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The Deepwater Horizon Oil Spill: Potential Insurance Coverage Implications

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More than 300 lawsuits have already been filed in Louisiana, Florida, Texas, Mississippi, and Alabama against BP and other corporations involved in the Deepwater Horizon oil spill, including Transocean, Halliburton, and Cameron, with thousands more anticipated. This article briefly addresses the contours of the coverage lawsuit already filed against BP and other coverage disputes we may see in the future.

On the morning of April 22, 2010, the Deepwater Horizon oil rig sank into the Gulf of Mexico. By that afternoon, oil from the undersea wellhead, owned by BP plc ("BP") had appeared and begun to spread on the surface of the Gulf. By the time the flow of oil was stanched with a temporary cap on July 15, more than 200 million gallons of oil had leaked into the Gulf, creating an oil slick over 140 miles long and 70 miles wide, as well as multiple undersea plumes of dissolved oil invisible from the surface. A massive cleanup effort has been underway since shortly after the leak began; BP has spent more than $4 billion in a plan that involves over 30,000 workers. In addition to efforts to contain the oil at the wellhead and to skim oil from the surface, more than 11 million gallons of oil have been burned and hundreds of thousands of gallons of potentially toxic chemical dispersants have been sprayed to break up the oil.

More than 300 lawsuits have already been filed in Louisiana, Florida, Texas, Mississippi, and Alabama against BP and other corporations involved in the spill, including Transocean, Halliburton, and Cameron, with thousands more anticipated. Eventually, more than 100 classes of persons and businesses are expected to assert damages ' double the number after the 1989 Exxon Valdez oil spill, the claims from which are still being litigated today. Claimants will allege a wide variety of damages claims, including claims for environmental cleanup expenses, bodily injury, medical monitoring, and business interruption. Litigation is expected to focus on causation, damages, punitive damages, and allocation issues. While much of the ultimate liability for the spill is likely to fall directly on BP and other companies involved with Deepwater Horizon, the exposure to the insurance industry is estimated at between $1.5 and $3.5 billion. (Moody's; Business Insurance). Given that exposure, coverage disputes are likely to arise, even though the current implications may not yet be fully understood. This article briefly addresses the contours of the coverage lawsuit already filed against BP and other coverage disputes we may see in the future.

Several major players are involved in the coverage landscape as potential targets of primary liability. BP is a central figure, as the 65% owner and operator of the well; BP is largely self-insured. The other owners of the well are Anadarko Petroleum Corporation, with a 25% share, and MOEX Offshore 2007, owned by Mitsui, with a 10% share. Transocean was the owner of the rig itself.

Halliburton Energy Services served as a contractor for the site and was cementing the production casing at the time of the rig's explosion. Weatherford was the subcontractor tasked with installing casing, the actual pipe within the borehole which carries oil, and M-I Swaco was the subcontractor responsible for monitoring drilling mud. Finally, Cameron International Corporation was the manufacturer of the failed blowout preventer, which, if functional, would have prevented the vast majority of the spill.

Potential Claims

Claims from the BP oil spill may arise in a number of potential areas. There are bodily injury claims both from the workers on the rig itself, of whom 11 were killed and 17 injured, and from individuals ' either residents or cleanup workers ' who may claim to be sickened by either the oil or the chemicals used in the cleanup. Property damage claims may arise from the damage the oil causes to property, primarily real property along the waterfront, but also personal property such as fishing equipment or boats. The largest likely source of initial claims is business interruption. Several industries have suffered a substantial disruption of their business activities as a result of the oil spill. The fishing industry in the region is the largest source of U.S. fish, and has been essentially shut down for months. Shipping in the region may also be affected, especially if the oil spreads into shipping channels or seaways, interfering with clear passage of commercial ships. The tourism industry, which includes significant gaming and hospitality components, has experienced serious losses. Finally, the oil spill may interrupt the Gulf oil industry itself, since oil refineries and power plants in the area that rely on Gulf waters for cooling processes may have their operations impacted if the available water is deemed too contaminated for use. Although the oil on the surface of the Gulf has been significantly decreased by skimming efforts and controlled burns, over 100 million gallons or more of oil remain in the Gulf in an uncertain status, which could be exacerbated by, among other things, the arrival of one or more hurricanes.

The First Coverage Dispute

The types of insurance coverage to be implicated by the pending claims, whether through first-party or third-party insurance, are similarly broad. They include property damage, business interruption/contingent business interruption, maritime, natural resource damage, and personal injury/wrongful death. In some cases, exclusions for pollution, cleanup costs, and environmental liabilities may limit the scope of coverage. Finally, several types of claims are likely to involve additional insureds and potential subrogation claims.

The first coverage dispute has already begun, focused on BP itself. BP has a captive insurer, Jupiter Insurance, with $6 billion in capital, but coverage from Jupiter is limited to $700 million for any single event. BP gave notice on May 14 to Lloyds of London as an additional insured on the policy that Lloyds provided to Transocean as the operator of the rig. In response, Lloyds and other excess insurers filed a declaratory judgment action in the Southern District of Texas on May 21, seeking a judgment that BP is not covered as an additional insured. The excess insurers argue that BP was covered as an additional insured only for liabilities assumed by Transocean under the terms of the drilling contract; that Transocean only assumed liabilities "originating above the surface of the land or water from spills, leaks, or discharges of [various pollutants] in the possession of [Transocean]"; and that BP is thus not covered under the policy as an additional insured for damages arising from oil leaking from BP's undersea wellhead. The limits of the policies at issue in the suit involve $700 million in excess coverage over a $50 million primary policy. (Lloyds Complaint, pp. 3-5).

BP filed its answer and counter-claims on Aug. 6 seeking declaratory relief, equitable relief and money damages for the excess insurers' alleged breach or anticipated breach of the Transocean policies. BP's answer did not provide much substance in response to the insurers' allegations and did not provide an alternative interpretation of the policy language purportedly limiting spill coverage to liabilities originating above the surface of the land or water. Interestingly, BP alleges in its counter-claims that BP Corporation North America Inc. is the named insured under a commercial general liability policy issued by National Union and that on June 28, National Union tendered its full policy limits of $300 million and assigned its contribution, indemnification, and subrogation rights to BP. BP asserts three counter-claims: a claim for declaratory judgment; a breach of contract claim; and a claim for subrogation, contribution and indemnity. The case will presumably proceed into a discovery phase under Judge Melinda Harmon.

Useful Background

Two other significant disasters provide useful background: the Exxon Valdez spill, which was the most significant and expensive modern oil spill before the current event, and Hurricane Katrina, which was an event of similar magnitude in the same area within the last five years.

The Exxon Valdez oil spill began in Prince William Sound in Alaska on March 24, 1989. Over the course of the spill, 10.8 million gallons of oil were released, less than a tenth of the Gulf oil spill. The mechanics and location of the Exxon Valdez spill meant that the insurance coverage implications were significantly different. The spill was in a particularly remote location, complicating cleanup. Essentially all of the oil remained on the surface of the water, as opposed to the oil hidden under the surface in the Gulf spill. Cleanup efforts in Alaska cost Exxon an estimated $2 billion, rather than the more than $4 billion already spent by BP. Finally, the types of damage were significantly different. The Exxon Valdez spill caused tremendous environmental damage, and consequently disrupted business activities primarily in the fishing and tourism industries, much like in the Gulf. Bodily injury and property damage claims, on the other hand, were much less significant in the Exxon Valdez context than they are expected to be in the BP spill. Lawsuits, including coverage disputes, from the Alaskan spill have lasted more than 20 years and some are still ongoing.

While the Exxon Valdez spill was of a similar nature, Hurricane Katrina affected the same geographical area and is closer both in time and scale. Katrina struck on Aug. 29, 2005 and was estimated to have caused damages totaling well over $100 billion. Estimates of the eventual cost of the Deepwater Horizon spill range from $29 to $63 billion. In terms of insurance coverage, Katrina's costs to insurers were estimated at the time at as much as $60 billion, and eventual payouts totaled approximately $41.1 billion in satisfaction of 1.7 million claims, not including $2 to $3 billion in insured damages to energy facilities offshore. With the oil spill, on the other hand, the insurance industry's exposure is estimated at a substantially lower range of $1.5 to $3.5 billion.

This lower estimate for the Gulf oil spill has three causes. First, while the Gulf oil spill is a widespread environmental catastrophe, it has not damaged property as pervasively and severely as Katrina's winds and flooding. Second, business interruption claims are expected to be significantly lower with the Gulf oil spill: business interruption claims require some form of property damage for eligibility under first-party coverage, and many businesses with operations interrupted by the Gulf oil spill have suffered no property damage. Third, the insurance industry exposure is expected to be lower with the Gulf oil spill because BP will face the majority of potential liability and is largely self-insured for the majority of its losses. This is not to minimize the impact that the Gulf spill will have on coverage litigation: While more than 1,100 underlying suits were filed based on Hurricane Katrina, over 300 have already been filed based on the Gulf spill, and the total may surpass Katrina's. Overall, however, the oil spill appears likely to have less of a broad systemic impact on the insurance industry than Hurricane Katrina due to lower claim amounts and the concentration of liability among a few key players.

The Claims Fund

An additional wrinkle in the coverage landscape for the Gulf oil spill comes from the establishment of the BP claims fund, known as the Gulf Coast Oil Spill Claims Facility. The fund consists of $20 billion set aside to pay claims arising from the oil spill. The fund will pay "all legitimate claims for damages resulting from the oil spill and necessary response costs," including bodily injury, property damage, net loss of profits and earning capacity, subsistence loss and natural resource damage, removal and cleanup costs, the costs of increased public services, and the net loss of government revenue. The exact contours of the claims that will be allowed are unknown. In particular, the eligibility and causation standards that will be applied are unspecified, as is the extent of coordination with other insurance. BP has deferred making determinations on the legitimacy of some types of claims, including tourism and restaurants remote from beaches affected by oil, workers affected by the offshore drilling moratorium, real estate values depressed solely by perception and not by oiled beach proximity, and seafood processors remote from the Gulf. Determinations of those categories will be made by Kenneth Feinberg, who has been appointed to administer the facility. Persons or businesses receiving a distribution from the fund are obliged to disclaim any rights to submit additional claims against BP. More than $303 million has already been paid out of the fund in response to 40,100 claims. A total 143,000 claims have been submitted to the fund. BP is expected to submit at least a portion of those claims to Lloyds under Transocean's policy as an additional insured.

Potential coverage disputes may arise from the interaction of multiple insuring parties. It is unclear how the BP fund will treat requests for subrogation from first-party insurers after policyholders' claims have been paid. The claims fund is not a traditional insurance policy and may not face the same legal requirements for subrogation. These requirements are especially muddy in the case of claims that may be paid by the fund but that are not legally mandated by the Oil Pollution Act, including the types of claims listed above as being deferred to Feinberg's decision. In an alternate scenario, individuals or businesses may seek compensation from the fund, and then seek to supplement whatever recovery they receive from other potentially liable parties. Those persons will need to release BP to receive funds from the claims fund, but there is no requirement to release additional parties, including those involved in the spill itself or the cleanup effort. The other major players in the oil spill have liability policies in the hundreds of millions of dollars: Given the magnitude of the overall economic damages, however, some of those companies may eventually have to pay costs out-of-pocket as BP is already doing.

Conclusion

As the insurance coverage ramifications of the Gulf oil spill play out, observers will be monitoring how the BP claims fund deals with claims not legally mandated, how the fund handles subrogation claims from various insurers, and the extent to which individuals and businesses will be able to successfully seek payment from multiple sources. The creation of the BP claims fund could have a transformative impact on how coverage issues are formulated and processed going forward. Moreover, BP's early coverage dispute with Lloyds will provide guidance about the degree to which the oil spill defendants will be able to access each other's policy limits. The rulings from Hurricane Katrina and the Exxon Valdez spill may also prove useful to insurers and policyholders alike in deciding how to pursue coverage decisions in the wake of the Gulf oil spill.

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