

**The California Oil and Gas Report**

# Fracking and Insurance Risk Transfer

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##### Part 4 of a 4-part series

Traditionally, operators carry several types of insurance policies that have the potential to provide environmental coverage in the event of a loss at a site.

These include: (1) Casualty Insurance Programs (i.e., General Liability and Umbrella Policies); (2) Operators Extra Expense (OEE) Policy (often referred to as “Control of Well”); and (3) Environmental Site Liability (ESL coverage). Nearly all operators carry the first two lines of coverage, but ESL coverage is far less common.

While casualty and OEE programs provide important protection, there are significant potential gaps between the risk and the coverage these policies provide. For example, the casualty coverage within an energy package program commonly provides third-party liability coverage from sudden and accidental pollution releases. But some policies include a total or absolute exclusion on pollution claims.

A policy may cover pollution claims that result from a “named peril” covered by the policy, such as fire. This is better than nothing, but it can still result in significant coverage gaps if the pollution does not happen to relate to the specific named peril.

A better option is to include an endorsement that adds “blended” pollution coverage to a casualty insurance program. The blended coverage provides for both named peril coverage and “time element” coverage. Claims resulting from a pollution condition are covered as long as they are discovered and reported within the time period specified by the policy – typically a seven-day discovery time period and a 21-day reporting time period.

This coverage protects against “sudden and accidental” losses. However, a gradual pollution condition, which can take years to be discovered, would not be covered. In addition, these casualty programs do not provide any coverage for the costs of on-site cleanup.

There is another potential gap that insurance buyers should remember. Casualty programs do not cover the cost of fines and penalties. Natural resource damages (NRD) are often imposed as a “civil fine” or “civil penalty.” Therefore they would not be covered under typical casualty insurance policies even if the cause of the pollution was “sudden and accidental.”

Most exploration and production companies also carry Operator’s Extra Expense or Control of Well insurance, which includes pollution coverage for third-party exposures as well as cleanup coverage.

Here again, however, the coverage only applies to “named peril” releases associated with a triggering event under the policy, such as a well “out of control.” These policies may also contain time element restrictions, meaning control of well coverage would not apply to gradual losses or claims related to historic use of hydraulic fracturing. As with casualty programs, fines and penalties will also be excluded, so NRD losses may not be covered.

Broadly speaking, Environmental site liability policies cover losses resulting from pollution conditions at, on, under, or emanating from a covered location. These policies are offered on a claims-made basis, meaning they can cover pollution conditions that may have begun long before the policy was issued.

These policies may provide coverage for:

* Off-site cleanup
* bodily injury and property damage claims
* Civil fines, penalties and punitive damages
* natural resource damages
* costs of investigation
* defense costs, including attorneys’ fees
* non-owned disposal sites (liability arising from disposal of wastes to a third-party disposal site)
* business interruption resulting from pollution conditions

The insurance industry has introduced enhanced coverage for the unique risks associated with fracking, horizontal drilling and salt water disposal wells.

Some examples include:

* Broad additional coverage of non-operating partners and municipalities
* Blanket waiver of subrogation – designed to meet needs of the standard I.A.D.C. drilling contract
* Excess and difference in conditions, designed to work with a CGL and OEE policy for more seamless coverage
* Automatic coverage for non-owned disposal site coverage

These policies are available to on-shore oil and gas operators, including those involved in the hydraulic fracturing of shale formations.

Operators should work with their risk advisors and underwriters to maximize their coverage while minimizing clashes or overlaps in coverage.

For example, a pollution policy covers a pollution event regardless of the cause, so a blowout would be covered. However, OEE policies would also cover the recovery costs to bring the well under control. The operator needs both policies, but the potential overlap should be eliminated by coordinating the coverage.

It is also important that the policies be clear about which coverage is primary, and for what conditions. For instance, in the event of a gradual pollution condition, the ESL policy should be primary, because gradual pollution conditions generally are not covered by casualty or OEE policies.

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