macondo, some 50 miles off the coast of Louisiana, in 5,000 feet of water. BP Plc – along with its partners Anadarko Petroleum Corp. and Mitsui Oil Exploration Co. – acquired the prospect in 2008 in a sale of leases run by the U.S.A. government’s Minerals Management Services. The well had been drilled to 18,000 feet when a blow-out occurred. The explosion, and fire that followed, killed 11 out of the 126-man crew. A day-and-a-half later the rig collapsed into the sea and sunk, and oil begun to spread across the surface of the water, eventually making landfall to the

¹⁵ Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

¹⁶ Vacation and beachfront property owners have seen significant losses from the tar-contaminated beaches and long strands of boom, which are now the central focal point of beachfront views. The closing of many commercial and sport fisheries has created enormous financial setbacks for local economies; See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

¹⁷ Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

¹⁸ Kotula, M., *Insurance, Pollution Exclusions, and the Deepwater Horizon Gulf of Mexico Oil Spill*, http://www.lexisnexis.com/Community/emergingissues/blogs/gulf_oil_spill.aspx, accessed on Sept. 10th, 2010.

north-east.¹⁹ BP, being the majority stakeholder in the Macondo oil well, has largely been identified with the spill. Anadarko Petroleum Corp. and Mitsui Oil Exploration Co. own 25% and 10% stakes in the well, respectively, and may share in the cost of responding to the oil spill. The oil platform was being leased by Transocean Ltd. to BP Plc., and now sits on the sea floor over 5,000 feet below sea level. Prior to the explosion on April 20, 2010, Halliburton Co. had been engaged in cementing operations on the well, and cementing operations have previously been associated with other oil well accidents. The explosion and fire, occurred in spite of the existence of specialized oil spill prevention equipment - called a blowout preventer (BOP) – i.e. a failsafe protection against an ongoing oil spill, manufactured by Cameron International Corp.,²⁰ and especially designed to avert this type of disaster.²¹ The failure of the BOP left the well unsecured and leaking from the marine riser. BP Plc set up an escrow account of 20 billion U.S.A. dollars to meet an unspecified number of claims for consequential losses arising from the oil spill.²² The amount of oil and gas, escaping from the subsurface well has been estimated to have been in the range of 35,000-60,000 barrels of oil a day, making the incident the largest oil spill in U.S.A. history.²³ The Macondo oil well, was initially sealed in mid July 2010, 87 days after the incident occurred, was further sealed in early August 2010, having reached the amount of 4,1 million oil barrels, and finally cemented on 19th September 2010. However, the termination of the oil spillage does not, necessarily, entail a simultaneous end to the legal aspects of it. The imposition of fines, the adjudication of class action law suits by the thousands of victims, the cleansing and environmental rehabilitation operations are, only, some of the consequences of the oil spillage. It is, highly possible that, in order to meet the above and other claim demands, BP Plc. may have to further sell assets, in addition to those which are already planned for sale and are being estimated at a value of 30 billion U.S.A. dollars.²⁴

¹⁹ Focus Magazine, *Macondo: Assessing the Implications*, Oil and Energy Trends, Focus Magazine (2010) 35, 3-6, 3.

²⁰ Kotula, M., *Insurance, Pollution Exclusions, and the Deepwater Horizon Gulf of Mexico Oil Spill*, http://www.lexisnexis.com/Community/emergingissues/blogs/gulf_oil_spill.aspx, accessed on Sept. 10th, 2010.

²¹ Blowouts occur during offshore drilling operations when pressure exceeds the weight of the drilling fluid in the well, which results in an uncontrolled flow of oil. The oil flow could result in loss of the property at the drill site ; See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 3.

²² Focus Magazine, *Macondo: Assessing the Implications*, Oil and Energy Trends, Focus Magazine (2010) 35, 3-6, 3.

²³ See, Deepwater Horizon Unified Command, *U.S. Scientific Team Draws on New Data, Multiple Scientific Methodologies to Reach Updated Estimate of Oil Flows from BP's Well*, June 15, 2010, at <http://www.deepwaterhorizonresponse.com/go/doc/2931/661583> accessed on Sept. 10th, 2010; See also Allison Winter, *USGS Director Quietly Wages Fearless War on Oil Spill*, The New York Times, June 16, 2010, at <http://www.nytimes.com/gwire/2010/06/16/16greenwire-usgs-director-quietly-wages-fearless-war-on-oi-83792.html>. accessed on Sept. 10th, 2010; See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 3.

²⁴ Kathimerini Newspaper, *End of Oil Spill and Beginning of Compensations?*, Kathimerini Newspaper, Issue of 14/08/2010.

II.1.b. Reasoning

No single factor caused the Macondo well tragedy. Rather, a sequence of failures involving a number of different parties led to the explosion and fire which, in its turn, led to 11 human fatalities and also caused widespread pollution. A report, released by BP Plc to the public on 8th September 2010, has concluded that decisions made by “multiple companies and work teams” contributed to the accident which arose from “a complex and interlinked series of mechanical failures, human judgments, engineering design, operational implementation and team interfaces.”²⁵

It has been found that: a) the cement and shoe track barriers at the bottom of the Macondo well failed to contain hydrocarbons within the reservoir and allowed gas and liquids to flow up the production casing; b) results of the negative pressure test were incorrectly accepted by BP Plc. and Transocean Ltd.; c) for more than 40 minutes, the Transocean rig crew failed to recognise and act on the influx of hydrocarbons into the well until it was too late; d) the well-flow caused gas to be vented directly on to the rig and this flow of gas created a potential for ignition; e) even after the explosion and fire the rig’s blow-out preventer on the sea-bed should have activated automatically to seal the well, but failed to do so as because critical components of it were not working. Based on its key findings, the investigation team has proposed a total of 25 recommendations designed to prevent a recurrence of such an accident. The company has also expressed that it expects a number of the investigation report’s findings to be considered relevant to the oil industry more generally and also for some of the recommendations to be widely adopted.²⁶

III. The Environmental (Marine – Oil) Pollution Liability Legal Regime

The marine oil pollution liability legal regime has been developed via the various conventions, resolutions and codes that the United Nations International Maritime Organisation (IMO) has enacted. The 1973/78 International Convention for the Prevention of Pollution From Ships (MARPOL) stands as the core treaty in this area.²⁷ MARPOL followed as one of the consequential measures adopted after the Torrey canyon oil disaster of 1967.²⁸ However, the immensity of the Exxon Valdez incident in 1989 prompted the imposition of further measures; hence, the Oil Pollution Act 1990 (OPA) was enacted in the U.S.A. in 1990, which imposed stronger duties of care to ship-owners and also included a right of action against operators. Not

²⁵ See, “BP Releases Report on Causes of Gulf of Mexico Tragedy”, <http://www.bp.com/genericarticle.do?categoryId=2012968&contentId=7064893>, accessed 15th Sept. 2010.

²⁶ See, “BP Releases Report on Causes of Gulf of Mexico Tragedy”, <http://www.bp.com/genericarticle.do?categoryId=2012968&contentId=7064893>, accessed 15th Sept. 2010.

²⁷ Its Annex I, concerned with oil pollution, contains detailed technical provisions designed to eliminate intentional discharges. MARPOL is credited as instrumental in significantly reducing discharges from marine transportation; See, Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69. Department of Geography and Environment, London School of Economics and Political Science, London, 2002, p. 4.

²⁸ Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69., Department of Geography and Environment, London School of Economics and Political Science, London, 2002, p.4.

least, it also shifted the burden of accountability, i.e. liability, towards the harm producer. However, it is the International Convention on Civil Liability for Oil Pollution (CLC) 1992 and the International Convention on the Establishment of an International Fund for Compensation for Oil Pollution Damage (Fund) 1992, in force as of 1996, which have set the current terms of application of claims for compensation within contracting states.²⁹

III.1. The International Framework

The international regime for the compensation of pollution damage caused by oil spills from tankers is based on two treaties adopted under the auspices of the IMO, the CLC 1992 and the Fund 1992 Conventions, which replace two corresponding Conventions adopted in 1969 and 1971 respectively.³⁰

Article I(6) of the CLC 1969 defined pollution damage as “loss or damage caused outside the ship carrying oil by contamination resulting from the escape or discharge of oil from the ship, wherever, such escape or discharge may occur, and includes the cost of preventive measures and further loss of damage caused by preventive measures”. While it was clear from the beginning that this wording covered economic losses connected with property damage or personal injury, the absence of any reference to environmental damage left this aspect to the interpretation of national courts as per the each time domestic implementation of the CLC.³¹ However, due to some destabilizing liberal court rulings on damage, the environmental damage article I(6) of the CLC 1992 was transformed and hence pollution damages was defined as: “a) loss or damage caused outside the ship by contamination resulting from the escape or discharge from the ship, wherever such escape or discharge may occur, provided that compensation for impairment of the environment other than losses of profit from such impairment shall be limited to costs of reasonable measures of reinstatement actually undertaken or to be undertaken (emphasis added), and b) the costs of preventive measures and further loss of damage caused by preventive measures”.³² As a system of economic compensation for oil spill

²⁹ Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69. Department of Geography and Environment, London School of Economics and Political Science, London, 2002, pp.6-7; See generally, Little, G., Hamilton, J., *Compensation for Catastrophic Oil Spills: A Trans-Atlantic Comparison*, (1997) 4 L.M.C.L.Q. 554-557; See, Gauci, G.M., *Protection of the Marine Environment Through the International Ship-Source Oil Pollution Compensation Regimes*, Review of European Community and International Environmental Law, (1999), 8(1), 29-36.

³⁰ Jacobsson, M., *The International Oil Pollution Compensation Funds and the International Regime of Compensation for Oil Pollution Damage*, 138-150, 138-139, in Basedow, J., Magnus, U. (Eds.), *Pollution of the Sea – Prevention and Compensation*, Hamburg Studies on Maritime Affairs, Vol. 10, Springer: Berlin, Heidelberg, New York, 2007.

³¹ Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69. Department of Geography and Environment, London School of Economics and Political Science, London, 2002, pp.7-8; See generally, Wetterstein, P., *Trends in Maritime Environmental Impairment Liability*, (1994), L.M.C.L.Q., Part 2, 230-247.

³² Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69. Department of Geography and Environment, London School of Economics and Political Science, London, 2002, p.7; See generally, International Maritime Organisation, *Civil*

damage, the recovery of environmental reinstatement costs under the CLC/ Fund Conventions' regime has turned on whether they are deemed acceptable according to the international rules.³³

The existence of a spatial delimitation of oil pollution liability under the international conventions has always deferred to the sovereign rights of contracting parties, for, both the CLC 1969 (Article II) and the Fund Convention 1971 (Article 3) apply only to pollution damage caused or impacting on the territory, including the territorial sea, of member states. However, the broadening of the geographical scope of the liability conventions was considered essential and was reinforced by an international agreement, which clarified that the liability Conventions cover measures - wherever taken - to prevent oil pollution damage within a territorial sea or EEZ.³⁴ As incorporated into CLC 1992 (Article II) and the Fund Convention 1992 (Article 3), the oil pollution liability conventions are geographically defined as applying exclusively: a) to pollution damage caused: i) in the territory, including the territorial sea, of a Contracting State, and ii) in the EEZ of a Contracting State, established in accordance with international law, or, if a Contracting State has not established such a zone, in an area beyond and adjacent to the territorial sea of that State determined by that State in accordance with international law and extending not more than 200 nautical miles from the baselines from which the breadth of the territorial sea is measured; and b) to preventive measures - wherever taken - to prevent or minimise such damage.³⁵

The CLC 1992 lays down the principle of strict liability for ship-owners and creates a system of compulsory liability insurance. Ship-owners are normally entitled to limit their liability to an amount which is linked to the tonnage of the ship. The CLC also set up the International Oil Pollution Compensation Fund which provides additional compensation to victims when compensation under the 1992 CLC is inadequate.³⁶ The 1992 Fund accepts claims in relation to loss of earnings suffered by the owners or users of property contaminated as a result of a spill (i.e. consequential loss). An important group of claims comprises those relating to "pure economic loss", i.e. loss of earnings sustained by persons whose property has not been polluted. In

Liability for Oil Pollution Damage: Texts of Conventions on Liability and Compensation for Oil Pollution Damage, 1996, IMO, London.

³³ Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69., Department of Geography and Environment, London School of Economics and Political Science, London, 2002, p.8.

³⁴ Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69. Department of Geography and Environment, London School of Economics and Political Science, London, 2002, pp.11-12; See generally, International Maritime Organisation, *Civil Liability for Oil Pollution Damage: Texts of Conventions on Liability and Compensation for Oil Pollution Damage*, 1996, IMO, London, 48, 69.

³⁵ Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69. Department of Geography and Environment, London School of Economics and Political Science, London, 2002, pp.11-12; See generally, International Maritime Organisation, *Civil Liability for Oil Pollution Damage: Texts of Conventions on Liability and Compensation for Oil Pollution Damage*, 1996, IMO, London, 48, 69.

³⁶ Jacobsson, M., *The International Oil Pollution Compensation Funds and the International Regime of Compensation for Oil Pollution Damage*, 138-150, 138-139, in Basedow, J., Magnus, U. (Eds.), *Pollution of the Sea – Prevention and Compensation*, Hamburg Studies on Maritime Affairs, Vol. 10, Springer: Berlin, Heidelberg, New York, 2007.

order to qualify for compensation, a sufficient causation link between the contamination and the loss or damage sustained by the claimant must exist.³⁷

The strict marine oil pollution civil liability model, which was imposed by the CLC 1992 and the Fund 1992 Conventions, has been further extended to the International Convention on Liability and Compensation for Damage in Connection with the Carriage of Hazardous and Noxious Substances by Sea, (HN) 1996 and the International Convention on Liability for Bunker Oil Pollution Damage, (BOPD) 2001.³⁸ Both Conventions broadly share the environmental reinstatement provisions and jurisdictional scope of CLC 1992. Significantly though, the BOPD Convention 2001, which covers fuel oil spills from vessels other than tankers, breaks with the liability channelling provisions of the CLC 1992, by exposing to compensation claims operators and charterers as well as registered owners, all with rights of limitation. This notable shift to multiple liabilities indicates pressure from the U.S.A. and the European Commission on IMO to accord more with the existing American liability norms in this area of oil pollution, and it also reflects the need to make up for the absence of a second tier of supplementary compensation – as under the Fund Convention.³⁹

III.2. The Position in the U.S.A.

III.2.a. Previous Response to Oil Spill Incidents - Similarities and Differences

Nearly twenty years of litigation followed the Exxon Valdez spill, and there was not a single case, but many. By understanding some of the history of the Exxon Valdez cases, one can better appreciate the legal ramifications of the Deepwater Horizon case. At the same time, the many differences between the two spills suggest that history will not repeat itself⁴⁰: a) the OPA (invoked in response to the Deepwater Horizon) was enacted after, and more specifically, in response to the Exxon Valdez. While the elements of the liability case against responsible parties under OPA are similar to those asserted under the Clean Water Act, which applied in the Exxon Valdez case, OPA allows plaintiffs to potentially recover a broader range of

³⁷ Jacobsson, M., *The International Oil Pollution Compensation Funds and the International Regime of Compensation for Oil Pollution Damage*, 138-150, 141, in Basedow, J., Magnus, U. (Eds.), *Pollution of the Sea – Prevention and Compensation*, Hamburg Studies on Maritime Affairs, Vol. 10, Springer: Berlin, Heidelberg, New York, 2007.

³⁸ Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69. Department of Geography and Environment, London School of Economics and Political Science, London, 2002, p. 20; See generally, Little, G., *The Hazardous and Noxious Substances Convention: A New Horizon in the Regulation of Marine Pollution*, (1998) L.M.C.L.Q., Part 4, 554-567; See, Wren, J., *The Hazardous and Noxious Substances Convention*, in Nordquist, M.H., Moore, J.N., (Eds.), *Current Maritime Issues and the International Maritime Organisation*, Kluwer Law International, The Hague, 1999, pp.335-349.

³⁹ See, Mason, M., *Transnational Compensation for Oil Pollution Damage: Examining Changing Spatialities of Environmental Liability*, LSE Research Papers in Environmental and Spatial Analysis (RPESA), no. 69. Department of Geography and Environment, London School of Economics and Political Science, London, 2002, p. 20; See generally, Wu, C., *Liability and Compensation for Bunker Pollution*. Thomas Miller P&I Ltd., New Jersey, 2001.

⁴⁰ Marten, B.M., *Fighting the Last War: The Relevance (and Irrelevance) of the Exxon Valdez Oil Tanker Spill to the Deepwater Horizon Oil Rig Spill*, http://www.lexisnexis.com/Community/emergingissues/blogs/gulf_oil_spill.aspx, accessed on Sept. 10th, 2010.

compensatory damages, including: damages to real or personal property; subsistence use; federal, state, and local tax revenues; lost profits and earning capacity; and the cost of providing additional public services resulting from the spill. In that sense, the law is more complex now than it was at the time of the Exxon Valdez spill, involves more parties and more and different potential claims. There is also very little case law decided under it; b) the causation issues in the Exxon Valdez case were far simpler than in the present spill. There was no question as to the cause of the 1989 spill into Prince William Sound - a tanker hit a reef. In the case of the Deepwater Horizon, on the other hand, press reports and briefings by BP Plc. point to a chain of events, each of which may have contributed to the explosion and to the still mounting damages; c) unlike the Clean Water Act, OPA expressly allows for contribution claims among responsible parties that were not available under the Clean Water Act. Therefore, BP Plc., as the primary party responding to the spill, may have statutory claims, that it will choose to assert against other responsible parties at some future time; d) the Exxon Valdez case involved a single state (Alaska) and the federal government (and Alaska Native corporations). By comparison, several states have already become involved in the Deepwater Horizon spill (including Louisiana, Mississippi and Alabama), raising potential jurisdictional questions and possible conflicting claims among the governmental plaintiffs; e) in oil spill cases, one of the potentially largest claims the government can bring is for natural resource damages. In order to do so, however, the government has to establish a "baseline" of pre-spill conditions. This is much more difficult to do in some of the ports and commercial areas along the Gulf Coast that are already impacted by hydrocarbons, as opposed to the relatively pristine waters of Alaska's Prince William Sound.⁴¹

III.2.b. Legal Framework under U.S.A. Law for Environmental Pollution Liability

The U.S.A. has an explicit oil spill liability mechanism to address the Deepwater Horizon incident. In 1990, Congress enacted the OPA to strengthen the safety and environmental practices in the offshore energy exploration and production business, to create a system of so-called "financial responsibility laws"⁴², and to place limitations on liability. The offshore facility rule, authorised by OPA, applies to facilities "in, on or under" navigable waters. Offshore facility liability limits are based on calculations of a "worst-case" oil spill discharge.⁴³

Under the OPA, BP Plc., as lessee of the drilling area, is responsible for removal and government response costs, property and natural resource damages, and economic losses resulting from the oil spill.⁴⁴ Although liable for all removal costs,

⁴¹ Marten, B.M., *Fighting the Last War: The Relevance (and Irrelevance) of the Exxon Valdez Oil Tanker Spill to the Deepwater Horizon Oil Rig Spill*, http://www.lexisnexis.com/Community/emergingissues/blogs/gulf_oil_spill.aspx, accessed on Sept. 10th, 2010.

⁴² Together with compulsory liability insurance combined with strict liability standards; See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, Summary.

⁴³ Boyd, J., *Compensation for Oil Pollution Damages: The American Oil Pollution Act as an Example for Global Solutions?*, 137-163, 157-159, in Faure, M.G, Hu, J. (Eds.), *Prevention and Compensation of Marine Pollution Damage: Recent Developments in Europe, China and the U.S.A.*, Kluwer Law International, 2006, The Netherlands.

⁴⁴ Cessna, M., *Insurance Implications of the Deepwater Horizon Disaster*,

current law limits an offshore facility's liability for economic and natural resources damages to 75 million U.S.A. dollars per incident. Damages in excess of the cap could be paid by the Oil Spill Liability Trust Fund, which is financed primarily through a fee on domestic and imported crude oil. Lease holders of a "Covered Offshore Facility" (COF) must demonstrate a minimum amount of "Oil Spill Financial Responsibility" (OSFR) of 35 million U.S.A. dollars per 35,000 barrels of "worst case oil-spill discharge" up to a maximum of 150 million U.S.A. dollars for COF located in the "Outer Continental Shelf" (OCS) and 10 million U.S.A. dollars in state waters. OSFR can be demonstrated in various ways, including surety bonds, guarantees, letters of credit, and, in some cases, self-insurance, but the most common method is by means of an insurance certificate.⁴⁵ BP Plc.'s liability limit up to U.S.A. 75 million U.S.A. dollars is subject to an exception for gross negligence or wilful misconduct. On the other hand, OPA does not limit the liability of Transocean Ltd., Halliburton Co., or Cameron International Corp.. Nor does OPA limit actions for contribution or contractual indemnification.⁴⁶ Coastal business owners also have a better prospect of recovering those economic losses from BP under OPA.⁴⁷ Legislative measures,⁴⁸ currently seek to raise the limit of environmental liability on responsible parties from an oil spill from the current 75 million U.S.A. dollars, in some cases abolishing the limit altogether.⁴⁹ Notwithstanding the above efforts, the moratorium on deepwater oil and gas drilling, imposed by the Obama administration in July 2010 in response to the Deepwater Horizon oil spill was lifted on 12th October 2010, six weeks ahead of schedule. The USA government considered it as "appropriate" that deepwater oil and gas drilling resume, provided that operators certify compliance with all existing rules and requirements, including those that recently went into effect, and demonstrate the availability of adequate blow-out containment resources. The recent safety rules include the Drilling Safety Rule, issued on 30th September 2010 under an emergency rule-making process, which strengthens requirements for safety equipment, well control systems, and blow-out prevention practices on offshore oil and gas operations. Following the lift of the moratorium, on 21st October 2010, Chevron Ltd., one of the top leaseholders in the Gulf of Mexico, sanctioned development of a prospect, namely the "Jack/St. Malo" project, scheduled to operate in the Lower Tertiary trend in the deepwater of the USA part of the Gulf of Mexico. The "Jack/St. Malo" fields are estimated to contain hydrocarbon deposits able to produce combined total recoverable resources in excess of 500 million oil-equivalent barrels. Although on the one hand the agony of the petroleum industry to gain permits and resume drilling operations is understandable, on the other hand it is highly important that it be ensured that the added safeguards put in place will actually be followed and will lead to responsible operations. To this effect the quick

<http://www.insurancelawanddisputesblog.com/2010/05/insurance-implications-of-the-deepwater-horizon-disaster/>, accessed on 10th Sept. 2010.

⁴⁵ King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, Summary.

⁴⁶ Cessna, M., *Insurance Implications of the Deepwater Horizon Disaster*,

<http://www.insurancelawanddisputesblog.com/2010/05/insurance-implications-of-the-deepwater-horizon-disaster/>, accessed on 10th Sept. 2010.

⁴⁷ Cessna, M., *Insurance Implications of the Deepwater Horizon Disaster*,

<http://www.insurancelawanddisputesblog.com/2010/05/insurance-implications-of-the-deepwater-horizon-disaster/>, accessed on 10th Sept 2010.

⁴⁸ S. 3305, H.R. 5214, H.R. 5629.

⁴⁹ King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, Summary.

resumption of operations in the area justifies the scepticism that exists whilst the USA government continues to build on the reforms already implemented.

III.3. The European Response towards a Legal Framework for Environmental Pollution Liability

The environment is increasingly being viewed and understood as a whole. It is known now that polluting substances can move between different media.⁵⁰ The holism of the natural world contrasts sharply with existing environmental legislation, organisational structures and administrative procedures, in all EU member states. This is why the need for an integrated approach to the protection of the environment as a whole has been accepted as a political principle by the European institutions and all national governments. The main obstacle to adapting regulatory objectives, structures and procedures to the holism of the natural world is the problem of incommensurability of environmental goods.⁵¹

In addition, the development of methods and criteria for a cross-media assessment of environmental effects on the environment as a whole is very controversial. Proponents of integrated environmental policies acknowledge these difficulties of integrated decision-making but tend to downplay the practical implications of integrated environmental policies for regulatory systems in terms of legislation and implementation. Lack of information and knowledge regarding dose-effect relationships, synergetic and antagonistic effects as well as the interactions among the elements of environmental systems add to the methodological problems posed by the incommensurability of environmental goods.⁵² While there seems to be no open opposition to integrated environmental policies, sceptics emphasize that a scientifically tenable assessment of environmental cross-media effects is not really feasible in practice. Therefore they tend to take a “wait and see” position. However, one should keep in mind that the incommensurability of public goods does not constitute a decision situation, which is unique to environmental policies. What is needed is a legislative and administrative framework along with guidance by the competent authorities to increase the likelihood of reasoned integrated decisions in environmental protection.⁵³ In consistence with the above, the EU is not only working

⁵⁰ E.g. this can mean that the solution to a water pollution problem, for instance, may entail the intensification of an air or soil pollution problem. The control policies that successfully solved local air and water problems may contribute to a waste problem on land as the air and water pollutants are collected and dumped into landfills. Also, the dilution of air pollutants are deposited; See, Bohne, E., *Chapter 1: Issues and Research Objectives*, 9-13, 9, *The Quest for Environmental Regulatory Integration in the European Union: Integrated Pollution Prevention and Control, Environmental Impact Assessment and Major Accident Prevention*, Kluwer Law International, The Netherlands, 2006.

⁵¹ This means that there is no common denominator for the assessment of chemical, physical and biological impacts on air, water, land, flora, fauna, human health and cultural assets; See, Bohne, E., *Chapter 1: Issues and Research Objectives*, 9-13, 9, *The Quest for Environmental Regulatory Integration in the European Union: Integrated Pollution Prevention and Control, Environmental Impact Assessment and Major Accident Prevention*, Kluwer Law International, The Netherlands, 2006.

⁵² See, Bohne, E., *Chapter 1: Issues and Research Objectives*, 9-13, 9, *The Quest for Environmental Regulatory Integration in the European Union: Integrated Pollution Prevention and Control, Environmental Impact Assessment and Major Accident Prevention*, Kluwer Law International, The Netherlands, 2006.

⁵³ See, Bohne, E., *Chapter 1: Issues and Research Objectives*, 9-13, 9-10, *The Quest for Environmental Regulatory Integration in the European Union: Integrated Pollution Prevention and Control*,

as a driving force in the international arena to promote more stringent environment policies, but has moreover recognised the ineffectiveness of previous EU laws. As a result it has striven to keep Community laws in line with the international regimes.

Prevention and compensation are two sides of the same coin. However, prevention cannot always be successful and unavoidably the issue of how to adequately compensate the victims arises.⁵⁴ The sufficiency of the compensation regime is not only to be evaluated in terms of the amount of compensation, but, rather, in terms of the types of damages that are covered by the regime. Thus, the European Commission purports that if damage types are to be extended, the amounts available for compensation should be raised accordingly. Hence, a substantial increase of financial limits is to be justified by the expanding definition of the damage to be covered.⁵⁵

The EU originally took the point of view that marine oil pollution was an international problem better solved at international level. Hence, the EU counted on its Member-States to ratify the various international conventions aiming at the promotion of maritime safety. The international regime established under the CLC and Fund Conventions, as amended, covered pollution damage, including preventative measures and, to a limited extent, environmental damage *per se*, for accidents occurring in the coastal waters (up to 200 miles) of the States.⁵⁶ Despite the more stringent rules entailed in the international Conventions, lack of implementation throughout the world has resulted in lack of overall international monitoring, sanctions and courts and has left the IMO with no real auditing authority as to the observance by countries of the relevant rules.⁵⁷

This prompted the EU to include international standards in the EU legislation and to also check for compliance. Directive 2004/35/EC was, indeed, the first EC legislation whose main objectives included the application of the "polluter pay" principle. Although it established a common framework for liability with a view to preventing and remedying damage to animals, plants, natural habitats and water resources, and damage affecting the land, nevertheless, nevertheless, this liability scheme applies only to certain specified occupational activities and to other activities in cases where the operator is at fault or negligent. In addition, as per Directive's liability regime, the public authorities are responsible, for ensuring that the operators responsible take or finance the necessary preventive or remedial measures themselves. However, although it had been considered by the European Commission that the introduction of rules at community level in this respect would enhance the implementation of the "polluter pay" principle, and, hence, in this way also extend the scope of the definition of pollution damage, the adopted EU Environmental

Environmental Impact Assessment and Major Accident Prevention, Kluwer Law International, The Netherlands, 2006.

⁵⁴ Hui, W., *Recent Developments in the EU Marine Oil Pollution Regime*, 1-23,21-23, in Faure, M.G, Hu, J. (Eds.), *Prevention and Compensation of Marine Pollution Damage: Recent Developments in Europe, China and the U.S.A.*, Kluwer Law International, 2006, The Netherlands.

⁵⁵ Hui, W., *Recent Developments in the EU Marine Oil Pollution Regime*, 1-23,21, in Faure, M.G, Hu, J. (Eds.), *Prevention and Compensation of Marine Pollution Damage: Recent Developments in Europe, China and the U.S.A.*, Kluwer Law International, 2006, The Netherlands.

⁵⁶ See, Hui, W., *Recent Developments in the EU Marine Oil Pollution Regime*, 1-23, 23, in Faure, M.G, Hu, J. (Eds.), *Prevention and Compensation of Marine Pollution Damage: Recent Developments in Europe, China and the U.S.A.*, Kluwer Law International, 2006, The Netherlands.

⁵⁷ Hui, W., *Recent Developments in the EU Marine Oil Pollution Regime*, 1-23,21, in Faure, M.G, Hu, J. (Eds.), *Prevention and Compensation of Marine Pollution Damage: Recent Developments in Europe, China and the U.S.A.*, Kluwer Law International, 2006, The Netherlands.

Liability Directive 2004/35/EC has explicitly excluded marine oil pollution damage.⁵⁸

However, the EU is currently deliberating on the need for common legislation for offshore oil and gas platforms, reducing the risk of an environmental disaster in European waters. Following the Deepwater Horizon incident, the Commission has taken a hard look at EU safety and environmental standards for the oil industry and has found that although safety standards are generally high, nevertheless there are gaps in legislation, mostly due to differing standards between countries and that the rules often vary from company to company. Thus, and given these shortcomings, introducing common rules across the EU would help prevent oil spills at sea, protecting people and the environment. And if an accident did happen, the rules would ensure that the companies responsible will manage the response and pay for the cleanup.

In view of the above acknowledged facts, and in light of the lift by the USA government of the moratorium on deepwater oil and gas drilling on 12th October 2010, the European Commission, on 13th October 2010, adopted the “Communication “Facing the Challenge of the Safety of Offshore oil and Gas Activities”” contemplating new EU standards, including criteria for granting drilling permits, controls of the rigs and safety control mechanisms. The legislative proposal is aimed to cover standards on the prevention, the response and the financial liability in relation to granting permits, controls, standards for safety equipment, damages and responses to it, as well as ways to better address international response and measures.⁵⁹

The new rules would raise standards to the highest level possible, requiring:

- companies seeking drilling permits to have response plans in case spills occur. They would have to prove they have the means to pay for the cleanup and environmental damage.
- national authorities’ oversight of safety inspections to be evaluated by independent experts.
- equipment for oil platforms and mobile offshore drilling rigs, in particular blow out preventers, to meet the highest safety standards.
- companies to clean up and pay for environmental damage to water and sea life up to 200 miles (322 km) from the coast. The current limit is 12 miles (19 km).

The EU will also negotiate with neighbouring countries to set similar standards for oil drilling and extraction companies. People living in coastal areas will benefit from the greater protection of their livelihoods and the environment. And common EU rules and standards would help the oil industry – companies would not have to deal with different sets standards depending on where they drill. The legislation is set to be proposed in early 2011.⁶⁰

⁵⁸ Hui, W., *Recent Developments in the EU Marine Oil Pollution Regime*, 1-23,21, in Faure, M.G, Hu, J. (Eds.), *Prevention and Compensation of Marine Pollution Damage: Recent Developments in Europe, China and the U.S.A.*, Kluwer Law International, 2006, The Netherlands.

⁵⁹ See DG Energy, Press Release of 13.10.2010, *Offshore Oil & Gas Platforms Standards* http://ec.europa.eu/energy/oil/offshore/standards_en.htm, accessed on 14.10.2010.

⁶⁰ See DG Energy, Press Release of 13.10.2010, *Stringent Rules for Offshore Oil Platforms*, http://ec.europa.eu/news/energy/101013_en.htm accessed on 14.10.2010.

IV. The Environmental Pollution Insurance Regime – Response to the Deepwater Horizon Oil Spill

IV.1. Evolution of Environmental Insurance – From Past to Present

In the early 1940s, property and casualty insurers began aggressively marketing “Comprehensive General Liability” (CGL) insurance, which, unlike earlier policies written to cover specific risks, generally covered all liabilities arising out of an insured’s operations, unless specifically excluded. These policies covered liability arising out of accidental or unexpected and unintended property damage or bodily injury that happened during the policy period, even if a claim was not made until long after the policy period. Because early CGL policies did not exclude liability arising out of pollution, pollution claims were covered subject to other terms and conditions of each policy.⁶¹ Beginning in the early 1970s, property and casualty insurers began to include the so-called “qualified” pollution exclusion in their policies, which excluded “bodily injury or property damage arising out of the discharge, dispersal, release or escape of ... contaminants or pollutants” unless “such discharge, dispersal, release or escape is sudden and accidental.”⁶² Around 1986, insurers began including the so-called “absolute” pollution exclusion in CGL policies, which excluded coverage for pollution claims whether or not they were sudden and accidental.⁶³ However, by the mid-1980s, as claim expenses quickly outpaced premium revenues, insurers either ceased issuing “Environmental Insurance Liability” coverage (EIL), or policyholders stopped buying EIL coverage because it had become prohibitively expensive.⁶⁴ In the late 1990s, new environmental insurance products began to appear on the market. These second generation environmental insurance products, include “Pollution Legal Liability Insurance”, “Cleanup Cost Cap Insurance”, and a number of more specialized products, such as “Contractors Pollution Liability Insurance”, “Commercial Real Estate Pollution Legal Liability Insurance”, and “Contaminated Property Development Insurance”.⁶⁵

Initially, CGL policies would typically promise to provide coverage for “*all sums which the insured shall become legally obligated to pay as damages because of ... property damage to which this insurance applies, caused by an occurrence*” and defined “*occurrence*” as “*an accident, including continuous or repeated exposure to conditions, which results in ... property damage neither expected nor intended from*”

⁶¹ See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 33-34.

⁶² See, e.g., ISO 1973 Standard Form for CGL Policy; Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 33-34.

⁶³ See, e.g., ISO 1986 Standard Form for CGL Policy; Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 33-34.

⁶⁴ Waeger, A.M., *Environmental Insurance: Emerging Issues and Latest Developments on the New Coverage and Insurance Cost Recovery, Current Insurance Policies for Insuring Against Environmental Risks*, 2008, SN050 ALI-ABA 339, 342-343; See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 33-34.

⁶⁵ See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 33-34.

the standpoint of the insured."⁶⁶ Such policies typically excluded coverage for "property damage to ... property owned or occupied by or rented to the insured" and, gradually added pollution exclusions.⁶⁷ Finally, the policies required notice to the insurer of an occurrence "as soon as practicable".⁶⁸ Modern environmental coverage differs from historical CGL coverage in several important respects. Most fundamentally, CGL policies provide broad coverage for all risks not expressly excluded and do not expressly identify environmental claims as a covered risk. Environmental insurance, on the other hand, is written expressly to cover environmental claims. Thus, while the insurance industry historically has argued - contrary to all evidence - that environmental claims were never intended to be covered under historical CGL policies, such arguments clearly are not available to defeat claims made under modern environmental coverage policies. With regard to environmental insurance, the issue simply is whether the particular each time environmental claim falls within the scope of the environmental coverage that was purchased. Second, unlike CGL policies which cover accidents or occurrences that happened during the policy period regardless of when the claim is made, modern environmental coverage typically is "claims made." In theory, this means that a policyholder may have coverage under a modern claims-made environmental insurance policy and a historical CGL policy for the same claim if the alleged property damage occurred during the CGL policy period and the claim was made during the claims-made policy period.⁶⁹ Typically, however, modern environmental

⁶⁶ See ISO 1973 Standard Form for CGL Policy; See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39,34.

⁶⁷ See ISO 1973 Standard Form for CGL Policy; See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39,34.

⁶⁸ See ISO 1973 Standard Form for CGL Policy; In the context of environmental claims, these policy provisions have spawned decades of litigation regarding (1) whether environmental cleanup costs constitute "damages" (e.g., *Johnson Controls, Inc. v Employers Ins. of WaU.S.A.u.*, 665 N.W.2d 257 (Wis. 2003) , rev'g *City of Edgerton v General Cas. Co. of Wis.*, 517 N.W.2d 463 (Wis. 1994)), (2) whether compliance with the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) or analogous state laws constitute sufficient legal compulsion for CGL coverage to apply (e.g., *Weyerhaeuser Co. v Aetna Cas. & Sur. Co.*, 874 P.2d 142, 147-53 (Wash. 1994)); (3) which policies are "triggered" by the continuous injurious process of environmental contamination, (e.g., *Montrose Chem. Corp. v Admiral Ins. Co.*, 913 P.2d 878 (Cal. 1995)); (4) whether "sudden" in the "sudden and accidental" pollution exclusion means temporally abrupt or unexpected, (e.g., *Queen City Farms, Inc. v Central Nat'l Ins. Co. of Omaha*, 882 P.2d 703, 718-719 (Wash. 1994)); (5) whether "expected or intended" refers to the act causing the damage (i.e., the disposal of waste) or the resulting damage (i.e., the contamination caused by the disposed waste) (e.g., *Overton v. Consolidated Ins. Co.*, 38 P.3d 322, 325 (Wash. 2002)); (6) whether the exclusion for "property damage to ... property owned or occupied by or rented to the insured" applies once groundwater - which is owned by the state - is or imminently will be contaminated, (e.g. *Olds-Olympic, Inc. v Commercial Union Ins. Co.*, 129 Wash. 2d 464, 478-80 (1996)); (7) whether failure to comply with the notice provision bars coverage if the insurer has not been prejudiced (e.g. *Pfizer, Inc. v Employers Ins. of WaU.S.A.u.*, 154 N.J. 187 (1998)); and (8) how damages should be allocated among multiple insurers with varying limits at different attachment points, each of which promised to pay "all sums which the insured shall become legally obligated to pay." (e.g. *Plastics Engineering Co. v Liberty Mut. Ins. Co.*, 759 N.W.2d 613, 627 (Wis. 2009); These same issues, and perhaps new ones, will continue to arise as policyholders seek coverage under historical CGL policies for second generation environmental claims, including claims for sediment cleanup, natural resources damages and trans-boundary pollution; See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 34.

⁶⁹ See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 34-35.

policies have multi-year policy periods, often as many as 10 or more years.⁷⁰ Another feature of modern environmental policies is that they typically restrict coverage based on the location, time, and source of the liability. For example, different coverages will apply (and must be purchased separately) for "on-site" and "off-site" conditions. And different coverages may apply (and often must be purchased separately) to pollution that begins before the policy period as compared to pollution that begins during the policy period. Additionally, some policies only cover "sudden" pollution events (which the policies define to mean "abrupt"), and some policies require that the pollution be discovered within a defined period of time (e.g., within 72 hours of the event), and have very short reporting periods (e.g., 30 days) in order for coverage to apply. Finally, different coverages must be purchased to address potential on-site clean-up versus other third-party liability.⁷¹

IV.2. The Present Case Scenario

The key players and insurance coverage which is in place include BP Plc.⁷², Anadarko Petroleum Corp.⁷³, Mitsui Oil Exploration Co.⁷⁴, Transocean Ltd.⁷⁵, Cameron International Corp.⁷⁶ and Halliburton Co.⁷⁷. The loss is a major event for the offshore energy insurance and reinsurance market.

⁷⁰ E.g., Steadfast Insurance Company Environmental Impairment Liability Insurance Policy, Form U-EIL-D-100-B CW (8/99); See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 34-35.

⁷¹ See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 36.

⁷² With a 65% interest in the *Deepwater Horizon* joint venture, *BP Plc.* says it is self-insured. *BP's* captive (*Jupiter Insurance Ltd*) has \$6 billion in capital, but does not purchase outside reinsurance protection. Jupiter's *per occurrence* limit on physical damage and business interruption is \$700 million and is not expected to cover environmental clean-up costs or third party liability. *BP Shipping* purchases \$1 billion of marine liability pollution insurance through mutual insurance associations (P&I clubs), but it is unclear if this coverage will respond); See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 34-35.

⁷³ With a 25% interest in the *Deepwater Horizon* joint venture, *Andarko Petroleum Corp.* is believed to have a \$100 million owner's extra expense policy (covering re-drilling, re-gaining control of well, etc); See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 34-35.

⁷⁴ With a 10% interest in the *Deepwater Horizon* joint venture, *Mitsui Oil Exploration Co.* is believed to have a \$45 million owner's extra expense policy;); See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 34-35.

⁷⁵ *Transocean Ltd.*, the drilling contractor is believed to have \$560 million of physical damage insurance, which is highly syndicated. Insurers have already paid out over \$400 million to-date under this coverage. In addition, *Transocean Ltd.* carries some \$950 million in third party liability insurance, of which \$700 million excess of \$50 million is thought to cover offshore risks;); See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 34-35.

⁷⁶ The manufacturer of the blowout preventer that failed on the rig has a 500 million U.S.A. dollars liability insurance policy;); See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 34-35.

Companies with exposure to the Deepwater Horizon oil rig are insured for losses totaling 1.4 billion U.S.A. dollars to 3.5 billion U.S.A. dollars, according to reports. Litigation, D&O liability and workers compensation losses may bring the total insured loss in the range of 4 billion U.S.A. dollars to 6 billion U.S.A. dollars. But, likely limits on lawsuits via the 20 billion U.S.A. dollars fund could reduce chances for large liability awards. Moreover, the risks are also well-syndicated, with the insured loss spreading across a broad range of insurers and reinsurers on a global scale. The operating group for Deepwater Horizon is a joint venture led by BP. Since BP Plc., which owns 65% of the Deepwater Horizon consortium, self-insures, a large portion of the losses will not hit the insurance industry. Lawsuits against equipment manufacturers, suppliers and sub-contractors, and business interruption claims, will likely increase the amount of the total insured losses. BP Plc. stated it will assume liability for all legitimate claims caused by the oil spill. Accordingly, primary liability for clean up costs will be with BP Plc. consortium.⁷⁸

IV.3. Possible Types of Insurance Coverage and Claims to Arise

Several types of insurance might respond to pay for losses stemming from the oil spill, including insurance policies for: first-party property insurance coverage⁷⁹ (including “business interruption” insurance coverage,⁸⁰ loss of production income insurance coverage and “operator’s extra expenses” insurance coverage⁸² – occurred for the control of the well); directors & officers liability insurance coverage⁸³; event cancellation liability insurance coverage⁸⁴; trade disruption insurance coverage⁸⁵,

⁷⁷ Service provider to *Deepwater Horizon* has liability insurance in excess of 1 billion U.S.A. dollars; See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 34-35.

⁷⁸ On June 1, 2010, U.S.A. Attorney General said federal authorities have opened criminal and civil investigations into the spill. As of August 9, BP says that the cost of the response totals \$6.1 billion. Former BP CEO Tony Hayward had insisted that other parties besides BP may be responsible for costs and liabilities arising from the oil spill, and that those parties are expected to live up to their obligations. However, *Anadarko Petroleum Corp.* accuses *BP Plc.* of gross negligence.

⁷⁹ The extent of property damage from the Gulf oil spill so far is unclear; See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

⁸⁰ In addition to covering property damage, many property policies also provide some or all of the following coverage designed to help the policyholder recover for other losses caused by the oil spill. In order to be implicated, policies typically require damage by a covered peril to property; See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

⁸¹ See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

⁸² See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

⁸³ See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

⁸⁴ See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

comprehensive general liability insurance coverage, physical damage insurance coverage, workers compensation insurance coverage or employers liability insurance coverage. In addition insurance may be provided for mitigation costs.⁸⁶

The extent of property damage from the Gulf oil spill so far is unclear. First-party property policies protect a policyholder's place of operations and inventory, and provide coverage for lost or damaged property. Many property insurance policies are sold on an "all risk" basis, meaning that they cover losses to real property caused by any peril not expressly excluded. Because of the breadth of coverage afforded by an "all risk" policy, once a policyholder shows that it has suffered a loss, the burden of proof shifts to the insurer to show that the loss is not covered. By comparison, a second type of property insurance — a "*named peril*" policy — covers only those perils expressly listed. Both types of policies may contain exclusions to coverage. It is important to carefully review all aspects of a policy to determine if coverage for the specific loss is clearly excluded.⁸⁷ The likely issues to arise under first-party property insurance policies revolve around the basic elements of first-party coverage, i.e. (1) that there has to exist a covered property, (2) that there has to exist a sustained physical loss or damage, and (3) that it has to occur as a result of a covered peril. Physical loss or damage has been defined in case law as well.

In *Columbiaknit, Inc. v Affiliated FM Insurance Co.*,⁸⁸ it was stated that:

"...the requirement that the loss be 'physical,' given the ordinary definition of that term, is widely held to exclude alleged losses ...intangible or incorporeal, and, thereby, to preclude any claim against the property insurer when the insured merely suffers a detrimental economic impact unaccompanied by a distinct, demonstrable, physical alteration of the property."

In *Trinity Industries, Inc. v Insurance Co. of North America*⁸⁹ it was stated that:

"...the language 'physical loss or damage' strongly implies that there was an initial satisfactory state that was changed by some external event into an unsatisfactory state".

The actual coating by oil can constitute contamination and, of itself it can also constitute physical loss or damage. In the case of boats, docks, other seaside structures or dwellings that come into contact with oil from the spill, it is likely that

⁸⁵ See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

⁸⁶ E.g., companies may purchase equipment, such as booms, in an effort to protect property from contamination; See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

⁸⁷ See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

⁸⁸ *Columbiaknit, Inc. v Affiliated FM Insurance Co.*, 1999 U.S. Dist. LEXIS 11873 at *9 (D. Or. 1999).

⁸⁹ *Trinity Industries, Inc. v Insurance Co. of North America*, 916 F.2d 267,270-71 (5th Cir. 1990).

such contamination will rise to the level of physical loss or damage if there is enough oil on the property to require its removal.⁹⁰

“Business Interruption” insurance coverage, reimburses the policyholder for the amount of gross earnings minus normal expenses (i.e., its profits) that the policyholder would have earned but for the interruption of the policyholder’s business. Such coverage may be implicated, for example, for businesses in the fishing industry which are forced to cease operations due to contamination. In the context of municipalities, this coverage may be implicated if the municipality experiences a decrease in tax revenue (e.g. the city of Biloxi, Mississippi obtained reimbursement for millions of dollars of lost tax revenue when Hurricane Katrina caused casinos to shut down and Biloxi experienced an ensuing loss of tax revenue). Business interruption coverage requires that an “interruption” result from damage to covered real or personal property (e.g. policyholders, for example, have obtained reimbursement under such coverage when widespread disasters such as Hurricane Katrina and the 9/11 terrorist attacks caused business interruption). In particular, the typical elements of a business interruption claim entail: (i) that there exists an actual loss of business income, (ii) that the said actual loss is due to the necessary suspension of operations, (iii) that it is happening during the period of restoration, and (iv) that the suspension of operations must result from physical loss to covered property caused by a covered cause of loss. The typical elements of a contingent business interruption claim entail: (i) that there exists business income loss or extra expense incurred due to impairment of insured’s operations, (ii) that the property of the dependent business must sustain damage at dependent business premises, and (iii) that the impairment of insured’s operations must be caused by direct physical loss or damage to property of a dependent business at a dependent business premises.⁹¹ Business interruption losses may not be as high as expected due to a number of mitigating factors, such as physical damage⁹², pollution⁹³, civil action⁹⁴, or due to subrogation factors.⁹⁵

⁹⁰ See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

⁹¹ See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

⁹² “Business Interruption” losses may not be triggered for many third parties because the coverage typically responds in the event of physical damage from a covered peril ; See, Nevius, J.G., *Insurance Implications of the Gulf Oil Spill*, http://www.lexisnexis.com/Community/emergingissues/blogs/gulf_oil_spill.aspx, accessed on Sept. 10th, 2010.

⁹³ Usually, excluded as a covered peril in admitted market policies; See, Nevius, J.G., *Insurance Implications of the Gulf Oil Spill*, http://www.lexisnexis.com/Community/emergingissues/blogs/gulf_oil_spill.aspx, accessed on Sept. 10th, 2010.

⁹⁴ Civil authorities may limit access to an area after a disaster, forcing an industry to shut down, but losses are only covered if they arise out of a covered peril; See, Nevius, J.G., *Insurance Implications of the Gulf Oil Spill*, http://www.lexisnexis.com/Community/emergingissues/blogs/gulf_oil_spill.aspx, accessed on Sept. 10th, 2010.

⁹⁵ Insurers may try to recover losses by suing the *BP Consortium*, if the cause was pollution, but this would imply paying losses first and then suing *BP Consortium* which could be a long drawn out and costly litigation process; See, Nevius, J.G., *Insurance Implications of the Gulf Oil Spill*, http://www.lexisnexis.com/Community/emergingissues/blogs/gulf_oil_spill.aspx, accessed on Sept. 10th, 2010.

In addition to traditional liability and business interruption insurance, specialty spill-related or other environmental cleanup coverage is available domestically, generally on a surplus or specialty market basis. Numerous off-shore international underwriting syndicates, including the London Market, will likely face large claims as well. However, many companies have been known to accept large portions of major oil-spill risk themselves through the use of large “self-insured retentions” and/or of the so-called “fronting policies”. In addition, captive insurance programs are often used by sophisticated policyholders to, among others, provide various tax benefits, direct claim-handling, and potential direct access to reinsurance markets.⁹⁶

“Extra Expense” insurance coverage provides indemnity to the policyholder for the reasonable and necessary increased costs of conducting its business operations due to property damage caused by an insured peril. In the present case, one example of such expense would be increased costs of raw materials and transportation as a result of the oil slick (e.g., a restaurant might obtain seafood from Asia or Latin America due to a lack of supply from the Gulf).⁹⁷

“Directors & Officers” policies may provide defence and indemnity coverage for companies and their directors and officers who face claims regarding their preparation for, or response to, the crisis. For example, claims may be made against directors and officers for failure to have proper procedures and plans in place for dealing with the oil spill.⁹⁸

“Event Cancellation” policies are designed to compensate policyholders for losses arising out of the cancellation, interruption, or postponement of specified events. These policies typically specify that coverage is triggered if the cancellation, interruption, or postponement is caused by factors that are beyond the policyholder’s control. They typically insure a wide range of events, including concerts, sporting events, conventions, conferences, exhibitions, and trade shows. These policies have provided coverage, for example, when a policyholder incurred losses arising out of the cancellation of music concerts in the aftermath of the 9/11 terrorist attacks.⁹⁹

“Trade Disruption” policies are designed to protect against loss of earnings and extra expenses caused by disruption in the supply chain, even when there is no physical loss or damage to the policyholder’s assets. This coverage was designed specifically for businesses that depend on global supply chains.¹⁰⁰

BP Plc is reported to be self-insured or insured under a program issued by captive insurance company, Jupiter Insurance Ltd., which is said to have retained its BP liabilities with no reinsurance. Anadarko Petroleum Corporation is reported to have cover for 178 million U.S.A. dollars in expenses excess of a 15 million U.S.A. dollars deductible. No information is available concerning Mitsui Oil Exploration

⁹⁶ Nevius, J.G., *Insurance Implications of the Gulf Oil Spill*, http://www.lexisnexis.com/Community/emergingissues/blogs/gulf_oil_spill.aspx, accessed on Sept. 10th, 2010.

⁹⁷ See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

⁹⁸ See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

⁹⁹ See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

¹⁰⁰ See, Kellner, L. et al, *Insurance Coverage Issues for Third-Party Businesses and Municipalities with Losses Due to the Oil Rig Explosion in the Gulf of Mexico*, Insurance Coverage Alert, Dickstein Shapiro LLP, May 2010.

Corporation's potential cover. Transocean Ltd. reportedly has cover for the total loss of the Deepwater Horizon oil platform and wreck removal to the extent it may be required, with a reported total insured value of the platform at \$560MM.¹⁰¹

Because the platform now lies over 5,000 feet below sea level it is possible that only limited wreck removal may ultimately be required. However, if more substantial wreck removal were to be required, then the wreck removal costs could be quite significant. Transocean Ltd. also reportedly carries 950 million U.S.A. dollars of third-party liability coverage excess of deductibles. The extent of Halliburton Corporation's potential cover has not been reported. Cameron International Corporation reportedly has 500 million U.S.A. dollars in liability insurance. It will take a full investigation to determine which of these players may have liability for the explosion, well rupture and oil spill, and perhaps even more time before we learn whether the insurance coverage reportedly carried by these companies may apply. It is possible that certain of the coverage issues may be determined under Louisiana law, which would potentially apply under the federal Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1333, as the Macondo oil well lies off the coast of Louisiana. While the insurance contracts held by the players in the incident are sure to vary, many of the issues likely to be encountered will require a deep understanding of insurance issues that have been encountered in countless other pollution claims.¹⁰²

Claims against BP Plc. offer a unique intersection of environmental, tort, administrative, maritime, and insurance law. In addition to the environmental remedies the OPA provides, it essentially insures every U.S.A. citizen and business against economic loss caused by discharge of oil by a private party in U.S.A. waters. Even if each claimant pursues different routes of recovery, the OPA will, nevertheless, be common to all.¹⁰³ Since the OPA has never been applied in a large scale disaster such as this, so there is very little case law on the areas of recovery and valuation that will be at issue. The litigation in response to the Exxon Valdez disaster did not fall under the OPA and the state statutes promulgated in accordance with it¹⁰⁴, so we are entering relatively uncharted territory. Especially in the areas of subsistence use and economic loss without accompanying property damage, the "BP oil spill litigation" will become precedent. As the OPA essentially provides insurance for all who suffer economic damage caused by a discharge of oil into U.S.A. water, the amount of recovery one can achieve may likely depend upon whether the injured party seeks recovery from BP Plc., by claim or lawsuit, or from the Oil Spill Liability Trust Fund.¹⁰⁵

¹⁰¹ Kotula, M., *Insurance, Pollution Exclusions, and the Deepwater Horizon Gulf of Mexico Oil Spill*, http://www.lexisnexis.com/Community/emergingissues/blogs/gulf_oil_spill.aspx, accessed on Sept. 10th, 2010.

¹⁰² Kotula, M., *Insurance, Pollution Exclusions, and the Deepwater Horizon Gulf of Mexico Oil Spill*, http://www.lexisnexis.com/Community/emergingissues/blogs/gulf_oil_spill.aspx, accessed on Sept. 10th, 2010.

¹⁰³ Merlin, W.C. Jr. Esq., *Understanding the Valuation Issues*, HB Litigation Conferences: Conference "Oil in the Gulf – Litigation and Insurance Coverage, Atlanta, U.S.A. , June 2010, p.1.

¹⁰⁴ See, *Tex.Nat.Res.Code Ann.* § 40.002(d) ("The legislature declares that it is the intent of this chapter to support and complement the Oil Pollution Act of 1990."), 30 *La.Rev.Stat.* § 2453(B) ("The legislature declares that it is the intent of this Chapter to support and complement the Oil Pollution Act of 1990"); See, Merlin, W.C. Jr. Esq., *Understanding the Valuation Issues*, HB Litigation Conferences: Conference "Oil in the Gulf – Litigation and Insurance Coverage, Atlanta, U.S.A. , June 2010, p.1.

¹⁰⁵ Merlin, W.C. Jr. Esq., *Understanding the Valuation Issues*, HB Litigation Conferences: Conference "Oil in the Gulf – Litigation and Insurance Coverage, Atlanta, U.S.A. , June 2010, p.1.

In addition, as the likely scale of clean-up costs and third-party damages will be vast, Congressional review of clean-up and damage compensation mechanisms has been prompted, as well as Congressional review of ways to facilitate future oil spill prevention, response, and recovery. A key element is the role of insurance in ensuring that costs of spills can be financed, while at the same time enabling the continued effective and responsible functioning of offshore energy exploration and production, as well as protecting related economic interests.¹⁰⁶ Legislative measures¹⁰⁷ currently seek to raise the limit of environmental liability on responsible parties from an oil spill from the current 75 million U.S.A. dollars, in some cases abolishing the limit altogether. The offshore energy insurance market currently has a finite amount of liability insurance capacity, including coverage for offshore oil pollution spills in U.S.A. waters, somewhere in the range of 1.25 billion U.S.A. dollars to 1.5 billion U.S.A. dollars. Some of the alternative risk transfer mechanisms include “reinsurance sidecars”, catastrophe bonds, and derivative financial instruments that securitize insurance risk. These alternative risk transfer mechanisms turn an insurance policy or reinsurance contract into a financial security that is then transferred to investors in the capital markets. These risk financing options could in theory provide the added capital needed in the insurance marketplace to cover the higher liability and associated OSFR limits.¹⁰⁸

4.3.1. Coverage Disputes Under Modern Environmental Coverage

There is a large body of case-law developed over nearly 30 years regarding coverage for pollution claims under historical CGL policies. There is a comparatively small body of case law regarding disputes under modern environmental policies, and the issues, like the policies, tend to be more individualized. The litigated issues under modern pollution coverage have been whether the particular claim is one the specific pollution policy was intended to cover.¹⁰⁹

IV.3.b. What Must Happen During the Policy Period?

Because modern environmental coverage is claims-made, insurers may take the position that the relevant claim - which varies depending upon the particular coverage implicated - did not happen during the policy period. In *Alan Corp. v International Surplus Lines Ins. Co.*,¹¹⁰ the insurer, ISLIC, issued a pollution liability policy covering third party claims for property damage or bodily injury arising out of a pollution incident if the pollution incident and the third party claim both occurred during the policy period. The policy covered "reasonable and necessary cleanup costs incurred by the insured in the discharge of a legal obligation validly imposed through governmental action which is initiated during the policy period." ISLIC denied

¹⁰⁶ King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, Summary.

¹⁰⁷ S. 3305, H.R. 5214, H.R. 5629.

¹⁰⁸ King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, Summary.

¹⁰⁹ Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 37.

¹¹⁰ *Alan Corp. v International Surplus Lines Ins. Co.*, 823 F. Supp. 33 (D. Mass. 1993).

coverage for Alan Corp.'s clean up costs because, although the pollution incident occurred during the policy period, the governmental action was not initiated until after the policy period. The court upheld ISLIC's denial of coverage.¹¹¹

IV.3.c. Known Conditions

As a general principle, liability insurance does not cover a specific loss that a policyholder knows exists prior to the inception of the policy ("known loss"). In the environmental insurance context, insurers issue coverage where: (i) the loss is known, but the extent of the loss is not (cost cap); or (ii) the liability causing event has already happened but the policyholder simply does not know the extent of contamination. Once a claim is made, the insurer nonetheless sometimes will contend that the policyholder knew of the contamination but failed adequately to disclose it.

D.C. Operating Co., LLC v Indian Harbor Insurance Co.,¹¹² highlights an issue likely to arise when claims are made under modern pollution coverage. In many instances, policyholders purchase pollution coverage precisely because the detection of contamination at a site suggests that there may be more as yet undetected contamination. Policyholders must examine the language of their policies closely before purchasing it to ensure that insurers have not attempted to exclude the entire risk for which the policyholder seeks coverage and will pay a premium. Policyholders also must be cognizant of the risk of pollution insurers conducting "*post-claim underwriting*", relying on statements from historical site assessments - reviewed by the insurer for the first time after a claim is made - to contend that the policyholder did not disclose important information in its application. An example of this is *John R. McKenzie Jobber, Inc. v Mid-Continent Casualty Co.*¹¹³ Policyholders are likely to encounter similar arguments from their insurers when making claims under policies covering sites at which there has been a history of environmental investigations and even past remediation. The purpose of environmental assessment reports is to identify potential contamination that may exist at a site. Thus, such reports are likely to be fertile ground for statements that an insurer may seek to use against the policyholder after a claim is made, even if the insurer failed to review these same reports during the underwriting process.¹¹⁴

One of the few decisions that has addressed these issues in detail is *Viacom International, Inc. v Admiral Ins. Co.*,¹¹⁵ which involved 47 environmental sites located in 17 states, and more than 80 insurance policies issued between 1948 and 1986. In the first phase of the litigation, which focused on sites in Pennsylvania and Illinois, the insured (*Viacom*) contended that under Pennsylvania's vertical allocation rule, it was entitled to select the EIL policies to pay their full limits first. After the EIL

¹¹¹ *Alan Corp. v International Surplus Lines Ins. Co.*, 823 F. Supp. 33 (D. Mass. 1993) at 39; See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 37.

¹¹² *D.C. Operating Co., LLC v Indian Harbor Insurance Co.*, Decision and Order Granting in Part and Denying in Part Defendants' Motion to Dismiss the Complaint, No. 07-CV-0116 (S.D.N.Y. Mar. 27, 2007).

¹¹³ *John R. McKenzie Jobber, Inc. v Mid-Continent Casualty Co.*, No. 07-214, 2007 U.S. Dist. LEXIS 84169 (M.D. Fla. Nov. 14, 2007).

¹¹⁴ See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 37-38.

¹¹⁵ *Viacom International, Inc. v Admiral Ins. Co.*, No. L-1739-99 (N.J. Super. Ct. App. Div. April 21, 2006) (reprinted in 19-9 Mealey's Poll. Liab. Rep. 21 (2006)).

policies were exhausted, damages would then be allocated vertically to each successive layer of CGL policies covering the same policy periods as the EIL policies. The court agreed that *Viacom* was entitled under Pennsylvania law to select the EIL policies to pay first, and then vertically exhausted successive layers of CGL coverage during the same policy periods, but held that the EIL insurer were entitled to seek contribution or set-offs from the CGL insurers. As *Viacom International, Inc. v Admiral Ins. Co.*,¹¹⁶ illustrates policyholders may be able to trigger current and historical CGL policies to cover the same claims. Which policies are available and to what extent will depend upon the applicable policy language, such as the "other insurance" provisions in the policies, as well as which state's allocation rules will apply. In *Viacom International, Inc. v Admiral Ins. Co.*,¹¹⁷ the court interpreted a somewhat unusual "other insurance" provision in the Environmental Insurance Liability (EIL) policies, which allowed the policyholder to treat the EIL coverage as either primary or excess to other applicable insurance.¹¹⁸ Modern pollution policies often have "other insurance" provisions that attempt to limit the coverage available to the same claims or occurrences. For example, some provisions state that if the same claim or occurrence implicates more than one coverage, it will be subject to the highest applicable limit and the highest applicable deductible.¹¹⁹ These provisions, however, will have to be reconciled with potentially conflicting "other insurance" provisions in historical CGL policies, many of which purport to make them excess over any other applicable insurance.¹²⁰

IV.3.d. Claims Implicating Current and Historical Policies

Pollution claims may implicate multiple coverage - within the same policy, and may implicate multiple policies, including both historical occurrence policies and current claims-made pollution coverage. When the same claims implicate both historical CGL policies and current claims-made pollution coverage, a number of complex allocation issues arise. How these issues will be resolved will depend upon the specific policy language, in the current claims-made policy, as well as the law regarding allocation in the relevant jurisdiction.¹²¹

Courts, or the parties in private negotiations, will determine such arising "duelling" policy language and applicable jurisdiction provisions as well as the difficult issue of allocation between the current claims-made pollution policy and historical CGL policies.¹²²

¹¹⁶ *Viacom International, Inc. v Admiral Ins. Co.*, No. L-1739-99 (N.J. Super. Ct. App. Div. April 21, 2006) (reprinted in 19-9 Mealey's Poll. Liab. Rep. 21 (2006)).

¹¹⁷ *Viacom International, Inc. v Admiral Ins. Co.*, No. L-1739-99 (N.J. Super. Ct. App. Div. April 21, 2006) (reprinted in 19-9 Mealey's Poll. Liab. Rep. 21 (2006)).

¹¹⁸ *Viacom International, Inc. v Admiral Ins. Co.*, No. L-1739-99 (N.J. Super. Ct. App. Div. April 21, 2006) (reprinted in 19-9 Mealey's Poll. Liab. Rep. 21 (2006)) at 35.

¹¹⁹ E.g., Zurich Z Link-Commercial General and Pollution Liability Policy, Form STF-GLP-100-C-W (08/04/08); See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 37-38.

¹²⁰ See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 37-38.

¹²¹ See, Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 38.

¹²² See Plumer M., Lathrop A., Suomela K., *Insurance For Environmental Claims*, New Appleman on Insurance: Current Critical Issues in Insurance Law, Lexis Nexis, Spring 2010, 33-39, 38.

IV.3.e. Marine Insurance Coverage

The offshore energy insurance market provides coverage for offshore oil and gas exploration and production business operations. Because the offshore exploration business is conducted in bodies of water, the offshore energy insurance market is closely associated with the marine insurance industry. Thus, marine insurance is considered to be a component of the offshore energy insurance market. Operators of vessels, including MODUs, like the Deepwater Horizon oil rig, face multiple property and liability loss exposures for which they use marine insurance to cover. Marine insurance coverage is available for vessels and their cargoes for both property and liability risk exposures.¹²³

IV.3.f. Typical Offshore Energy Insurance Coverage

The main types of insurance coverage commonly used in the offshore energy insurance market that are relevant to the Deepwater Horizon incident include: (1) offshore physical damage coverage for physical damage or loss to offshore fixed platforms, pipelines, and production and accommodation facilities. This coverage provides post-loss financing for any direct physical loss of or damage to fixed offshore drilling, production, and accommodation facilities, including (1) offshore energy drilling, production, and accommodation facilities;²⁵ (2) pipelines; (3) sub-sea equipment; and (4) offshore loading. All risks are covered unless specifically excluded, but such risks are covered in OEE policies. For example, oil wells and regaining control of the well after a blow-out and re-drilling expenses are typically excluded.¹²⁴; (2) Operator's Extra Expense (OEE). This covers the costs of well blow-out and indemnifies the offshore facility operator for third-party bodily injury claims, damage to and loss of third-party property, and the cost of clean up and legal defence expenses as a result of a blow-out. OEE covers evacuation expenses, the removal of wreckage and making wells safe, and the property of others in the insured's care custody and control. Coverage may also include the re-drilling of a well after a blow-out to the original depth and comparable condition prior to the loss, as well as the legal expenses emanating from an incident such as the sinking of a rig or an oil spill. The oil pollution incident must be sudden and accidental and the occurrence must have taken place during the period when insurance coverage is in force. Also, the incident must become known to the insured within 90 days and the insured must report the claim to the underwriter within 180 days. OEE is sold as a "Combined Single Limit of Liability" and covers actual costs or expenses incurred in regaining control of an unintended subsurface flow of oil. The operator is responsible for damage to drilling equipment as determined by the "Operating Agreement" between the operator of the rig and the drilling contractor listing the risks the operator will cover. Under these Agreements the drilling contractor is typically held harmless with respect to pollution liability for underground resources and liability for damage to operator's property or injury to operator's personnel arising out of the

¹²³ King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 8.

¹²⁴ See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 10-12.

employee/employer relationship.¹²⁵; (3) Excess Liability insurance. This coverage is purchased in layers that attach excess of a certain dollar limit. A typical operator would have many layers of excess liability that adds up to a certain aggregate level of protection. Although excess liability coverage is purchased as an additional layer of coverage in excess of the OEE policy it is subject to its own terms and conditions. Thus, whereas OEE covers pollution-related third-party bodily injury and third-party property loss or damage or loss of use on a strict liability basis, the excess liability insurance policy excludes pollution from wells. The policy generally has a limited “buy back,” which requires the pollution event to be sudden, accidental and unintended and subject to strict discovery and reporting requirements. The offshore energy facility operator must purchase specific “pollution endorsements” that overrides the pollution exclusion provision in the excess liability policy. A point of note is that the use of pollution endorsements could have the effect of reducing overall insurance capacity for clean up of pollution from wells because the insurer is potentially liable for higher levels of third-party liability on each policy¹²⁶; (4) business interruption. This coverage indemnifies the insured for lost net income that would have been earned had the damage not occurred, as well as for refunding fixed expenses incurred during the period of indemnity. Contingent business insurance coverage provides payments for damages based upon loss income due to damage to upstream facilities such as processing plants, trunklines, and refineries owned by third parties but upon which the insured’s income depended. This coverage is usually written in conjunction with offshore physical damage coverage on standardized forms published by Insurance Services Office, Inc. or those that resemble the ISO form. Because of the standardization in contract language there tends to be more predictability in claim payments and, therefore, reduced potential litigation over contract interpretation. Companies filing a business interruption insurance claim must show that their business operation sustained actual direct physical loss of or damage to the insured property. Without this proof, the BI claim could be denied because, as many experts agree, the consequences of oil spill can be far reaching without any need for the oil itself to actually reach those affected.¹²⁷; and (5) workers’ compensation. This provides coverage for claims arising out of employee injuries or deaths incurred while the employees are in the line of duty.¹²⁸

Protection and Indemnity (P&I) insurance sold by P&I clubs also provides insurance coverage with respect to third-party liability protection for owners and operators of vessels. However, P&I policies do not often offer coverage to indemnify offshore energy facilities for oil pollution damages and supplemental pollution liability insurance must be obtained under a separate marine policy.¹²⁹

¹²⁵ See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 10-12.

¹²⁶ See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 10-12.

¹²⁷ See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 10-12.

¹²⁸ This provides coverage for claims arising out of employee injuries or deaths incurred while the employees are in the line of duty; See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 10-12.

¹²⁹ King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 10-12.

IV.3.g. Compensating Oil Pollution Victims

Hazards faced by the offshore oil and gas exploration and production industry¹³⁰ can, inter alia, cause liability for marine oil pollution. Such liability is governed by the OPA and by any number of stricter statutes in individual U.S.A. states. The main sources of funds for compensating victims of offshore oil pollution damages include: (1) oil pollution compensation funds. The International Tanker Owners Pollution Federation (ITOPF) which was established following the 1967 *Torrey Canyon* grounding and oil spill, administered a voluntary fund that offered compensation to parties affected by oil spills. The U.S.A. is not a party to the ITOPF and oil spills that occur in the U.S.A. are covered under the OPA. In the event claims for oil spill and related damages are not paid by the responsible party the claimant may file a claim directly to the Oil Spill Liability Trust Fund (OSLTF) or file a lawsuit in court. The fund is currently authorized to provide up to U.S.A. \$1 billion per oil pollution incident. If offshore energy insurance capacity is scarce or expensive, another option could be for the government to create mandatory insurance pooling arrangements to which all participants in drilling activities contributed in proportion to their involvement in drilling activities. Operators who benefit from oil and gas exploration and production would bear risk and implement stronger safety and environmental controls to reduce losses.¹³¹; (2) commercial insurance. The offshore oil and gas exploration and production business has the potential to affect third parties who may be physically injured or whose property may be damaged or both. The most prompt and effective compensation for pollution victims is thought to be compulsory insurance on a strict liability basis. Given the high level of risk associated with oil and gas exploration and limited insurance and reinsurance capacity for these risks, oil companies usually join together, pool their financial resources, and establish a wholly owned affiliate company called a captive insurance company that is established to exclusively underwrite the risks of the parent company or group of companies in an industry or trade association.¹³²; (3) federal disaster insurance, and (4) tort law. Another way to compensate for damage caused by offshore oil pollution is through state tort liability, i.e. through a private lawsuit brought by an injured party against the entity proximately causing the injury. Liability insurance may be used to distribute the costs imposed under the tort or other liability system when a court determines that an entity is liable. Torts that are potentially implicated by such damage include negligence, trespass, private nuisance, and perhaps strict liability for abnormally dangerous activities (breach of contract is a separate area of law; a breach of contract is not a tort). Although the compensation of an injured party pursuant to a court judgment may not reverse the environmental damage done, or even completely

¹³⁰ E.g. blowouts, explosions, oil spills, and fires, as well as hazards associated with marine operation, such as collision, grounding, and damage or loss from severe weather; See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 10-12.

¹³¹ See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 12-13.

¹³² See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 12-13.

redress the economic harm, it can play four important roles in mitigation future offshore oil and gas pollution damages.¹³³

IV.4. Potential Future Policy Considerations

In the aftermath of the Deepwater Horizon incident, one issue that Congress may wish to consider is the willingness of the global offshore energy insurance market to participate in the OSFR program. Commercial insurance companies might be concerned about the proposed change to remove the liability limits under OPA and also the proposal to increase the OSFR requirement to some higher level that is yet to be determined. If insurers were willing to continue to participate, another question might be whether the new limit of liability is supported by the availability of insurance coverage on adequate terms and conditions in the global commercial insurance market for offshore energy facilities, given: (1) the insurability of future offshore oil spill hazards; and (2) the impact of the global financial market crisis on insurance market's capacity for underwriting "catastrophe" or "peak" risks, including oil spill damages.¹³⁴

IV.5. Potential New Liability Limits and Potential New Insurance Capacity

Congress has been called upon to reconcile two policy issues: (1) the desire to remove the limitations of liability for operators of offshore energy facilities for economic losses caused by oil pollution damage and raise the criteria for demonstrating OSFR; and (2) the limited capacity of offshore energy insurance and reinsurance to cover loss of well control, cost to re-drill a blow-out well, and pollution liability facing operators of offshore energy facilities. Several congressional hearings were held to consider these issues and to determine whether offshore energy facility operators of any size will be able to obtain sufficient amounts of insurance at acceptable prices to demonstrate evidence of financial responsibility under new, yet to be proposed, OPA insurance requirements. Concerns have been expressed that the higher limits of liability on responsible parties for oil spills and the corresponding insurance requirement could lead to the domination of drilling activity by major oil companies, if many smaller oil firms and their investors are not able or willing to expose themselves to such liability. It would appear that the energy insurance market currently has a finite amount of available insurance, including coverage for offshore oil pollution spill in U.S.A. waters, which now stands in the range of 1.25 billion U.S.A. dollars to 1.5 billion U.S.A. dollars. The "working capacity" or the dollar amount that an insurer will typically commit to any single risk, for "control of well" (COW) risks is in the range of 600 million U.S.A. dollars to 750 million U.S.A.

¹³³ See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 14.

¹³⁴ King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 15-20.

dollars on a stand alone basis. The working capacity for Oil Spill Financial Responsibility Certification is allegedly no more than 200 million U.S.A. dollars.¹³⁵

IV.6. Future Insurability of Offshore Oil Spill Perils

Large-scale disasters, such as the 9/11 terrorist attacks, Hurricane Katrina and the Deepwater Horizon oil spill, may prove instructive. As a major source of post-disaster recovery financing, commercial insurance companies have been called upon to pay for catastrophe-related losses; in some cases, beyond their contractual policy obligation. For example, after the 9/11 terrorist attacks insurers faced pressure to interpret policy language liberally with respect to war risk coverage and the number of occurrences. After some negotiation between private insurers and reinsurers, legislators, and other industry participants, which led to the passage of a pre-disaster risk financing scheme, i.e. the Terrorism Risk Insurance Act, insurers agreed to pay claims related to the 9/11 incident. Insurers did not charge an additional premium to cover that risk. In other notable examples, in particular, after the Hurricane Katrina incident, the courts reinterpreted some water exclusion provisions in homeowners' policies, resulting in expanded coverage for water damage. Consideration of coverage expansion, through the reinterpretation of insurance contract language by the courts, could affect the availability of insurance for offshore energy facilities going forward.¹³⁶

IV.7. On the Future Availability of Offshore Energy Insurance for Oil Spills

In the aftermath of the Deepwater Horizon incident, offshore energy insurance underwriters have begun to reassess their risk exposures in response to newly perceived operational risks involving blowouts, fires, explosions, lost control of well and other non-hurricane risks. Insurance experts expect offshore energy insurance rates to increase in the short term as a result of the perception of greater potential risk exposure. Changes in the insurance market will likely not be driven by the operator's exposure to windstorm damages; rather, they will be driven by reassessments of operational risks. Coverage for drilling contractors and control-of-well expenses are the areas most likely to be targeted by underwriters for rate increases.

The proposed increase in the limit of liability required under OPA carries at least four consequences in the offshore energy insurance and reinsurance market: a) first, some insurance market experts have asserted that the global commercial insurance capacity for third-party liability insurance, "operators' extra expense" (OEE) and "excess liabilities" coverage, which is currently available to meet OSFR requirements, is approximately 1.5 billion U.S.A. dollars. This amount is likely to be far below the OSFR associated with the new unlimited liability limits. Insurers have pointed out that the strict liability standard with direct access to the insurer serves to

¹³⁵ King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 15-20.

¹³⁶ King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 15-20.

further limit overall industry capacity. The reason is that the insurer cannot control claims payment with contract terms and conditions. Moreover, the OEE coverage, as currently structured, provides a combined single limit for well control, well re-drilling after a blow-out, and sudden and accidental seepage and pollution clean-up. This means prioritizing the single limit, for example, by first using the insurance proceeds to hire a well control expert to retake control of the well and, if necessary and funds remain, drill a new well, with the balance of the OEE insurance limits used for pollution cleanup and containment of oil spills;¹³⁷ b) second, given basic economic supply-demand principles and the fallout from what may be the largest up to date oil spill in U.S.A. history, most insurance market experts expect the supply of insurance coverage for the new OSFR to only be available at a high premium, if coverage is available at all. The imposition of higher strict liability limits for large-scale oil pollution could have the effect of greatly increasing the demand for liability insurance protection. This situation could multiply the challenges insurers might have in evaluating risk exposures, defining reasonable limits for the coverage and calculating insurance prices. Operators may find themselves assuming or retaining higher levels of self-insurance, which might affect the BOEMRE's offshore oil and gas lease bidding and ultimately the royalties earned for the U.S.A. Treasury; c) third, if the past is an indication of the future, private commercial insurers may be reluctant to commit financial capital in underwriting unknown new risks in the post-Deepwater Horizon environment until there is greater clarity on the legislative and legal climate. Insurers would want to collect the necessary data for evaluation of risks associated with certain severity of loss and insurability, recalculate rates, policy terms and conditions, and set limitations. Conduct of these normal activities, at least in the short term, will be affected by the uncertainty of the losses associated with the recent Gulf of Mexico oil spill. OPA's oil spill financial responsibility rule is a pre-disaster risk financing strategy that, in the wake of the Deepwater Horizon incident, could come under intense pressure because of capital shortages in the offshore energy insurance and reinsurance market. From an insurer's perspective, one issue that may arise is the potential for future massive environmental-related, i.e. strict liability, damages which leads to the question of whether offshore oil pollution will be insurable or insurable only with government support. Given the magnitude of losses and the uncertainty about future profitability in the energy insurance business, a "hard" energy insurance market involving scarcity of coverage and high prices may emerge following the *Deepwater Horizon* incident. Prior to this event, the third-party pollution liability market was thought to be in a "soft" phase where rates were low as a result of oversupply of capacity.¹³⁸; d) fourth, many insurance market experts would likely support a more efficient pre-disaster risk financing approach to managing and financing large-scale oil spill disasters. The availability of alternative sources of insurance capacity for spreading financial risks associated with oil spills, perhaps through "reinsurance sidecars",¹³⁹ catastrophe bonds ("CAT bonds") or energy insurance financial futures and options (i.e., derivative financial instruments that securitize insurance risk, turning an insurance policy or reinsurance contract into a security), could provide the added capital needed in the insurance marketplace to

¹³⁷ King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 15-20.

¹³⁸ See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 15-20.

¹³⁹ See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 15-20.

cover the higher liability and associated OSFR limits.¹⁴⁰ A reinsurance sidecar is a limited-life reinsurance company that is established to provide property catastrophe (quota-share) reinsurance for the upper layers of an insurance contract or the worst-case-oil-spill scenario event.¹⁴¹ The option of the use of a “reinsurance sidecar” is considered optimal as by the use of a “sidecar special purpose vehicle”, a ceding insurer or reinsurer can transfer oil spill risks to a newly licensed reinsurance company that assumes risk, collect premiums, and pay claims losses to the ceding insurer or reinsurer via a reinsurance agreement. The sidecar issues fully collateralized debt to its investors. Reinsurers typically create sidecars by transferring policies and premiums to a special purpose reinsurer (SPR) that uses them as collateral for bonds, loans, and equity. This allows the sidecar to diversify (or spread) individual reinsurers’ risk among the global reinsurance marketplace. Proceeds from the security offering, as well as premium and investment income, are transferred to a collateral trust, which invests the proceeds and disburses funds to the ceding insurer or reinsurer on behalf of the sidecar to pay claims. Funds are also disbursed to the holding company, via the sidecar, to pay interest on debt and dividends, if any, to the shareholders. Sidecar payouts are determined via the reinsurance agreement contract between the ceding company and the sidecar, and are triggered by the loss experience of the ceding company. Hedge funds, private equity investors, and other institutional investors provide the bulk of the funds via equity and debt financing to capitalize these unusual insurance investment vehicles. Thus, capital market investors were able to get into the lucrative post-Katrina reinsurance business without having any underwriting experience. Investors agree to invest the funds for two to three years and typically earned 20% to 30% or more return on their investment. The reinsurer receives a commission. Investors get interest and dividend payments from the collateral trust when the sidecar expires, assuming that all of the capital has not been used to meet claims.¹⁴²

IV.8. Potential Effects on Domestic Offshore Energy Production

The future of offshore oil and gas exploration and production in the Gulf of Mexico, an important source of energy for the nation, could be affected by the imposition of higher liability limits. Some maintain that quantifying the impact of OPA’s higher liability limit requires a rigorous analysis due to the many variables that affect the economics of offshore oil and gas development, such as price/demand of oil and natural gas, rig availability, discoveries, regulatory requirements, and capital availability for the Gulf of Mexico, among other things. Increasing the liability cap for oil spills may change the landscape of offshore leasing activity. Arguments have been made that if a new cap were applied retroactively, it might cause current operators who are unable or unwilling to meet the new insurance requirements to relinquish their leases. This may cause a sharp decline in shallow water production since smaller operators operate in such conditions. In the deepwater regions that are already dominated by the majors or large-scale independents, production could be

¹⁴⁰ See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 15-20.

¹⁴¹ See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 15-20.

¹⁴² See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 15-20.

affected if those lessees could not find buyers in the lease resale market after they have optimized their production. If there are no qualified buyers, the initial lease holder may relinquish the lease early. With a higher oil spill liability cap, at the lease sale level, one would likely expect to have fewer bidders and less competitive lease sales, which could result in lower “bonus bids” offered for the leases, according to economists at the Bureau of Ocean Energy Management, Regulation and Enforcement (BOEMRE). Small independent involvement in the OCS allegedly declined after the 2005 hurricane season because of the higher costs to operate in the OCS. As costs get higher and as shallow water offers fewer opportunities, small-scale independent involvement may continue to decline unless the small operators are willing and able to take equity positions in the larger and more expensive deepwater operations.¹⁴³

IV.9. A Global Solution?

In combination with liability law, financial responsibility rules foster the internalization of social costs by polluters, by ensuring that firms possess the resources needed to compensate society for environmental costs. Two financial assurance rules govern marine oil and hazardous waste operations. There are four types of allowable mechanism that can be used to demonstrate the existence of coverage: insurance, surety bond, self-insurance, and financial guaranty. All four mechanisms exist to guarantee that liabilities can be satisfied up to the statutory coverage requirements. Insurance and surety bonds are financial commitments purchased by third parties guaranteeing payment of claims arising from liability of the purchaser. Self-insurance allows relatively deep-pocketed companies to satisfy the coverage requirement by demonstrating sufficient financial strength. A financial guaranty, or indemnity, agreement allows another firm, like a parent corporation, to satisfy the coverage requirement. An important policy question is whether financial assurance for environmental liability should be made mandatory. This question is easily answered to the positive if we consider the fact that existence of political opposition to mandatory financial responsibility serves as a proof that insurance is unlikely to be provided voluntarily.¹⁴⁴ Financial responsibility rules are an important compliment to liability law particularly because marine accidents can in an instant create multi-million dollar liabilities, and thus, regulations should exist to ensure that such liabilities will be in fact internalised by a polluter.¹⁴⁵

¹⁴³ King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, 15-20.

¹⁴⁴ Boyd, J., *Compensation for Oil Pollution Damages: The American Oil Pollution Act as an Example for Global Solutions?*, 137-163, 157-159, in Faure, M.G, Hu, J. (Eds.), *Prevention and Compensation of Marine Pollution Damage: Recent Developments in Europe, China and the U.S.A.*, Kluwer Law International, 2006, The Netherlands.

¹⁴⁵ Boyd, J., *Compensation for Oil Pollution Damages: The American Oil Pollution Act as an Example for Global Solutions?*, 137-163, 159, in Faure, M.G, Hu, J. (Eds.), *Prevention and Compensation of Marine Pollution Damage: Recent Developments in Europe, China and the U.S.A.*, Kluwer Law International, 2006, The Netherlands.

V. Critique – Discussion

V.1. Critique on the Environmental Pollution Liability Regime

The ramifications of the explosion, fire and subsequent oil spill from the well which was drilled for BP Plc. by Transocean Ltd. in the Gulf of Mexico, go well beyond BP and have already led to a moratorium on drilling in the Gulf of Mexico which potentially could also slow down or even prevent exploration in other off-shore areas across the world.¹⁴⁶ As efforts have proceeded to contain the current spill, the likely scale of clean-up costs and third party bodily injury and property damages has prompted congressional consideration of (1) environmental damage; (2) the allocation of the cost of oil pollution clean-up; (3) disaster victim compensation; and (4) future oil spill prevention, response, and recovery.¹⁴⁷ A key element is the limit on liability for operators of offshore energy facilities and the amount of third-party liability insurance that is available from the commercial insurance market to meet operators' demand for coverage to satisfy existing governmental requirements. Without the ability to spread risk broadly through risk diversification¹⁴⁸, the nation's supply of oil and gas, as well as U.S.A. government royalty payments from the sale of offshore oil and gas could become impaired.¹⁴⁹ By statute, modern environmental policy has sought to control oil pollution discharge into navigable waters or upon adjoining shorelines. Federal agencies implement these statutes or laws through regulations, rules, administrative orders, memoranda, and programs.¹⁵⁰ Major oil spills in the past¹⁵¹ have influenced the development of ocean energy policy and, ultimately, prompted the enactment of the OPA.¹⁵² Although liable for all removal costs, current law limits an offshore facility's liability for economic and natural resources damages to 75 million U.S.A. dollars per incident. Moreover, liability limits would not apply if the incident was "proximately caused by" the "gross negligence or wilful misconduct of" or "the violation of an applicable Federal safety, construction, or operating regulation"¹⁵³ for, if one of these circumstances is determined to have occurred, the

¹⁴⁶ Focus Magazine, *Macondo: Assessing the Implications*, Oil and Energy Trends, Focus Magazine (2010) 35, 3-6, 3.

¹⁴⁷ King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, Introduction, 1.

¹⁴⁸ E.g., insurance or alternative risk transfer mechanisms such as risk securitization; See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, Introduction, 1.

¹⁴⁹ King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, Introduction, 1.

¹⁵⁰ King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, Introduction, 1.

¹⁵¹ Including the super-tanker *Torrey Canyon* (1967), the Santa Barbara channel oil spill off the California shore (1969), and the *Exxon Valdez* oil spill in Alaska (1989); See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, Introduction, 1.

¹⁵² OPA established a comprehensive prevention, response, liability, and compensation regime to deal with oil pollution caused by vessels and offshore energy exploration and production facilities within U.S.A. navigable waters (P.L. 101-380; 104 Stat. 484); See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, Introduction.

¹⁵³ 33 U.S.C. § 2704(c) ; See, King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, Introduction.

liability would be unlimited.¹⁵⁴ The existence of an impressive number of conventions on pollution damage has not necessarily broadened our knowledge on causal links which are necessary in this respect, although science continues to expand the factual basis of knowledge. Notwithstanding the above remark, where sufficiently plausible results are offered, and reasonable grounds for concern exist, action should be taken, be it legal, economic or otherwise. Especially in relation to the protection of the marine environment, less than full conviction with respect to causation must sometimes be sufficient to justify measures adopted as well as any other form of response otherwise a successful reaction may come too late. However, this realisation by no means entails that an adequate response to marine pollution is necessarily the full prohibition of a certain activity.¹⁵⁵ Preventive measures limited in time or space should also be considered, including the application of the said “precautionary” principle.¹⁵⁶

Maritime affairs and activities are international by nature. So, are the perils embodied in their sphere. Their international nature requires, in its turn, international cooperation. This is further justified by the simple realisation that there is almost no local activity that does not affect distant regions via the medium of water. Thus, due to the foreseeing of global implications, global rules are also required. In effect, all measures reasonably expected to effectively protect the marine environment against dangers of serious concern should be taken.¹⁵⁷ International law, i.e. the United Nations Convention on the Law of the Sea (LOSC) grants jurisdiction not only to the flag States but also to the port States, even when the discharge has taken place outside national boundaries. Although the international network of technical safety, control management and compensation has been greatly improved, nevertheless the international regime on marine pollution aims mainly and rather solely at compensating victims. Thus, the international liability regime should be opened up to reforms to promulgate the establishment of a well-functioning legal regime of compensation, funding solutions and liability rules.¹⁵⁸ In mentioning legal rules that focus on the liability of the actors involved and thereby also promoting the prevention of marine pollution there can equally be a need to discuss the role of criminal law. However, the international framework is ambivalent. On the one hand side, LOSC strengthens the jurisdiction of the port States by giving them the right to start up criminal investigations and initiate proceedings against any sea discharge from a vessel, even outside their internal waters, territorial sea or exclusive economic zone. However, with the exception of the case of wilful and serious act of pollution in the territorial sea, only monetary penalties can be imposed with respect to violations by ships flying a foreign flag. Current maritime insurance practices, cover monetary penalties including sanctions of a penal nature related to pollution offences. At the

¹⁵⁴ King, R.O., *Deepwater Horizon Oil Spill Disaster: Risk, Recovery, and Insurance Implications*, Congressional Research Service, 7-5700, www.crs.gov, R41320, July 12, 2010, Introduction, 1.

¹⁵⁵ Magnus, U., *Closing Remarks*, 181-183, 181, in Basedow, J., Magnus, U. (Eds.), *Pollution of the Sea – Prevention and Compensation*, Hamburg Studies on Maritime Affairs, Vol. 10, Springer: Berlin, Heidelberg, New York, 2007.

¹⁵⁶ Magnus, U., *Closing Remarks*, 181-183, 181-182, in Basedow, J., Magnus, U. (Eds.), *Pollution of the Sea – Prevention and Compensation*, Hamburg Studies on Maritime Affairs, Vol. 10, Springer: Berlin, Heidelberg, New York, 2007.

¹⁵⁷ Magnus, U., *Closing Remarks*, 181-183, 182, in Basedow, J., Magnus, U. (Eds.), *Pollution of the Sea – Prevention and Compensation*, Hamburg Studies on Maritime Affairs, Vol. 10, Springer: Berlin, Heidelberg, New York, 2007.

¹⁵⁸ Heine, G., *Marine (Oil) Pollution: Prevention and Protection by Criminal Law – International Perspectives*, Corporate And/Or Individual Criminal Liability, 41-59, 54-55, in Faure, M.G, Hu, J. (Eds.), *Prevention and Compensation of Marine Pollution Damage: Recent Developments in Europe, China and the U.S.A.*, Kluwer Law International, 2006, The Netherlands.

same time, the flag State has a broad jurisdictional mandate and is not limited to imposing financial penalties. For the side of the flag State, there is often no political willingness to prosecute. Moreover, often port and coastal States are encouraged to warp international law by widening the exceptions do as to be effective at punishing the persons responsible for the pollution. However, imposing criminal sanctions on individuals has proven to be rather limited and inadequate globally-wise in the said context. The agenda of criminal law should steer global players towards adequate risk management and thus also adequate corporate liability measures to be adopted. Thus, marine incidents polluting the environment have to be seen under a new perspective, for what they really are, i.e. social disturbances via marine pollution, inside or outside territorial waters, which under certain circumstances fall under the liability of those entities that have encouraged the incident and have typically benefited from the incident or the circumstances concerned.¹⁵⁹ A broad spectrum of sanctions available, such as those adopted following the Exxon Valdez incident in 1989, include settlements, compensation, restitution and fines, or judicial directives restricting the entrepreneurial freedom and aiming to improve sea installations and marine tankers safety. Even sharper weapons available to criminal law include judicial termination, closure of an enterprise or confiscation of property.¹⁶⁰

V.2. Critique on the Environmental Insurance Regime

Following the explosion and sinking of the “Deepwater Horizon” in the Gulf of Mexico, we should expect to see another dynamic at work in the claims picture. On the one had litigation and insurance claims arising out of the BP explosion are in the opening minutes of a very long play. On the other hand, it’s one we’ve all seen before.¹⁶¹ When an insured is faced with a potential or actual environmental liability, it should first determine the universe of insurance potentially available to help cover the liability. Similarly, insurers receiving notice of environmental insurance claims from their policyholders should determine whether there is other insurance that may also respond to the same risk. Consideration should also be given to a company’s historic insurance portfolio and the portfolio of any predecessor or affiliated companies involved in the operations or transactions giving rise to liability. Policy archaeology may be necessary to identify or locate any missing policy evidence. A party may also consider whether obtaining additional or new environmental insurance could assist in handling environmental liability. If remediation is necessary, a “cost-

¹⁵⁹ Heine, G., *Marine (Oil) Pollution: Prevention and Protection by Criminal Law – International Perspectives*, Corporate And/Or Individual Criminal Liability, 41-59, 55, in Faure, M.G, Hu, J. (Eds.), *Prevention and Compensation of Marine Pollution Damage: Recent Developments in Europe, China and the U.S.A.*, Kluwer Law International, 2006, The Netherlands.

¹⁶⁰ However, the actors concerned might try to escape from corporate criminal liability, via the use of methods such as the so-called “one ship corporations” that can organise their own insolvency or corporate dissolution. However, even in such a case, corporate criminal liability may be useful for piercing the corporate veil; See, Heine, G., *Marine (Oil) Pollution: Prevention and Protection by Criminal Law – International Perspectives*, Corporate And/Or Individual Criminal Liability, 41-59, 56, in Faure, M.G, Hu, J. (Eds.), *Prevention and Compensation of Marine Pollution Damage: Recent Developments in Europe, China and the U.S.A.*, Kluwer Law International, 2006, The Netherlands.

¹⁶¹ Maniloff, R.J., *Deepwater Horizon Oil Spill May Be Insurance Claims Gusher*, http://www.lexisnexis.com/Community/emergingissues/blogs/gulf_oil_spill.aspx, accessed on Sept. 10th, 2010.

cap” environmental insurance policy may be a useful tool in limiting the insured’s exposure from cost overruns.¹⁶²

With regard to the global energy insurance markets, the Deepwater Horizon loss is a major event, described by many even as a “market-changing” one. However, other voices purport that while energy insurers have been unsettled by the loss, capacity has not constricted and price increases are likely to be modest unless further major losses occur.¹⁶³ Although it is being argued that energy insurance rates for offshore accounts will rise and terms and conditions will tighten¹⁶⁴, nevertheless, and given also the existing capacity levels, certain analysts argue that the event is not expected to lead to a sustained hard market in offshore energy insurance.¹⁶⁵

Notwithstanding the above, many firms involved in offshore activities are already reviewing their current insurance programs and seeking to top up their cover and looking at terms and conditions and analysts predict that the purchase of business interruption coverage resulting from pollution will augment. Concerns remain that if the U.S.A. raises the liability cap under OPA for offshore facilities to 10 billion U.S.A. dollars from 75 million U.S.A. dollars, insurance capacity will be insufficient and more energy companies will have to self-insure. Another concern is the potential reduction in reinsurance capacity. In the wake of the loss, reinsurers’ management may be starting to question necessity of writing offshore business which could impact energy insurers at year-end renewals. However, Munich Re has indicated¹⁶⁶ that, following the Deepwater Horizon oil spill and the critical voices which have been raised by the U.S.A. administration that there is not enough insurance capacity available, they have plans to increase the amount of insurance to be sold to oil-rig operators in the Gulf of Mexico.¹⁶⁷

¹⁶² Anderson, R.L., Beck, W.G., Merrigan, J.E., *Chapter 42: Understanding Environmental Insurance*, § 42-02, in Thomas, J.E., Martinez, L., Mayerson, M.S., Richmond, D.R. Esq. (Eds.), *New Appleman Insurance Law Practice Guide, Vol. 4: Separate Lines of Insurance*, 2010 Edition, Lexis Nexis.

¹⁶³ As of May 26, 2010, Lloyd’s estimates net claims from Deepwater Horizon loss at between \$300 and \$600 million. Richard Ward, Lloyd’s CEO: “*These figures are our estimate of the market’s total exposure...The event in the Gulf of Mexico is still developing.*” ; Towers Watson August 2010; Marsh Energy Monitor July 2010; Willis Energy Market Review (EMR) newsletter May-June 2010; Wall Street Journal 05/25/10; Credit Suisse Research Note 05/11/10.

¹⁶⁴ MarketScout CEO Richard Kerr predicts 15% to 25% rate increases for rigs operating in shallow water and up to 50% rate increases for operations further out to sea ; Towers Watson August 2010; Marsh Energy Monitor July 2010; Willis Energy Market Review (EMR) newsletter May-June 2010; Wall Street Journal 05/25/10; Credit Suisse Research Note 05/11/10.

¹⁶⁵ Towers Watson August 2010; Marsh Energy Monitor July 2010; Willis Energy Market Review (EMR) newsletter May-June 2010; Wall Street Journal 05/25/10; Credit Suisse Research Note 05/11/10.

¹⁶⁶ At the 2010 annual conference of reinsurers in Monte Carlo; See Crowley, K., *Munich Re to Offer \$20 Billion Drilling Cover After Gulf of Mexico Spill*, <http://www.bloomberg.com/news/print/2010-09-12/munich-re-to-offer-20-billion-drilling-cover-after-gulf-of-mexico-spill.html> , accessed 16th Sept., 2010.

¹⁶⁷ The Munich-based company is planning to sell operators as much as \$20 billion of liability cover that will pay third-party claims should a disaster occur; See Crowley, K., *Munich Re to Offer \$20 Billion Drilling Cover After Gulf of Mexico Spill*, <http://www.bloomberg.com/news/print/2010-09-12/munich-re-to-offer-20-billion-drilling-cover-after-gulf-of-mexico-spill.html> , accessed 16th Sept., 2010.

VI. Conclusions

Six months after the April 20 Deepwater Horizon explosion, the environment and economy of the entire northern Gulf of Mexico region remain in a state of uncertainty, with overturned livelihoods, out-of-work fishermen, reluctant tourists, widespread emotional anguish and untold damage to the sea and its shores. It could be years before the spill's true effects are understood.

There is definitely one lesson to be learned from the experience of the Deepwater Horizon loss, i.e. the realization that our natural capital assets and other public goods are far too valuable to put at such high risk from private interests. We need better, and not necessarily more, regulation and strong incentives to protect these assets against actions that put them at risk. The above realisations are also clearly reflected in recent statements of the U.S.A. President Barack Obama.¹⁶⁸

While the U.S.A. President's administration's demand for a trust fund to compensate injured parties was rather appropriate, nevertheless it arrived only after the actual incident occurred. The USA government has reopened about ninety per cent of the Gulf federal waters to fishing, and claims that all seafood caught in the newly opened areas is safe to eat. Yet the commercial fishing industry remains in turmoil, suffering from an acute image problem. Also, the USA government maintains much of the oil is now gone from the Gulf of Mexico. But independent researchers say they are discovering significant amounts of crude below the sea's surface, including on the ocean floor. Meanwhile, the six months since the spill began have brought many changes to the offshore drilling industry. The federal government swiftly imposed new regulations on the business following the spill. It recently lifted a moratorium on deep water drilling in the Gulf. The danger of a future catastrophe persists as oil companies continue to drill in deep water even though many measures that could help head off future spills — better cap-and-siphon containment systems to choke off leaks, for instance, or more thorough testing and analysis – to prevent blowouts – are not yet in place.

Common assets' trusts and new financial instruments like assurance bonds would be better able to shift risk incentives and prevent disasters like the Deepwater Horizon. Our entire society is taking far too many risks with public assets whose real value we are only now beginning to recognise. By shifting the financial burden of those risks onto the private interests who benefit from them, we can establish the right incentives, shift investment to less risky, more productive pursuits and create a more sustainable and desirable future.

Notwithstanding the Deepwater Horizon incident, the escape of toxic sludge from a reservoir at an aluminium processing plant in Hungary, in early October 2010, further highlights the need to further protect our natural capital assets and to establish a mechanism of secured financial response, possibly, as stated above, but not

¹⁶⁸ President Barack Obama has recently stated: *“For too long, for a decade or more, there has been a cozy relationship between the oil companies and the federal agency that permits them to drill. It seems as if permits were too often issued based on little more than assurances of safety from the oil companies. That cannot and will not happen anymore. To borrow an old phrase, we will trust but we will verify”*; U.S.A. President Barack Obama, May 14, 2010; (source: <http://www.whitehouse.gov/blog/2010/05/14/relentless-efforts-stop-leak-and-contain-damage>); and again, on June 2, 2010, U.S.A. President Barack Obama has stated: *“If we refuse to take into account the full cost of our fossil fuel-addiction – if we don't factor in the environmental costs and national security costs and true economic costs – we will have missed our best chance to seize a clean energy future”*; U.S.A. President Barack Obama, Carnegie Mellon University, June 2, 2010 (source: <http://www.whitehouse.gov/blog/2010/05/14/relentless-efforts-stop-leak-and-contain-damage>).

exclusively via the shift of the financial burden of risks related with public assets onto the private interests who benefit from them.

BP Plc.'s report on the causes of the accident that led to the loss of the Deepwater Horizon rig and the biggest oil spill in American history describes a litany of mistakes. Had this sequence of errors been halted, catastrophe might have been averted. Some of those mistakes, the report concludes, were BP's. But, its finger also points at Halliburton Co., which worked on the cement seal at the bottom of the well, and Transocean Ltd, which owned and ran the rig and maintained the BOP which so signally failed to live up to its name.¹⁶⁹ Thus, it seems that the stakes are high. If BP Plc. is found to have been grossly negligent in its role as operator the fines it faces would increase by billions of dollars and its chances of recouping money from its junior partners in the project, Anadarko Petroleum Corporation and Mitsui Oil Exploration Co, would be reduced. BP Plc's report implies such a finding is unlikely. But it makes a protracted, reputation-damaging series of suits and countersuits between the companies involved seem almost inevitable. Halliburton Co. has already quickly pointed to "substantial omissions and inaccuracies" in the report. Transocean Ltd., too, rejected it as self-serving and pointed to flaws in the well's design, as well as to BP's management of the project.

The report of BP Plc. concludes that the most criticised well-design choice, known as a long string, was a reasonable one and did not lead to the failure. Other reports from Transocean Ltd. and the various boards of investigation may differ, as may outcomes in the courts and in Congress.¹⁷⁰ However, one thing is certain, i.e. that private interests need actively be involved in the allocation of the financial burden of the risks involved.

¹⁶⁹ The Economist, *BP and the Gulf Disaster -The Case for the Defence*, Sep 9th 2010, <http://www.economist.com/node/16996781>, accessed 16th Sept., 2010

¹⁷⁰ The Economist, *BP and the Gulf Disaster -The Case for the Defence*, Sep 9th 2010, <http://www.economist.com/node/16996781>, accessed 16th Sept., 2010.