

Insurance Issues Facing the Energy Industry

Protecting and Preserving Your Assets Through Insurance

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Insurance Coverage for Long-Tail Liability

- Marshalling Insurance Assets Is an Evolving Challenge
- Length of the Coverage Battles (20-30 Years)
- Coverage Years at Issue (1950s-1980s)
- Evolving Nature of the Underlying Liabilities (Environmental, Premises, Toxic Tort, and Products Liability)
- Corporate and Regulatory Changes in the Energy Industry
- New Insurance Products Being Offered to Cover Potential Known (Cost Cap) and Unknown Liabilities

Prior Insurance Settlements

- Because coverage disputes have been fought over the past three decades, it is not unusual for there to be several waves of claims made under historic CGL policies.
- For instance, past settlements for MGP claims or specific Superfund sites may have carved out bodily injury claims and other types of environmental claims.
- It is not unusual for those with institutional knowledge of prior settlement to have retired or to no longer be with the company.
- It is also not unusual for insurers to attempt to stretch the bounds of prior settlements to attempt to sweep in unintended claims and policies.
- **PRIOR SETTLEMENTS SHOULD BE GATHERED AND SCRUTINIZED TO DISCERN THE SCOPE OF THE INTENT OF THE PRIOR RELEASE.**

Corporate Transactions

- Consolidation in the Energy Industry
 - Insurers will try to avoid obligations by claiming that insureds violated anti-assignment provisions of policies.
 - Care should be given when drafting purchase and sale agreements to avoid inadvertent forfeiture of insurance policies through violation of anti-assignment clauses.
 - Intent regarding access to insurance for long-tail claims and the interplay with any indemnities (i.e., insurance first, indemnity second) should be spelled out.

When Your Insurer Goes Bankrupt

- Major Insurer Insolvencies/Run offs
 - The Home Insurance Company
 - Lloyds/London Market Insurers (e.g., Equitas/North Atlantic Insurance Co.)
 - Kemper/Reliance
- Strategies to Maximize Recovery
 - Preserving and Presenting IBNR claims through liquidation proceedings
 - State guaranty funds
 - Seeking to “Cut Through” reinsurance arrangements to gain direct access to reinsurers
 - Follow the Money Trail (Zurich as alter ego of The Home).

Asbestos: FAIR Act

- STATUS: No Further Senate Deliberations This Year Unless Supporters Secure Filibuster-Proof Commitment to Bill.
- Insurance Cannot Be Tapped to Make Payments and Actually Would Be Eroded.
- \$140B Fund Paid For by Asbestos Defendants (\$90B), Insurers (\$46B), and Trusts (\$4B).
- 30 Annual Payments Ranging from \$100K To \$27.5M.
- Possible Return to Tort System If Fund Fails.

Coverage for Asbestos Liabilities

- Most Energy Company Defendants Are Sued Based on Allegedly Unsafe Premises
 - Suits Allege:
 - Exposure to asbestos conditions at plants and facilities.
 - Failure to provide business invitees reasonably safe places to work.
 - Failure to warn of dangerous conditions.
 - Coverage Potentially Available:
 - Your pre-1986 CGL per-occurrence-based policies.
 - Contractor Coverage: Pre-1986 CGL per-occurrence-based policies issued to contractors that built, repaired or renovated plants and facilities in which you were named as an additional insured.

Coverage for Asbestos Liabilities

(continued)

- A Key Coverage Issue – Choice of Law
 - Where policies are made, where claims or liabilities are located and where lawsuit is filed may determine the applicable law.
 - Insurance policies are interpreted under state law. States laws differ and can dramatically impact coverage available.
 - Choice of venue for insurance coverage litigation drives choice of law. Some state courts apply law of state where policies are “made” (*lex loci contractus* doctrine). Other courts apply substantial interest test analysis weighing factors including location of insured risks.

Coverage for Asbestos Liabilities

(continued)

– Number-of-Occurrences Issue

- Per-occurrence-based policies place a dollar limit on coverage for all BI & PD arising out of one “occurrence.” Some policies have per-occurrence SIRs or deductibles.
- Some state courts (e.g., NY) consider each asbestos exposure as one occurrence. Other states consider claims arising out of one premises location as one occurrence. With any significant SIRs or deductibles, difference in applied law can mean \$0 vs. millions of \$ in available coverage.

Environmental Coverage Issues

- Environmental Suits Allege:
 - Gradual and/or long-term damage of water or air
 - PD or BI from products/chemicals (such as MTBE)
 - BI from workplace exposure (such as welding fumes)
- Coverage Issues
 - So-called S&A pollution exclusions, acid rain exclusions
 - Possibility of post-1986 coverage for products claims (e.g., MTBE) or welding-rod-related claims. Recent MD Court of Appeals decision – absolute pollution exclusions do not apply to BI from localized workplace welding-rod-related fumes.

Current Issues in D&O Liability Insurance Coverage

Current Issues in D&O Liability Insurance Coverage

- Current Claims Climate
- Impact of Claims Climate
 - Limits and coverage types
 - Policy wording
- Rescission, Severability and Exclusions
- What Might the Future Hold?

Current Claims Climate – Did It Just Get Chilly in Here or Is It Just Me?

- Claim Frequency Less Alarming
 - 2004-05 increase is moderate, with marked decrease in securities claims
 - Less market volatility
- Claim Severity Rising
 - 2004-05 increase is significant
- Insureds Contributing Personal Assets to Settlements
- Tag-Along ERISA Claims

Impact of Claims Climate

- Limits – How Much Is Enough?
- Increased Sophistication of Officers and Directors
- Separation of Coverage “Sides” and Coverage Programs
 - Separate Side A policies
 - Separate outside director coverage

Rescission and Exclusions – The 700-Pound Gorilla Enters the Room

- How Broad Are Severability Provisions?
 - AEGIS language protects only those who were unaware of facts not accurately disclosed in application (even if they did not know application was inaccurate)
 - AEGIS language provides that only knowledge of CEO, President, COO, CFO or in-house counsel is relevant on corporate reimbursement side
- Beware the Severability “Gap”
 - Do your excess policies contain severability provisions as broad as those in your primary policy?
- How Broadly Is the Term “Application” Defined?
 - Some insurers seek to sweep in prior applications, as well as all prior securities filings
 - AEGIS language includes applications submitted over prior five-year period

Exclusions

- Fraud/Dishonesty Exclusions
 - Severability
 - Proof of wrongdoing (adjudications vs. allegations)
- ERISA Exclusions

Dispute Resolution Provisions

- Forum Selection
 - Mandatory arbitration provisions
 - London, Bermuda, New York City
- Choice of Law
 - New York choice-of-law provisions (except as to punitive damages)
- Different Legal Standards
 - AEGIS compensatory damages only language
 - No contra proferentem

What's in the Future

- Expect to Be Buying More Limits, More Coverage, More Separate Policies
- Commercial Insurers Returning to Marketplace
 - Some hope for differentiation on policy terms
- Expect to Face Increased Inquiry from Officers and Directors
 - Side C coverage a possible casualty?

First-Party/Business Interruption Coverage

Categories of First-Party Coverage

- Physical Damage
 - Buildings/Real Property
 - Refineries
 - Platforms
 - Overhead Power Lines
 - Pipelines
 - Transformer Stations
 - Storage Tanks
 - Personal Property (Insured and Its Officers and Employees)
 - Property of Others in Insured's Custody
 - Product in Pipeline
 - Product in Transit
 - Stored Gas
- Debris Removal
- Decontamination Costs/Pollutant Removal
- Demolition/Construction Costs

Time Element Coverages

- Business Interruption Coverage
- Contingent Business Interruption Coverage
- Extra Expense
- Civil Authority
- Ingress/Egress

Business Interruption Coverage

- Covers Actual Loss of Income/Earnings Due to Suspension of Operations Caused by Covered Loss
- Coverage Continues through Period of Restoration of Operations (Including Extended Coverage Period, if Provided)
- Lost Income/Earnings Typically Determined Based on:
 - Net income/earnings before the event
 - Likely or projected net income/earnings if no loss or damage had occurred
 - Continuing operating expenses, including payroll, to continue same level of operations
- What Is the Length of the Period of Restoration?

Contingent Business Interruption Claims

- Coverage Is Triggered Where Covered Damage to Suppliers or Customers Negatively Affects Your Business Operations
- Coverage Applies Even Where Insured's Own Property Is Not Damaged
- Examples
 - Utility Customers
 - Refineries
 - Port Facilities
 - Pipeline/Transport Operators

Extra Expense

- Covers Necessary Additional Expenses That You Incur:
 - To avoid or minimize the interruption of business
 - To repair or replace property, systems, lost information or damaged valuable papers

Civil Authority

- Business Interruption Claims Caused by Acts of Civil Authorities That Impaired Access to Your Business
 - Applies when government acts prohibit access to covered property due to covered damage (closures, curfews, ingress/egress restrictions)
 - Often limited to 30 days from date of civil action prohibiting access
 - Often subject to geographic limitations (i.e., within certain distance from insured location)

Ingress/Egress

- Applies when access to and exit from a policyholder's premises are blocked
- Applies even if the policyholder's property has not been physically damaged
- Typically requires damage of the type covered under the policy to uninsured locations

Key First-Party Policy Provisions and Coverage Issues

- Must Trigger Policy through Covered Cause of Loss
- All-Risk Policy – Typical Property Damage Coverage
 - All risks
 - Direct physical loss or damage
 - Property insured by policy
 - Occurring during the policy period
 - Except as excluded
- Specified Perils Policy – Enumerated Causes of Loss
- Insured Property
 - Real property listed on appropriate schedules
 - Personal property at scheduled locations

Key First-Party Policy Provisions and Coverage Issues (continued)

- Efficient Proximate Cause
 - Is covered cause of loss the dominant or efficient cause?
 - Majority rule: If so, damage from non-covered or excluded cause is also covered
- Minority Rule
 - Insured must prove the entire loss caused by an insured cause of loss; or
 - Insured must prove those damages resulting from covered cause of loss

Key First Party Policy Provisions and Coverage Issues (continued)

- Anti-Concurrent Causation Language
- Typically Provides:
 - No coverage if excluded peril causes a loss
 - Even if a covered cause of loss contributes concurrently or in any sequence to the loss
- “Sub-Limits” Coverage for Certain Perils
 - impact on Concurrent Causation

Key First-Party Policy and Time Element Coverage Issues (continued)

- Things to Consider:
 - Consider policy language very carefully
 - Consider drafting and negotiation of policy
 - Obtain all facts concerning development of your particular losses
 - Retain experts early
 - Protect privilege
 - Determine how best to characterize your losses
 - Consider appropriate forum for any coverage disputes
 - Win the race to the courthouse

The Nature of the NEIL Policies

- All Risk Policies Which A NEIL Interpretative Decision Explains Protects Against All Risks Of Direct Physical Loss Except As Specifically Excluded Even Where Cause of Loss Unknown
 1. Insured's Burden To Show Accident Occurred
 2. NEIL's Burden To Show Accident Excluded

The Nature of the NEIL Policies

(continued)

- Definition of Accident
 - A Sudden and Fortuitous Event, an Event of the Moment, Which Happens by Chance, Is Unexpected and Unforeseeable. Accident Does Not Include Any Condition Which Develops, Progresses or Changes Over Time, or Which Is Inevitable

The Nature of the NEIL Policies

(continued)

- NEIL's Interpretative Decision Explains That Its Policy Language Was Adopted From New York Law To Make Clear That "Damage Was Not Caused By Ordinary Wear And Tear."

The Nature of the NEIL Policies

(continued)

- New York Law Does Not Require An Abrupt Event
- Accident Under New York Law Is:
 - Sudden And Instant Happening, An Event Of The Moment Rather Than A Condition Which Continues To Develop, Progress And Change Through A Period Of Time ... An Unexpected And Unusual Happening ... An Unintended And Fortuitous Result From Intended Acts

The Nature of the NEIL Policies

(continued)

- Wear And Tear Exclusion
 - Coverage Does Not Apply “To Property Damage Caused By Or Resulting From
 - (j) Any Form Of Deterioration Or Wear And Tear, Including But Not Limited To
 - (iv) Rust, Erosion or Corrosion of Any Kind, Including but Not Limited to Stress Corrosion Cracking

The Nature of the NEIL Policies

(continued)

- NEIL Explains:
 - Wear And Tear Defined Judicially As “Ordinary And Natural Deterioration Or Abrasion Which An Object Experiences By Its Expected Contacts Between Its Component Parts And Outside Objects During The Period Of Its Natural Life Expectancy”

The Nature of the NEIL Policies

(continued)

- Under New York Law Exclusions Of This Type Only Apply To Natural Events
- NEIL's Own Interpretative Decision States That Purpose Of Exclusion Is To Bar Coverage For Damage Caused By Ordinary Wear And Tear

Owner/Contractor-Controlled Insurance Programs and Default Insurance

What are OCIP/CCIP Insurance Programs?

- Typical Coverages Provided:
 - CGL
 - Workers' Comp./Employers' Liability
 - Builder's Risk
 - Delay in Opening
- Coverage May Be Available for
 - Pollution Liability
 - Known pollutants existing at site accidentally released
 - Unknown pollutants at site uncovered
 - Pollutants brought to site
 - Professional Liability
 - Automobile Liability

Advantages/Disadvantages of OCIPs

- Advantages
 - Increased, uniform coverage on large projects involving many contractors/subcontractors
 - Potential overall cost savings - 2-10%, varies
 - Improved/coordinated risk management
 - Insurance limits not an obstacle for bidders
 - Eliminates coverage disputes and subrogation among owner, contractor and other insureds

Advantages/Disadvantages of OCIPs

- Disadvantages
 - Planning/marketing required
 - Contractor bidding can be more complicated
 - Instructions/meetings/bids (with and without OCIP)
 - Owner safety and loss control management
 - Required administration – enrollment, payroll, claims handling
 - May decrease coverage if not properly done

Who Is Covered under a Typical OCIP/CCIP Program?

- Owner, Contractor, and All Subcontractors of Every Tier
 - “arising out of any operations performed at the Project site within the scope of the Project”
- Important Typical Exclusions from Coverage:
 - Contractors/subcontractors performing work off-site
 - Vendors/suppliers and off-site fabricators
 - Architects/engineers and others performing “professional services” (testing/inspections, shop drawing review?)
 - Pollution liability (unless added)
 - Use of “automobiles”

Other Important Coverage Issues

- Limits of Primary and Excess Coverage
 - Primary is typically \$2M/occurrence
 - Define which carrier is primary
 - Excess limit is important
 - CGL should cover contractual liability, broad-form property damage and personal injury
- Coverage Period
 - Typically for the “life of the Project”
 - Completed Operations should extend at least three years “after completion and acceptance of the Work”
 - Pollution and Professional Liability may be “claims made”
- Exclusions, Limitations and Conditions Vary Greatly

Contractor Default Insurance

- Alternative to Performance Bonds
 - (not acceptable for public projects)
- Triggers on default by Contractor/Subcontractor
- Requires Contractor Prequalification
- Reimbursement for Direct and Indirect Costs to Complete Unfulfilled Contractor Obligations
 - Can include acceleration, extended GCs, LDs, legal exp.
 - Completing subcontractors' contractual obligations
 - Correcting defective or nonconforming work or materials
 - Costs and expenses incurred in the investigation, adjustment, litigation, and resolution of a default

Default Insurance vs. Bonds

CONTRACTOR DEFAULT INSURANCE

1. Definitions are vague or nonexistent
2. No legislative support
3. Untested in courts - no precedents
4. Deductible and co-payment before coverage
5. Insured pays losses then tries to recoup
6. Insured takes over project and manages default
7. Insured gathers financial info and determines which subs/suppliers are acceptable
8. Coverage can be voided if procedures not followed or if incorrect information is developed
9. Policy can be canceled by the insurance company
10. Insured commits to a three- to five-year term
11. Questionable degree of risk transfer
12. Insured picks aggregate limit of liability
13. Insured is prohibited from disclosing existence of insurance contract to subs/suppliers
14. Prime secures financial info, reviews it and determines acceptability
15. Claims-made policy - defective work discovered after the policy expires/is canceled is not covered

TRADITIONAL BONDS

1. Terms and conditions generally are understood
2. State and Federal legislative support
3. Long history of case law clearly established
4. Coverage applies from first dollar
5. Surety pays losses
6. Surety may be called upon to take over or otherwise arrange for, performance of contract
7. Surety provides underwriting/pre-qualification
8. Once executed, a bond remains in force
9. A bond cannot be canceled
10. Owner not locked into an ongoing agreement
11. Risk of contractor default transferred to surety
12. Owner can set performance and payment bonds, each equal to 100% of the contract price.
13. Subs responsible for procuring their own bonds
14. Minimal administrative burden: Set bond requirements and make sure subcontractor complies
15. Bond provides protection against legitimate claims until time for filing set in the contract, bond or statute of limitations runs out

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