

INSURANCE FOR THE ENERGY INDUSTRY IN THE WAKE OF KATRINA AND RITA

*New Orleans Chapter of the EBA, Panel Presentation — October 11, 2006**

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has been a loss adjuster for over twenty-five years, specializing in energy related claims for worldwide insurers.

PRESENTATION TRANSCRIPT

MS. BROWN: Good morning. I'm Stacy Brown, and on behalf of the New Orleans Chapter of the Energy Bar Association, I would like to welcome you this morning to our presentation of Insurance for the Energy Industry in the Wake of Katrina and Rita. While the energy industry is recovering from the property damage and business interruption losses that were suffered last year, the long and even short-term effects of the industry's ability to insure for these type of losses in the future is still uncertain. We have an exceptional panel here today to discuss these issues. So without further delay, I would like to introduce our moderator, Covert Geary. Cove is a lawyer with Jones Walker. He has been with the firm since 1985. He is a member of the firm's Energy Practice Group, and also co-chair of the firm's Insurance and Financial Services Group. He has handled a wide variety of energy litigation and insurance coverage issues. And in 2005, he spoke at an American Association of Professional Landman seminar on the well-known *Corbello* lawsuit and the wave of property restoration cases pending in Louisiana.¹ His paper from that seminar was published in AAPL's Landman Magazine.² After Hurricane Katrina, he wrote a paper on business interruption claims resulting from hurricane losses, and that paper was published by HarrisMartin's Catastrophic Loss and Liability Update.³ Earlier this year, Cove was recognized by the New Orleans City Business Magazine as one of New Orleans's leaders in law, due in part to his contributions to nonprofit agencies involved in the rebuilding of our city. Cove —

MR. GEARY: Thank you very much, Stacy, and welcome everyone. Right here in New Orleans, we have some of the world's leading experts in this field assembled for the panel today. We have an outstanding group. Mark Robertson is the director of risk management for Nexen, which is a publicly-traded independent oil and gas company based in Calgary, Alberta, Canada, with operations world-wide. Mark is a graduate of the University of Winnipeg, and he has over twenty years of experience in all aspects of risk management. Valerie Cusano is the President of Iridium Risk Services, a retail brokerage firm in Calgary. Valerie has an LLB from British Columbia and also a BSC from the University of Alberta. She practiced law in Calgary before working as a claims manager at Marsh McClendon. After growing her claims unit at Marsh she founded Iridium Risk Services where she represents clients with operations worldwide. Simon Pringle, who is a director and founding member of Newman Martin and Buchan in London, is a graduate of Oxford. He ran the Energy Division of the company for many years, and now he is the production coordinator. He specializes in the design and placement of programs for energy companies around the world and is a leading independent broker in the London market. Fourth, we have Bill Rothhammer, who is president and CEO of

1. *Corbello v. Iowa Prod. Co.*, 850 So. 2d 686 (La. 2003).

2. Covert J. Geary & Eric Whitaker, *Corbello v. Iowa Production – Lessons Learned from Louisiana*, THE LANDMAN MAGAZINE, November/December 2005.

3. Covert J. Geary, *Business Interruption Claims Following Hurricane Losses*, CATASTROPHIC LOSS & LIABILITY UPDATE, June 2006, at 3.

Bateman Chapman Group in Houston. Bateman Chapman is a leading international loss adjusting firm. They provide consultancy services to insurers with clients in the energy sector. They provide expertise in a wide variety of fields, including scientific engineering and business disciplines. Fifth, well-known to all the lawyers here, is Judy Barrasso. She is truly one of the leading litigation attorneys in the Gulf South. Judy's practice includes business torts, bank fraud, lender liability, bank practices, D&O insurance, attorney malpractice, commercial contracts, class actions, and insurance clauses relating to bad-faith issues. She has handled a number of class actions in the wake of Hurricane Katrina and has successfully defeated certification in a class action involving a number of homeowners. Judy is recognized by a number of accrediting agencies and she is a fellow of the American College of Trial Lawyers. Chambers USA has recognized her as one of the leading U.S. business lawyers. She has been named to the Best Lawyers of America since 2000. The Young Leadership Counsel here in New Orleans recognized Judy as role model of the year in 2004 for her many civic, community, and business activities. Most recently, Judy was counsel for BP in the *Barasich* case, which was a huge win for the oil & gas industry, which she will talk about today.⁴ I think Valerie and Simon will start.

MR. PRINGLE: Good morning, everyone. I'm Simon Pringle, and I'm going to try and give you some background about the energy insurance market, its makeup, types of coverage, the different parts of the energy industry, and its size and constraints, as a way of leading into describing and trying to explain its reaction to the 2005 storms.

Spindletop is where it all began on a hill near Beaumont, Texas going back a hundred years ago. By showing that large volumes of hydrocarbons were contained in buried layers of rock, and that rotary drilling was an effective way of getting to it, Captain Lucas was the midwife to the birth of the modern petroleum industry. And by blowing out of control for nine days, Spindletop was also the baby of the modern energy insurance industry.

A hundred years later both industries are bigger and more complex. But it all starts with something as small and simple as a plastic cup. Plastic or polymer is made from long chains of mainly carbon atoms put together in a plastics factory, from monomer feedstock—that is methane, ethylene, propylene, butane, and the like—in turn made from fractions distilled from crude oil in a refinery. The refinery makes various other products, notably fuel for the jet engine and, the love of your country, the internal combustion engine.

Moving down the food chain, there is a refinery in the south of France. It is in a very pretty location, but in 1992 it become quite ugly and took about a half billion dollars off insurers. The crude oil comes by pipeline or by tanker from the field. Quite often, at this phase of the industry, the company likes to use intermediaries to broker the sale and purchase of the crude. The oil comes from the field, either from onshore or from under the sea; but before that, it has to be discovered. The oil companies hire rigs like these to drill exploratory wells.

4. *Barasich v. Columbia Gulf Transmission Co.*, Nos. 05-4161, 05-4569, 2006 WL 3333797, at *1 (E.D. La. Sept. 28, 2006).

All of these assets and various types of related financial interests can be insured. What you do is go to a broker. You may already be getting the idea that there is a lot of pretending in insurance. Anyway these people take your requirements into the insurance market. Lloyd's of London began in 1688 as Edward Lloyd's Coffee Shop and has evolved over three centuries into a kind of Starbucks, franchising its brand name, licenses and market penetration to sixty-four syndicates (here in the middle), which between them write about \$28 billion in premium across a broad spectrum of insurance that includes marine, aviation, motor, life, general property and casualty, and reinsurance.

Only twenty-eight of the sixty-four Lloyd's syndicates write energy, and they are joined by 15 or so insurance companies which make up the rest of the international energy market.

A key to understanding the market's reaction to the 2005 storms is that nearly all of these players write broad portfolios, in which the energy line has to compete with other classes for capital. And a determinant of the energy market's size and appetite is the quality of return perceived as achievable from deploying capital to writing energy compared to other classes. Another key is that these insurers share the products they sell, giving them a uniformity around the fringes of which we brokers ply our trade. Now, Valerie is going to take over and talk to you about these products.

MS. CUSANO: Thank you, Simon. I'm going to try to use Canadian English as opposed to British English, but I may lapse back and forth from time to time. So feel free to ask questions if I use a funny word. We are going to start by talking about different kinds of insurance typically purchased by the energy industry. These are wholesale brokers. It's hard to control them from time to time. We are going to start by talking about the insurance that is frequently purchased by mobile drilling rigs. There are three types of drilling rigs: the first is a jack-up rig, the second is a semi-submersible rig, and finally we have a drilling ship. So typically, the kinds of insurance that the drilling rig contractors are going to buy are going to be hull & machinery. That is essentially coverage against physical damage to the property, which is obviously important; insurance that would be for the repairs. Loss of hire, or as we say in Canada, "loss of use." So then when you have the physical damage, you won't be able to use the drilling rig or lease it out, so you will lose revenues because of that. That is a fairly typically purchased coverage, as well. And then there is protection and indemnity. That is typically insurance that you buy to protect against liability to the crew. And then we have war and confiscation. It's frequently the case—and I know certainly Mark will talk more about this—that energy companies are drilling in areas of the world that are subject to terrorism, war, government changes, and that sort of thing. So they frequently buy insurance against war and against confiscation by the government. These rigs are moving around a lot, and they are often drilling in areas that aren't that friendly. The rigs are expensive, so there is obviously bank lending and mortgages involved, and so the bank will often insist on specific coverages that have to be purchased. For example, Operator's Extra Expense Insurance (OEE) and blowout coverage. Now, Mark is going to talk more about this topic as well, but historically, through contracts, there is some liability placed on the shoulders of the contractor for blowout, for example in the case of gross negligence. It

obviously varies depending on how much leverage the contractor has versus the operator. Certainly, in recent years, at least in the Gulf of Mexico, we have seen that a lot of the liability provisions in the contracts have changed quite a bit. And so that has affected how we go out and buy insurance for both the contractors and for the operators. And Mark, I know, is going to talk more about that, so I will leave that topic alone for now.

Certainly, in the field of offshore construction, these are expensive projects. And there are a lot of exposures that are faced by companies. And so contractors will often be buying insurance for the equipment when it is in their yard, because they are assembling things, and they have a lot of very expensive equipment that they are putting together, especially with the cost of steel increasing. They will also be buying liabilities and Protection & Indemnity (P&I) coverage, both for third-party liability and for some of their own employees. The oil companies themselves historically will go out to the market and they will buy what we call—there are various names for it—we call it often in North America COC or Course of Construction Insurance. They call it in the UK CAR, or Construction All Risk, or Erection All Risk, which I try to stay away from, typically, when I'm describing insurance. Anyway, so this insurance will cover physical damage to the project. Because you have a lot of very expensive equipment, you want to make sure that you have coverage in the event that some of it gets damaged. It will also include a component of moving cargo, because you may be shipping the work from many different places, and the cargo may sink. All sorts of things can happen to it. So you typically want to buy a component of that insurance, as well.

The other insurance that is available for a construction, but not very frequently taken up in offshore projects, is delay in startup insurance. And that is essentially business interruption insurance for a project. So in other words, if the project was scheduled to start January 1st, and it's delayed because of a physical damage event, then potentially you could buy insurance that protects you against your loss of revenues for the time that you're delayed because of a physical damage. So maybe you start off on June 1 instead of January 1, and you have covered a loss of revenue. The problem with delay in startup insurance is it sounds like a very lovely product, but it is fairly difficult to collect in the market, historically. And it's also very expensive for offshore construction projects. Because the insurers historically have been very leery of the risks that are associated with offshore delay because it's very common to have delay. And to attribute the delay to a physical damage event that is actually covered under the project, versus some other event, like bad weather or lack of labor, or whatever the other issues could be, is quite challenging. So the insurance is very expensive. They also buy, obviously, liability insurance. There is something that we have called Alpha Liability Project Insurance. And that covers against liability that is really the responsibility of any of the contractors or subcontractors that are working on the project. And it prevents in-fighting and lawsuits between a contractor, the owner and the subcontractor. It eliminates the need to assess fault, because they are all covered under one project insurance.

So moving along, I will be talking about offshore operating coverages. Offshore operating insurance is going to be something we buy, obviously quite often for our clients. A steel jacket pile to the seabed and a concrete gravity base

is typically very expensive to insure because there is a lot of value. There is \$1.5 billion of insured value to this type of platform. In another example the Troll A platform, operated by Shell, is apparently 472 meters high, and the tallest structure ever moved by man. The insured value of this platform is \$2 billion. So these are obviously fairly significant in terms of damage values, if damage occurred. The whole platform can be lost or parts of it, so you commonly buy property damage, (PD) coverage. And then frequently, you will buy some kind of contingent coverage for the pipeline. You will cover that exposure.

Removal of wreckage is another really big exposure. Because once you do have a blowout, you have to do something with what is left in the water. And the cost of that can be quite significant, as we have seen after Katrina and Rita. And then the blow-out cost. Blow-out can obviously be very expensive, and that is another thing that frequently is covered by O.I.L., which is a mutual insurer that we are going to talk a little more about. And then excess coverage is frequently bought through commercial programs.

So just moving along in terms of some of the coverages that are bought, we buy a lot of coverage for redrill costs which can be very expensive. We do a lot of placements in the UK where the redrill costs are amazingly expensive for each well. Once you lose a well, then you have to pay for the redrill. So we end up buying insurance for that, typically. In addition, we have pollution liability exposures, and obviously loss of production. And that is an issue that a lot of companies deal with differently, whether they want to protect the lost production or they don't want to protect it. And certainly, there are some times when companies have chosen not to insure it, and it has been a wise decision, and then there are some examples of when they have chosen not to insure it and it's been a not-so-wise decision. Employers' liability is another important issue, as is third party liability.

Let's take the example of a fixed jacket. A fixed jacket uses a whole lot of steel, because you have got to get those legs long enough so that it can sit on the bed. The insured values are quite high, as opposed to a spar, because the spar uses a lot less steel. For example, there is a spar called Genesis, which is operated by ChevronTexaco, about 150 miles south of New Orleans. And it uses a whole lot less steel, so the insured value is probably less than \$500 million, as opposed to the fixed platform where you have insured values of potentially two billion. So the values change a lot. There is also the Floating Production, Storage and Offloading Systems (FPSO), which is also commonly used, depending upon the depth. And they can be owned by an oil company or they can be owned by a leasing company. And depending upon who owns it, then the insurance needs are different. But again, the insured values are fairly less expensive than a fixed platform.

We then go to downstream property. And again, downstream is a word we use often, or we often also call it onshore. And it covers the things that happen to the oil and the gas after they have actually been produced, discovered, and produced. So that includes upgrading and refining. Their exposures, property damage exposures, are quite high. You can have vapor clouds and quite significant explosions, which we have seen fairly frequently. There is also debris removal cost, business interruption and then casualty exposures. For example, the Phillips Pasadena Chemical Complex near Houston suffered an

insured loss in 1989 due to a massive fire and explosion, and that loss cost about a billion dollars. So it is not unusual if you have a significant fire and explosion at one of the upgrading or refining or chemical plants to have those kinds of values experienced.

In our next example, we can consider the types of energy companies and the differences in their insurance buying patterns and can split them into two sides, being contractors and principals. There are many different types of contractors: Drilling, Construction, Supply and Utility, Well Service, and Seismic. In any large project, every single one of these contractors is going to be involved at some stage. These guys are buying insurance and they are typically not making a choice not to buy insurance because they really have to. Their revenues are such and their balance sheet is such that they don't have a lot of choice but to buy insurance. And so the buying patterns will be quite consistent among the different types of contractors, unless, of course, they can pass the liability through to the principals, which again, is frequently happening in some parts of the world, much more so than it used to.

If you move over then to the principals, there are many different kinds of energy companies: Exploration & Production (E&P) Companies, Refiners, Petrochemical, obviously, Power, and then Integrated. So these companies typically have balance sheets that can support, in some cases, much different patterns of insurance buying. They can support much larger retentions. They can support a lot more self-insurance. There are captives that can be utilized. They can choose to go without multi-cover. And frequently they are not financing their project, and so they don't need to be subject to the whims of the lenders. What is now interesting about insurance is, in our part of the world, in Alberta, we do have an area called the oil sands, which is developing very quickly in a massive way. There are billions of barrels in place, but it's in the ground. You actually can walk on it, if you go up to the oil sands in some of the areas. And so there are different projects that are taking place up there. Some of it can be mined, so we have huge trucks and shovels that pick up the oil sand, and then it goes through various processes that allow bitumen to be extracted and upgraded into synthetic crude. There are other projects, like one of the ones that Nexen is operating where they actually do something called "Seg D" which is steam. It is gravity drainage where the company drills wells that inject steam into the ground and allows oil to seep out and be collected through pipelines up into an upgrading facility. And those projects are very specific in terms of what types of insurance are dictated. And as an example, we have one property that we insure, and there are three companies that own the project together. One of them is quite small, and it's their only operating asset. Two of them are huge and they are integrated E&P companies, and they have very strong balance sheets. When you go out to place construction insurance, their needs are all fairly similar, and so one insurance policy can be purchased. When you go to buy operating insurance, their buying patterns are completely different. The small company is maintaining a very low deductible and the large companies are maintaining a very high deductible. So you see a lot of difference in the E&P companies in terms of their buying patterns.

Moving right along, we thought we would discuss a couple of examples of claims and how the claims can impact the insurance market before we get to

Katrina and Rita. Let's take the example of the Piper Alpha platform that is in the UK sector of the North Sea. It's in a field operated by Occidental. There was an explosion caused by the ignition of natural gas condensate that had leaked. The platform was destroyed and 167 people were killed. The loss in today's money would be greater than \$3 billion total just for this one platform. The loss happened on July 6, 1987, and it was six days after Occidental had stopped buying loss of production income (LOPI) coverage. They had been buying LOPI coverage up until this point and then made a decision not to on their July 1 renewal, and then the loss happened six days later. So that is the nature of insurance. You can make a hard decision that you think is very well thought out, and we do lots of modeling, but anything can happen. And this is an indication of how significant the size of one claim can be. And if you look at the values there, we see that there are all of the different types of insurance that we have been talking about. We had different large exposures for each one, including the LOPI of \$230 million, which they self-insured.

My last example is of Hurricane Andrew and the impact of Hurricane Andrew on the market, which has something to do with why the impacts of Katrina and Rita were so significant on the insurance market. If you look at Hurricane Andrew, the interesting thing is that it was all big losses, but the real big losses were in the property sector, [\$20.5 Billion] as opposed to energy [Offshore \$615 MM and Onshore \$300 MM]. And the energy market suffered relatively small losses, really, for a hurricane. The property losses were enormous—\$20.5 billion. So it was somewhat misleading to the market, because this then turned into an expectation of what they thought they could expect in a hurricane—that the energy losses would be smaller by a significant amount than the property losses, and it also had a significant impact on the cost of treaty reinsurance. Treaty reinsurance is something that Simon is going to talk more about. But treaty reinsurance basically is when the insurers reinsure their own book of business and buy reinsurance to protect them. And because the losses were so significant, the costs of treaty reinsurance went way up. And that meant that the insurers then charged a lot more for the direct insurance that they charged to insureds. And so it had a significant impact on the market going forward. Simon —

MR. PRINGLE: We have very different styles, don't we? As a third loss, this one happened at Toulouse fifteen days after the World Trade Center and went almost unnoticed. Although the property damage and business interruption was relatively small, it became the largest single-event third-party liability claim—scarily enough, it didn't even happen in the U.S.A. A fertilizer, or ammonia nitrate plant, originally built outside of the city of Toulouse in South West France but over time engulfed by the city's expanding suburbs, literally blew up. The blast measured 3.4 on the Richter scale. It killed twenty-nine people, destroyed surrounding homes, schools, a bus station, a rugby stadium, and surrounding businesses, notably a rocket fuel factory across the river.

The point of all of these losses is that their volume is a second determinant of the market's size; because self-evidently the demand for its products must over time be balanced by their price in relation to historical loss experience.

And the third influence is that of demand. Let's take BP's annual statistical review of world energy. For me, it portrays the comings and goings of an

enormous international enterprise—finding, producing, and transporting 80 million barrels of oil every day, and 45 to 50 million Barrel of Oil Equivalent (BOE) of gas to plants that convert the raw materials into energy fuels and household products in every corner of the globe. Trillions of dollars of insurable property values and business interruption losses, and almost immeasurable amounts of exposure. But sadly, it turns out that the demand for insurance is only a fraction of this. It reflects the appetite for risk transfer of an industry that every day takes much larger bets on commodity prices and wildcat wells. As we heard from Val, contractors tend to buy a lot of cover. But E&P companies, refiners, and integrated energy companies especially, which control most of the insurable exposure, purchase less. BP self-insures and the other two super majors only buy excess of the first several hundred million dollars per loss. In fact, energy insurance is mostly about the more volatile layers of event risk faced by companies that are contributing the thirty percent or so of world production that is not controlled by the top twenty-five producers, and only then to the extent that this risk is neither retained nor pooled into a mutual such as O.I.L.

O.I.L. is an industry insurance mutual based in Bermuda, in existence now for thirty-five years, in which eighty-three top energy companies pool or swap layers of their property, control of well and pollution risk externally to the competitive process of the commercial market. It is, so they call it, a zero sum game, in which premiums and claims are matched. Rates exactly reflect the loss experience, and the cost of losses is shared between members according to a formula that recognizes relative size and broad risk categorizations. While O.I.L. is a valuable tool for many energy companies, for the insurance market it is a nuisance and reduces the demand for its products.

Overall, the premiums which came to the commercial market in the years leading up to 2005 would have been about \$3 billion each year, net of self insurance, retentions, and placements made with O.I.L. The claims arising from this same commercial business were costing the market about \$3 billion a year. This was a market of forty to fifty players, as we have seen, supported by reinsurance, as we shall see, geared to expect and provide for losses and premiums of \$3 billion, give or take, per annum.

And the other aspect to notice, as Val mentioned, is how much the earlier windstorms cost in claims: Andrew, \$900 million in 1992; Lily, \$400 million in 2002; and even Ivan in 2004 was only \$1.5 billion in losses to the market.

So here is the background to 2005: forty to fifty underwriting units making cases to their capital providers for profitability from shares of a \$3 billion premium pot, their equations premised on expectations of aggregate annual loss in the range of 1 to 5 billion dollars per annum, and of a maximum loss from a single event to be satisfied from internal resources and the borrowed capital of treaty reinsurance of about 2 to 3 billion dollars per loss. This last estimate proved widely optimistic, and the sub-limiting of wind coverage that was experienced this year was a straightforward market reaction to the failure of loss models and hunches relied upon by underwriters in 2005.

For example, there are prescriptions from the Lloyd's Franchise Board for syndicates to calculate their estimated loss from a major Gulf of Mexico storm. Syndicates are instructed to list their dollar lines on a variety of interests under all policies exposed in a corridor fifty miles on either side of a specific defined

damage track. They are told to take specified percentages of those lines to arrive at a reasonable estimate of overall loss, depending upon the type of insurance and proximity of exposure to the center of the track. Now, all syndicates would have performed this exercise before the 2005 storms and derived a number based on one theoretical storm following the defined track, although with no confidence that this track for them produced the worst possible case. However, for many insurers all this exercise did was challenge their hunches, and in the battle between rudimentary modeling science and preconception, preconception won the day.

The laxity was partly due to treaty reinsurance. In a sample reinsurance program such as would have been bought in 2005 by an insurer writing a portfolio that included energy, an insurer writes a spectrum of risks. Above a retention, it buys specific treaty reinsurances for each class individually, above which additional layers are purchased on a whole account basis cutting across several classes at the same time. This kind of structure would have been typical for an insurer writing up to an expected maximum energy loss of \$75 million, i.e. only half the program's limits of \$150 million, and the excess buffer of \$75 million would have afforded some lazy comfort and tolerated perpetuation of false optimism about the possible size of windstorm losses in the event many underwriters blew through the top of such programs.

So this was the shape of cover freely given—and I mean that literally—last year. Most risk, in terms of both the number of units exposed and loss frequency, lies at the foot of a triangle, while at the top are relatively few and remote exposures. There are some companies electing to self-insure, although relatively few. And at the very bottom of our triangle we can see the retentions, typically half a million to a million dollars for property and forty-five to sixty days for business interruption or LOPI. Contributing to the \$75 billion of theoretical cover, which we believe was given in 2005, we see O.I.L. giving one billion and the market agreeing to drop down over it.

And then we have 2006. I will not try to describe the devastation and human cost of these storms, particularly Hurricane Katrina. The damage to energy insurers, net of self-insurance, retentions, and O.I.L., is developing to around \$5 billion per storm, made up in each case of individual claims ranging from 1 or 2 to \$500 million under about 125 policies covering E&P companies, drilling contractors, pipelines, refineries, gas plants, and terminals. A third of these amounts are business interruption or contingent business interruption, with the balance coming from physical damage, wreck removal and the cost of re-drilling or making safe wells connected to damaged structures. As a result, insurers' 2005 energy account will settle at about four times premium. And that is not the end of it, because across the whole property and casualty account, which sets the scene for excess of loss reinsurance pricing, these and the other 2005 events produced a total of \$90 billion of loss, about double the next worse year on record.

The first reaction of energy insurers was to wonder if there was any future in their business at all. They were not confident that the reasonable expectations of clients and capital providers could be reconciled, especially when nobody knew whether the experience of 2004 and 2005 was a blip or the start of a permanent change. No less a figure than Warren Buffet said: “[w]e don't know

if the last two years of hurricane activity are more relevant than a century of hurricane activity to determine pricing. If the last two years are the relevant years, we are not getting enough money for our products. We don't believe in modeling at all, it's silly, we get paid to make guesses."⁵ But for many energy insurers, it was now critical to calculate, or guess, right? They had lost money in the casino for three nights in a row, and were going back to the wife to plead for a last chance.

As often happens, treaty reinsurance drove behavior. From January 2006, treaty programs were split between risk and wind, or risk and elemental, towers. The first "risk" tower in our example is excluding cover for losses caused by named natural perils. The separate cover available for wind was expensive, limited, and required the reinsured to retain more primary loss. Even so, most energy insurers chose to buy it. Many were simply nervous after blowing through their programs in 2005, and had a legacy of policies to protect that would not expire before the new wind season. Most recognized that to stay in the energy game, they would have to offer wind cover, but in order to keep capital onside would also have to protect against recurrence of the 2005 experience or worse, through purchase of reinsurance and tailoring their original exposures to a much more stringent maximum loss modeling regime.

Here is what happened to our own E&P book of twenty companies in the Gulf of Mexico. In nineteen cases, coverage was renewed subject to increased wind retentions, aggregate wind sub-limits and big increases in premium. About a billion dollars of wind limit was bought by these companies at an average rate on limits of twelve percent. The twentieth company did not renew its wind cover, and Mark will talk about that in a few minutes. The experience across the whole offshore market was consistent with this. About a hundred E&P companies and fifteen drilling contractors have bought some form of wind limit, ranging from a few million up to \$250 million in some cases, more or less adequate for their needs, at an average rate of twelve percent.

This gives us the shape of the new cover. It is the triangle and at the foot of it we see increased retentions, while at the top the triangle is sliced off showing the effect of aggregate wind sub-limits. Business interruption or LOPI cover became very expensive, with contingent business interruption, i.e. cover for loss of production, resulting from damage downstream of the production source, particularly so, and also difficult to place at any price. The so-called "O.I.L. drop-down cover" virtually disappears. And in response to these changes, we see more clients choosing to self-insure. Overall, we think in the range of \$7.5 to \$9 billion of wind limit has been purchased, the small bit in green just ten percent of last year's amount, at a premium of about one billion dollars.

So with fingers crossed for a few more weeks, that was 2006. I don't know if any of you like Picasso, but I think he might have represented our market like this example of a destroyed platform. Personally I find anything after his blue period too difficult to interpret, and have a similar feeling when trying to rationalize all the various strands and influences into some sort of projection for

5. Mr. Buffet gave this quote at the Berkshire Hathaway, Inc. Annual General Meeting. The following source printed the quote, using additional grammar which has been omitted to maintain the speaker's tone, pace, and intent. *Recent Quotes*, ENERGY INS. NEWSLETTER (JLT Risk Solutions, Ltd.), July 2006, at 7, <http://www.jltgroup.com/files/pub/EnergyNewsletter0606.pdf>.

next year. However, we hope that this talk will have made energy insurance in 2006 a little clearer for some of you. Thank you.

MR. GEARY: Mark Robertson is going to present next.

MR. ROBERTON: Well, first of all, thank you very much for the opportunity to come and speak to you today. My objective is a little different than Simon's and Bill's and Judy's perspective. And what I want to try to do is, open up the corporate kimono a little bit and talk to you about how our risk-taking decisions have changed since the hurricanes. So just a bit of background with respect to Nexen, for those of you who don't know us. We are a Calgary-based international energy company, and we are primarily outside of Canada. So most of our business is non-domestic. We have operations in the Gulf of Mexico obviously, which for Nexen is non-domestic. We have operations in the United Kingdom, which is exponentially growing within the next six months. We are going to become one of the largest producers of crude oil in the U.K. coming up very quickly here. We are a significant player in Yemen—the largest player in Yemen, and have been for a long time. In addition to that, we also have operations in Columbia and Nigeria, and of course, produce significant operations in Canada. In Canada, our operation is primarily heavy oil. We also have some non-conventional Coal Bed Methane (CBM), those kinds of things. But most importantly, we are a very large player in the Canadian oil sands. And I won't bore you with all of those details. But that will be becoming a very significant portion of our portfolio over the next fifteen years.

We are operating in a challenging environment from almost every perspective; but we are primarily, again, an oil company, notwithstanding all of the other things that are going on. From a risk perspective, risk to us is a possibility or a probability of a loss or a gain, so we try to look at both sides of the equation. And it's a continually moving set of factors, which have to be thought about as we consider how much risk we want to take. One of the great ironies of Katrina and Rita, and Lily before that, is that we have seen extremely high oil prices—and that in part has been fueled by Katrina and Rita—that has resulted for our company in extremely strong returns, profitability, and the ability to reduce debt. So our company now has about \$16 billion in assets. Next year, we'll see in the range of \$5 billion in cash flow. And with all of this, we are in a very, very strong position to retain more risk. So the storms have not all completely been without the positive sides.

To make the risk transfer assumption decision, therefore, we require the data to properly assess, first of all, the size of the risk exposures which are in our company. And I'll talk a little bit about that. The cost which is going to be born by our company to retain risk, and the cost to transfer that risk if we decide to do that, are key points in our decision to assume or transfer risk. And I will quickly comment on that; we do use mathematical models to support the idea of retention amounts. Frankly, those are just rules-of-thumb kind of conventions. Mostly, and this is probably the most significant point that I will make this morning, is that the risk retention for us always is based upon the CFO's or senior management's gut feel. And when I say that, I'm not trying to be trite. Gut feel really has to do with our CFO being comfortable standing in front of our investors, standing in front of our shareholders, and explaining, post-loss, why we didn't buy or why we did buy insurance. So from our perspective, gut feel is

what he is comfortable doing. And that is not an explanation that any of us needs to make; it's an explanation that he needs to make. And I think that is pretty important as we consider retention.

Nexen has decided, and in some case has been required, to carry a lot more risk because of the hurricanes. But that is just one example of why we have to do that. I could tell you about terrorism; I can tell you about our exposures in the UK; I can tell you about exposures in the oil sands, and it would be the same story. Part of that push to take more risks is a conscious decision on the part of our company. If I took you back nine years ago, we would have taken very, very, very little risk. And we were able to buy that coverage at an extremely low cost. Today, the market has changed, and we need to adjust with that. Again, a strong balance sheet allows us to make those kinds of decisions. It is a process and we continue to grow into that process every year.

Nexen's spread of assets, as I have already mentioned, and risks is diversified due to our large projects, and they are developing them due to our existing asset base, and it's all coming to fruition at the same time for us. We have higher oil prices, we have a nice set of assets, and we are diversified. We do have geographic locations around the world which allows us to have an even nicer portfolio and transfer opportunities. But we tend to still have a large number of peak exposures because of where we are located and the size of individual assets relative to our entire asset base. Better spread minimizes the impact of loss to any one asset, and it dampens the overall impact on Nexen's balance sheet, in the event that we have any one loss.

I also wanted to make a comment about benchmarking. Our CFO is extremely big on benchmarking against what we consider to be our peer group, and my view of that is that it is directionally interesting. It's not the main driver in picking the retention that we choose. Why is that? Well, first of all, every single company—and some are represented here today—have differences in philosophy. Part of that difference in philosophy is driven by your balance sheet and your asset mix. So for those of you who are in the Gulf of Mexico—and it being your only asset—and we talked about that a little earlier—it's a different set of decisions than Nexen would be able to make with our spread of assets. We understand that, so we need to take that into account with the so-called peer groups. Secondly, your budget requirements. Nexen has been undergoing a significant capital program in the last couple of years. And we need to keep that in mind as we consider whether we are going to transfer risk. And it's also important that our international energy risk balancing be taken into account. I want to go through and just touch on this, and make a couple of comments on some other risk issues.

There is a tendency right now for the risk management groups to be consumed with the wind issue in the Gulf of Mexico. That certainly is not the only risk issue that we are facing. One of the major issues that our company has—besides employee retention and those kinds of issues—our major issue is the cost of contracting out. Nexen does not own drilling rigs for the most part, so we contract out all of our work. We get a tremendous amount of push back because of the economics in the Gulf and in other places in the world, only a part of which is related to hurricane damage. And that means that contractors are seeking to shift much of the risk back to the owners. And I will just give you a

couple of examples of how that is important to us. These are not necessarily risks typical to our company. I will just give you an example: we are being asked to take on a lot of rig exposure right now, even though we don't own rigs, and even though we believe that they are insured by the contractors. But there is a lot of push back to try to force that cover back to us. Again, partly because of the wind exposure, but also part of the economics of the business allows contractors to pass on some of that risk. The challenge which we face, and we have been trying to deal with, partly in the insurance market and partly with our contractors, is trying to make sure we keep the integrity of the chain of contracts. We are having tremendous trouble doing that right now. And to the extent that the violation of the chain of contracts is there, we have to go into the insurance market in a very difficult and distressed situation and try to fix this.

Risk/aggregation modeling has taken on even greater significance in our risk communities internally, particularly with our CFO. And what I mean by that is: he really wants to have a good perspective on where our risks are, how big they are, how much we are retaining, and how much we are able to transfer at a cost that we can live with. We probably should add to that that he is in need of that to be able to explain to the Finance Committee of the Board, the Audit Committee of the Board, exactly where these risks are retained and where they are transferred. So it's not only that he wants to know, it's also that we need to make sure that we communicate that, particularly from an investor perspective.

Just a quick comment: Everything takes a lot longer. This has probably been the biggest impact of the hurricanes. And every time we go through things like this, it causes these kinds of push backs. But it takes us a lot more time internally. And I'm going to touch more on this in a second. But it takes more time to do risk analysis, again thinking about the chain of contract integrity. It takes a lot more time to do risk assessment and modeling. Part of that has to do with this, and part of that has to do with science. It takes a lot more time to communicate, so we have to spend a lot of time internally talking to our customers, and that is what they are, our business units are our customers, talking about the amounts of risk that they are now being expected to retain and account for within their own individual balance sheets. And of course, we spent a great deal of time talking about risk finance this last year. So that was kind of risk retention.

We will talk about risk transfer a little bit. The insurance market in our opinion had become completely consumed with the Gulf of Mexico issues. And it's virtually all that they talked about. Our process is to go and see all of our insurers over the year face-to-face. And not surprisingly, but a bit disappointingly, they were completely consumed with the Gulf of Mexico. When you consider the mix of assets Nexen has, certainly the Gulf of Mexico is important, but it's only one of our issues. And so it's important for us, when we are thinking about risk within Nexen, to keep perspective on the fact that it's not only the Gulf of Mexico winds that are issues for us. We have all kinds of issues, all around the world, which we need to keep perspective on. Frankly, it became a bit of an advantage for us, I think, in certain ways. Because the insurers were so completely focused on the Gulf of Mexico, we probably got a better benefit on the risk transfer pricing on our other assets.

I can tell you that Nexen buys a lot of insurance. Now, included is business interruption. We understand that many of our peers up there do not buy that. Nexen's perspective has always been that we are trying to protect our cash flow. Why that is essential to our company is—we spend all of our cash flow every year, which I don't think is that atypical. But we are betting our future if we don't protect at least some portion of our cash flow. So our objective is to try in some fashion to design a program to protect the future investments that we are trying to make. Nexen should also tell you that it has had significant losses over the last three years. Between the Gulf of Mexico hurricane losses and some other problems that we have had, we have probably had \$200 million worth of claims in the insurance market. So just from a pure business point of view, it's been extremely attractive for us to do that transfer and it has been a good deal for us.

The cost of hurricane wind protection has exponentially increased and the amount of coverage available, as Simon has already detailed, is radically different post and pre-Katrina. Simon also mentioned O.I.L. There has been tremendous pressure on this company to change, and that is probably one of the biggest problems we have been dealing with internally. I'm not going to bore you with all the details. But O.I.L. diversified significantly over the last ten years. The membership base was pretty much pure energy—oil and gas companies prior to that; now they are energy, plus electrical, plus other things. And my personal perspective is that I think that the group has forgotten and sort of lost their mission in some senses. This is a mutual. And you need to be very grown up when you belong to a mutual, because this is a type of a mutual which allows assessments. And when you have extremely poor years like were caused by the hurricanes, you have to be able to stand up to your senior management and say: “look, you understood that this is a loss equal premium type of a proposition, and you're going to get a bill for \$15 million, or \$20 million, or \$50 million, or whatever the amount is going to be for your company.” The result for all of that was that there has been very much a split of membership. Those who do not have Gulf of Mexico exposures, and those who do. And we are now just going through a process of trying to decide how to fix O.I.L. to address that set of concerns. Nexen continues to assess O.I.L. We joined O.I.L. for a very specific set of reasons about six years ago. Those reasons, in our opinion, have not changed. And we don't plan to change our membership at O.I.L. It's essential for those who are on my side of the business to work with brokers who understand O.I.L., the concept of O.I.L., and how to design around its changes. So I'm sure you're well aware of that, but just to throw in a bit on that. It's one of the major reasons that we decided to work with NMB as our brokers.

What did we do post-Katrina, post-Rita? First of all, as I already mentioned, we did benchmarking with our peers, which is normal. We have certainly been challenged on price and coverage for wind. Just to put it into perspective, we probably had five to six hundred million dollars worth of wind protection available to us. This year we were offered \$100 million. Last year there was no identifiable cost for wind. This year due to the cost, we actually didn't place it, so it would have been maybe 25 to 30 million dollars for a hundred million dollars worth of coverage. Deductibles previously would have been 30 days for us and now are probably 90 days or 120 days. So the senior

management group recommended against buying business interruption in the Gulf of Mexico. Our view was that it was burning building type of pricing, and we were prepared to take that risk, plus it wasn't near the amount of cover that we would have used to protect the peak assets involved. So for a lot of different reasons, we just decided not to buy it. We do want—and I wanted to make this point—to buy an extensive program. We didn't throw out the baby with the bath water. We continue to buy physical damage protections. We continue to buy coverage for other types of losses in the Gulf of Mexico. We continue to buy business interruption on a global basis.

We are amazed and we were amazed at how many companies did buy wind coverage in the Gulf of Mexico. We had Simon do some benchmarking for us. Of the thirty-nine or forty companies we looked at, shockingly enough, thirty-eight of them bought the coverage. We were quite amazed by that. It did not change Nexen's view on what we wanted to do. Again, insurance for us is a tool. It is a faulty tool in our opinion, but it does have a job to do. Our senior management is very much of the mind that it doesn't pay very quickly, and it has all kinds of conditions and exclusions, which are all true. However, our objective with our insurance program, again, is to protect cash flow. We are in a position, because of our balance sheet, to take a lot of risks, and we can also wait for our money a little bit. Our insurers have been extremely responsive, I should tell you. So we have no complaints with how that has worked.

We have ramped up our insurance captive. I won't go into all of the details on our captive. Our captive experts would be happy to speak with you, because it is quite different than we have in the U.S. The benefits to a Canadian company are significantly different than they are to your clients or your companies. So Nexen significantly ramped up our captive this year. We would expect our captive to be right at about \$60 million in premium this year. We will continue to monitor and look for arbitrage opportunities. If the market softens on the wind coverage form, coverage limits, and costs, we will certainly take a look at that again. We don't ever say we are not going to do that again, but we're going to continue to take a look and see if it makes any sense.

We have had repercussions from the losses and overall, our insurance premium costs have significantly increased over the past year. Our insurance spent is about \$40 million, not including our captive or our construction program. If we included those, it's well in excess of \$100 million. As you can imagine, that is a significant item with respect to our cost of doing business and has senior management's attention.

We do have renewal planning off-site. We take our entire group off-site once a year to discuss our entire insurance and retention program.

One of the most important things that has changed in the last couple of years is, we now do pre-renewal board memos. We always do a post-renewal board memo where we put the results of our insurance renewal. But much more recently, we have moved toward briefing our CFO well in advance of renewal about what we think the market is going to be, and then report to the board on what it has done. We also do a specific CFO debrief. So once we have been in the market, and we have a much firmer idea of what exactly it is going to be, we bring Simon and Val in, and others, in order to meet with our CFO directly, so

that he has a lot of information to consider as he talks to the finance committee and the board.

I also encourage you, for those who don't do this, to be extremely accurate with your markets. Nexen has a philosophy of not changing markets. Our philosophy is to stick with the ones that brought you. We have been with the same leaders for many, many years. We don't intend to change those leaders. But it is important to continue to communicate with them.

I have also touched on extensive in-house communications. That certainly continues to be a major objective for us. We need our internal businesses to understand what is happening. And it's not a good idea to say: Here is the new insurance bill. So we need to have extensive communications, not only at the CFO level, but also at the business level. We also have extensive debates within our company about retention. We brought in all of our senior officers and there was a briefing with our CEO. So that kind of discussion and debate needs to take place. What was interesting from my perspective is the willingness and tolerance of the CFO to take risk, versus even other senior officers. He is much more aggressive than even other senior officers were. So it's good to have that debate. It's good to have that discussion and everybody getting on the same page after those kinds of discussions. As you can imagine, because of the changes in market, we have even more extensive board memos than we had in the past.

I want to talk about the significant use of our Barbados insurance captive. Again, we did about \$60 million in premium in 2006. We would expect it to be something similar next year. I will very quickly touch on this. We don't only look at insurance as our risk financing tool. We have our captive. We also took a very hard look at stop-loss reinsurance behind our captive and a CAT bond. And we continue to have those discussions with some of our major insurers. We didn't do it this year, but it's not something that we have forgotten about.

Just a quick observation with respect to risk financing. And this is my opportunity to be on a soap box, so let me just do that for a second. The insurance market is not big enough for us. It's not big enough. Nexen's peak risks are far bigger than we can buy insurance for, even if we tapped every single cent of the available capacity in the market, which we wouldn't do at any rate. Because of that, we are being forced to look at other risk financing opportunities, including CAT bonds and other things, and of course, use of our captive. It's important for us to communicate that to our insurers. There is a tendency to want to try to keep that kind of hidden, and I don't get that. Risk finance is a global concept for us, and we need to think about all the tools, insurance being one element. It's an important element, but it's only one element.

And you need to be honest with the insurers when you're considering those kinds of things. Not just because you want to leverage them, which of course you do want, but also because it's important that you tell them that they will be a piece of a larger puzzle as you are going forward in the business.

Other kinds of things that we expect, just kind of peeking forward in 2007: We need to keep focus on all of Nexen's risks. Costs are going to continue to escalate. We might see some mitigation of costs a little bit this year, because we have had such a good hurricane season. It's essential for us to continue to make good business decisions about how we work with our insurance partners. And

the integrity and data that we provide to our insurance partners has to be even better than it has been in the past.

A couple of comments on claims handling: we have had two major hurricane files in the last three years related to both Lily and now to Rita. Now, I suppose we could add a third one to that, being Katrina, because we had a captive claim for that storm. The claims are enormously time consuming, as we know working with the team that we are working with here trying to settle Nexen's claims. But they also have a significant interest on Nexen's senior management's radar. You don't have claims which look like about \$100 million and don't get extreme focus from the senior management team. That being the case, we need to manage the expectations of our internal stakeholders, including our CFO. One of the biggest mistakes risk management groups make in our view is that they do not communicate with their stakeholders internally. So we need to manage expectations. Things do change. Things are covered. Things are not covered. Losses increase; losses decrease. We need to communicate that on a regular basis.

I think that most of our recovery assembly team is here today. It is critical to have a good recovery assembly team. And it's made up of not just the risk management group, but the business unit, and we have been very, very fortunate to have a great leader on the Dallas team taking responsibility and reporting within his own team what is happening. Our brokers have been very supportive, including our adjusters—Bill and his team. So it's a team effort. These recoveries are complicated. They are time consuming and they are expensive to do, so we need to make sure that everybody is sort of working together. Assembling that team quickly and trying to get an understanding about the issues early on is critical to the success, and that internal communication that I mentioned.

Also, it's important to communicate to your internal management the timing issues. There is no point in having them think that you're going to get your recovery within thirty days. That will not happen. So we need to be realistic when we communicate timing and not just amounts to our senior management team.

One of the unexpected benefits of all of this, of course, is that the risk management group's profile has been raised significantly due to loss recoveries, and that is, in a funny sort of way, positive. It continues to be and will continue to be a critical thing that we have good open communication with our insurance partners. And we need to be honest with them and we need to communicate the best information that we have, which is extremely difficult when you have members moving all over the place all the time. So again, it's important to do that.

Nexen spends hundreds of thousands of dollars a year looking at our assets and doing strategic risk assessments. Our insurers need that information in order to make good risk decisions. Our view is that you want to over-communicate your risk to your insurance partners. Don't under-communicate them. We are not trying to hide anything. We are trying to have them understand and have them be partners with us on a long-term basis. We continue to spend a lot of money on that. Even though we're not buying any coverage for business interruption or wind, we will continue to locate wind exposures, primarily

because we continue to do it for our captive, but also because we may want back into the market again. So we need to keep our focus on those kinds of thing. I thank you for your time.

MR. ROTHHAMMER: Good morning, everyone. Thank you. I want to thank Stacy Brown for inviting me here to speak with you ladies and gentlemen this morning. I'm going to get more into the actual handling of the claims and the O.I.L. issues. The discussion topics I am going to address concern the implementation of the O.I.L. Aggregation Limit Loss for both Katrina and Rita, which is the first time in O.I.L.'s thirty-three-year history that they actually invoked the aggregation limit of one billion dollars per occurrence. Second, I will discuss the interaction with the Insured's other insurance policies such as excess wordings, wrap-around wordings and drop-down wordings. I will analyze these various forms, outlining the application of each in respect of the Oil Aggregation Limit Loss being invoked. Finally, I will talk a little bit about direct and contingent business interruption (BI) and loss of production income (LOPI). Over the last three years, Insurers have tried to simplify these forms, and they have done a great job in doing so. But again, no one can write a policy which takes in all aspects of a claim; the size of a Katrina or Rita claim. As a result, there are still a number of issues arising in regard to Business Interruption and LOPI claims. Before I go any further, I would like to say that I'm glad to be in a winning football town. Why did we not get Reggie Bush?

The O.I.L. aggregation limit for Hurricane Katrina is one billion per occurrence, combined for all shareholders' claims. Currently, O.I.L. is reporting \$2.46 billion in Katrina losses, which is roughly going to mean a recovery for the shareholders of something less than fifty percent. Typically, the O.I.L. policies require a \$10 million to \$25 million deductible, with coverage above the deductible up to \$250 million. O.I.L. is currently making interim payments of twenty-five percent, as they don't know what the losses are going to end up totaling. I know the first interim payment for any Katrina hurricane claim was to Entergy here in New Orleans, which was done in December of 2005. Hurricane Rita for O.I.L. is currently estimated to be in the range of \$1.265 billion, for all shareholders reporting losses. Shareholder recovery is going to be in the range of seventy to eighty percent. Originally, when we requested interim payments, O.I.L. advised they would preliminary pay forty percent to their shareholders. However, that has now been reduced to thirty-five percent for interim payments. The other insurance markets have built a number of policy forms around the O.I.L. wording, and it's up to the individual insured to choose the best form for their needs. We will briefly discuss four basic forms. The first, Form A, is the simplest form, and they will get more complex as we build on top of the second, third and fourth forms.

Policy Form A is purely excess coverage in the amount of \$150 million sitting above both the \$20 million O.I.L. retention and the \$250 million limit. The key thing here is that the wording here is typically used for physical damage coverage only when BI or LOPI is not purchased.

If we continue to review Form A, we see pure excess wording. It sits above the O.I.L. limit, and so it responds above \$270 million. In this case, the coverage gap would be \$125 million for the Katrina loss, if the insured has a loss above \$270 million and the recovery from O.I.L. is fifty percent of limit. For example,

if they have a \$400 million loss, there's going to be a gap in coverage, as the excess will not start paying out until the claim reaches \$270 million. This excess wording typically is different, and not as broad as the O.I.L. wording, and from an adjusting standpoint, it creates problems and delays as we have to look at the excess wording and its coverage as stand-alone and then value the claim from zero dollar up to see if the claim actually will get into the excess layer, regardless of O.I.L.'s coverage. So you are basically adjusting two claims within the one claim.

Now moving to Form B. This is an improvement over Form A. Typically, this form follows the O.I.L. wording. This section insures the interest of the insured in property and control of wells arising out of the Insured's operations, all subject to the terms, conditions, and exclusions of the insuring agreements 1 and 2 of the Insured's O.I.L. insurance policy. We can also consider Agreement 1 and 2 in here. Agreement 1 is in the O.I.L. wording, its all risks of physical loss or damage caused by an occurrence to property of any kind, wherever located. Agreement 2 is: a. Sue and labor, b. Control of Well, c. Removal of Debris, d. Well restoration/redrilling. In this instance, we are working basically with an excess coverage policy but using the O.I.L. wording to define the claim presentation. Additional coverage is also provided as follows: in the event of the reduction or exhaustion of the aggregate limits of liability of the underlying O.I.L. policies, this section shall in the event of reduction pay excess of such reduced underlying or in the event of exhaustion, pay as primary insurance excess of the insured's O.I.L. deductible.

The next example is a summary of Form B, which is excess coverage sitting above O.I.L. limits for Physical Damage, Sue and Labor, Control of Well, and Removal of Debris. It provides coverage identical to the O.I.L. wording and responds to the O.I.L. aggregation limit exhaustion, all of the way down to the O.I.L. deductible. So if the O.I.L. member has a \$10 million deductible, and O.I.L. did not pay, paid zero dollars, this policy would drop all the way down to the O.I.L. deductible. It also recognizes that under the O.I.L. coverage, there are coverages, other than Agreements 1 and 2. There is an Agreement 3, which is legal liability arising out of seepage and pollution. So the insured's claim can erode the \$250 million limit, with other types of coverage, for example, a claim under O.I.L. Agreement 3, even though this policy has no coverage for legal liability. We typically don't see this wording where an insured wants to purchase BI or LOPI coverage.

The next policy, Form C, provides Marine and Non-Marine coverage, including Operator's Extra Expense. This form is similar to Form B, but it requires the insured to purchase the O.I.L. replacement cost wording, instead of actual cash value wording.

Moving to the next form. This form is identical to Form B, except it requires that replacement cost wording be purchased. It's a wrap-around policy with specific additional coverage beyond O.I.L. so it's broader than the second form I showed you. It's giving Excess and Difference in Condition, EDIC, coverages. And it typically provides broader coverage in the area of sue and labor, removal of debris, and making well safe coverages. So in this instance, when working with these two forms, the O.I.L. and Form C, we have to carefully segregate the claim costs. Most insureds are aware of the differences in the

coverages, and we work with them to put their claims in the proper baskets, one going to O.I.L. and the other going to the excess policy in an effort to provide them with the broadest coverage. The Form D is Excess of and Difference in Conditions Coverage, building on top of Forms B and C. This is what we typically will see attached to an insured's policy when they are interested in purchasing loss of production income, LOPI coverage, or BI coverage. Under this coverage, insurers will pay to the insured the expense incurred in order to either more expeditiously affect repair or replacement of items covered, and to restore production to platforms or fields from which production has been interrupted or reduced. The O.I.L. wording provides for physical damage coverage only. O.I.L. does not care how long it takes the insured to repair the damage. They do not pay overtime. They do not pay overhead, and O.I.L. has no interest in expediting repairs. It's just pure physical damage coverage for the loss.

Form D further broadens coverage in comparison to O.I.L. by providing indemnity on a replacement costs basis, or the actual or estimated costs of repair or replacement, whether or not actually repaired. This does not require the insured to actually repair the property. They will pay replacement cost or the estimated cost to repair. Under the O.I.L. wording, the insured must affect or start repairs within two years of the occurrence in order to receive indemnity on a replacement cost basis. For example, with the Entergy claim, there are a number of aspects of that claim where it's doubtful that repairs will commence within the two-year period. Under the O.I.L. wording, Entergy will only receive the actual cash value, ACV, for that property. This excess policy (Form D) would pay the difference between the ACV that O.I.L. pays and the replacement cost. This form also adds expediting and extra expenses, and is also a wrap-around policy. Commonly you will see deductible buy-back coverage included with this form.

So if you go to the next example, you will see that insurance can be rather colorful and complex. This is an existing package of policies, which apply to the insured's Katrina and Rita claims. It's a very complex placement. The business structure of this company is offshore pipeline transmission, offshore exploration, onshore production, refining, gas processing, with exposures throughout the Gulf States. Looking at the example on the left, the green box represents a total insurance placement of \$500 million, the risks the insured has transferred to the insurance markets. The quota share policy in green wraps around all coverages the insured has purchased. You see the little orange barrel in the middle; the insured is a member of O.I.L. with a \$250 million limit of liability, excess of a \$10 million retention. These other policies are various wrap-around policies, such as Form D we just discussed, all first having the benefit of the O.I.L. recovery. The problem we face in a complex placement such as this is that you will typically, as in this case, have certain underwriters that are only on one of the policies, say for example, the \$50 million onshore layer or maybe only on the \$250 million offshore layer, but not on the \$300 million onshore excess layer.

In the Katrina claim, we now have six files requiring six separate reports to the different policy layers. It's quite complex. Also, we are now essentially putting forth partial payments on account for the Physical Damage, BI and LOPI. Arguments among the underwriters have ensued because of the way

O.I.L. stipulates the method of erosion of the deductible. For example, O.I.L. is, of course, first dollar above the \$10 million deductible, but there is a deductible buy-back clause. There is \$7.5 million deductible buy-back coverage for all the primary wrap-around policies. Under the O.I.L. wording, the insured must use or claim their 100% owned properties first to erode their deductible. In this case, the insured's offshore properties are all at 100%. And most all of their onshore properties are at something less than 100%. So in order to erode their \$10 million deductible, the insured put the offshore claim in first. What that means for the people paying the \$7.5 million above \$2.5 million on the buy-back, is the offshore underwriters are picking all of that up. And they feel that the onshore insurers should share in a portion of the \$7.5 million deductible buyback claim. When we put the payment on account forward to the offshore group of insurers, we advised them to make the payment on a "without prejudice basis," as their overall exposure is much greater than the payment on account, and we can't calculate the proportions between the various policies until the full claim is determined. We still had some underwriters object and reduce the payment on account on a without prejudice basis.

Now moving to the next example, there is the claim I was just speaking about. It is our estimate of the Katrina claim exposure calculation sheet for the onshore capped at \$50 million. In this case, the total is essentially a \$76.5 million claim for onshore. We can outline the offshore claim, adding an additional \$20 million for a total combined claim of \$96.5 million. So you can obviously see why the offshore underwriters think the onshore underwriters should share a little more of that first \$7.5 million. We accounted for the portion of the claim to be covered by O.I.L. In this case, the onshore physical damage is shifted to the O.I.L. layer, yet the BI/CBI remains with the excess onshore underwriters. After moving the \$23.5 million to O.I.L., the onshore insurers up to \$50 million essentially have a \$53 million onshore claim after retention. So the onshore underwriters have capped their loss at \$50 million.

Now the onshore policy layer excess of \$50 million would appear to have an exposure of \$3 million. But in this case, the \$23.5 million going to O.I.L. will be paid at potentially fifty percent; that means an \$11.75 million shortfall, and taking into account an additional fifteen percent difference in conditions coverage results in a total of an additional \$15 million to the onshore layer above \$50 million. Their claim has increased from \$3 million now to \$18 million because of the O.I.L. aggregation situation. Now, looking at the quota share policy, they originally had a net exposure of \$65.5 million. However, we estimate off to the right, now due to the O.I.L. shortfall adds an additional \$19.5 million, resulting in an \$85 million claim to the quota share underwriters.

This shows the complexities of these claims and the various factors involved in the claim adjustment process. As adjusters, we are here to be the mediator, or moderator, between two parties to a contract of insurance, in order to reach a successful resolution of the various issues. Claim adjusting is about communication between underwriters, brokers and the insured; interpretation of policy language; intent of the policy language; accuracy of the reported information within the policy, reality of the income loss situation, reasonableness of what is expected; and indemnity for the actual loss sustained. In the realm of energy insurance, we find in general both insurers and insureds to

be reasonable people. They realize they have a potential for a long-term relationship. We find that they will work together and can be very flexible. And we try not to see everything in black and white.

The next example is a true story about communication and interpretation. The cause of loss was reported to underwriters as follows: 300-pound pig breaks free, travels 100 yards, striking a 58 ton bulldozer; bulldozer is a total loss. Of course, we got a few phone calls from underwriters. How does a 300-pound pig destroy a 58-ton bulldozer? What happened here was a twenty-four-inch pipeline in Michigan was being laid. They were running a pipeline pig using air compressors to scrape all the slag off of the welds inside. It got stuck. It broke free. It went through the catch timbers and traveled a hundred yards in the air striking the caterpillar bulldozer's frame totaling the caterpillar. It was quite humorous to hear some of the comments coming from underwriters.

We'll talk a little bit about direct and contingent business interruption and loss of production income insurance. As I said in the beginning, over the last four years attempts have been made to simplify the formulas for these types of claims. Initially, offshore BI was fashioned after non-marine wordings where you have to account for non-continuing expenses, actual loss sustained, measure of recovery, and analysis of post-repair production levels. This made the claims very time consuming. The offshore industry does not typically keep as detailed records as, let's say, a refinery. They group or commingle production from numerous production facilities. Every platform is different. The working interests are different. Production is always on a decline. All of these factors made for a very time-consuming claim adjustment. Since the hurricane Lili policies, we have come a long way.

Now what they have done is incorporate a schedule for fixed and agreed production volumes. Meaning, the insured has put together a schedule of what they know the daily production to be from that field or the well. And then they also scheduled the fixed and agreed commodity prices. So, it is fairly simple, and it has improved the speed and efficiency of the claim adjustment process.

We handle a great number of LOPI and BI claims throughout the world, and on the scheduled pricing we see two schools of thought. We have numerous insureds that will price their production to recover their ongoing costs or just breakeven costs. The production will eventually be recovered and they will earn the revenue. The second is that the commodity prices are based on current market prices over the course of the interruption period, or somewhere in between these two methods. We have seen insureds price a barrel of oil as low as five dollars, which is their cost of continuing expenses. When coverage is provided for market value, it's more time consuming to adjust, as you have to monitor the market price over the course of the interruption period. You have to record the daily prices and build those into your claim model for calculations. You have to forecast prices in the future when you set claim reserves, based upon the time you think it will take to return the operation to producing status.

Contingent LOPI schedules also have been attached to the policies. The insureds schedule all third-party properties that could affect their production such as other platforms, pipelines and gas processing facilities or refineries. If they have not named the contingent property in the schedule, then they will not have coverage for contingent BI. In the past, there was no schedule of how

various production streams were interconnected. A great deal of time and work has gone into it from the Lloyds market adjusting community to identify all of the interconnected property in the Gulf of Mexico. So it's an important thing for risk managers to review these schedules to see if any of these contingent properties have changed hands or changed names, so when a claim occurs, the adjustment process is not delayed because of issues surrounding the correct location or name of the property. These policy changes have simplified the adjustment process, but it has not solved all of the issues, and they have created some new issues.

The largest issue we run across is the inaccuracy of scheduled production volumes. It sounds simple. Well, it's not simple. For example take a typical loss of production income policy. The limit of liability is \$200 million. The deductible is excess of sixty days. The period of indemnity is 365 days, commencing on date of exhaustion of the waiting period. The coverage is to pay the insured fixed and agreed daily amounts scheduled for each day of the loss of production, excess of the waiting period. Partial interruption of income is defined as: pay difference between actual barrels of oil, or MCF of gas being produced, times the fixed and agreed commodity prices and the fixed and agreed daily amount. Under policy conditions, liability shall cease when physical loss or physical damage is repaired to the extent wells can be placed on production at an amount equal to or greater than agreed daily production volumes. Well, agreed daily production volumes are the ones that the insured gave the underwriters in their schedule.

Taking a production graph of one well of many in this claim we can see the gas is in red and the oil is in green. When the insured was performing the risk evaluation, in order to schedule production volumes, it was back during the time period of January 1 of 2005. So the red dotted line and the green dotted line are the scheduled gas and oil volumes in the policy. As you can see, the well is on decline, as most wells are. And, if we look at the claim, we see there was sixty days, plus about ten days after that, before they came back on production. So essentially, they have gone beyond the waiting period. And in that ten-day period they had about a \$2.4 million loss on this one well. Now, if we read the policy wording, they're repaired and back up and operating post-Rita, which you would think is simply the end of the loss period. But it's not if you read the wording. The wording says: Partial interruption of income is the fixed and agreed daily pricing, less any oil or gas actually produced. So in this case the value is the difference between the dotted lines and the actual production (bumpy lines) after the loss. They have a 365-day indemnity period. So for the next 365 days, they will never get back up to the scheduled volume. They were not even near the agreed scheduled volumes to begin with at the time of the loss. And this is happening over and over. It goes back to the accuracy of the information in the policy and how it can affect the loss. In this case, we based the claim on actual production lost during the ten days extending beyond the waiting period. We are hopeful the insured will be reasonable and can see that they are fully repaired, up and operating, and received their actual loss sustained. The difference on this one well alone, if you were to carry out the loss for the remainder of the period of indemnity, is \$10 million. Of course, it's income they

never would have received. It's not true indemnity to have a windfall. Thank you, and I hope you have some questions later.

MR. GEARY: Judy Barrasso will now discuss legal issues.

MS. BARRASSO: I'm at the end of the food chain. After the insurance has been obtained and there has been a loss, and Bill has adjusted the claim, we end up in litigation, sometimes. And what I am going to talk about a little bit is what claims and litigation we have seen, and then a little bit about Entergy's insurance claims.

In the legal arena, what we are seeing is lots of litigation since Hurricane Katrina hit thirteen months ago. And it's really been a blame game going on, where everybody—meaning people who have suffered damages, companies that have suffered damages—is running around and trying to sue whoever they can, and we haven't yet seen it all. There hasn't yet been just a deluge of commercial suits or even suits involving the energy industry. And I'm attributing that to the good adjusting that is going on and the cooperation of the parties. Also, the statutes of limitations in most of the commercial policies are more than one year. So I think the companies are not fearful, like many of the homeowners were, that they had to file by August 29, 2006.

What claims have we seen? There are some claims out there for business interruption. There are lots of claims, unfortunately, against brokers. In the claims that we are seeing against the brokers, the plaintiffs are saying that you didn't tell me what was available, particularly in terms of flood and excess flood. You didn't tell me I was underinsured. You didn't tell me to go get enough insurance. And the other thing that we have seen so far, and this has really come up in the nature of fights about removal and remand, is a lot of brokers and agents are being added in suits primarily to try to keep them in state court. So the fight about whether the claim lies against the broker or agent has been so far in the remand context. And several federal judges here in the Eastern District have held that there is no claim against the broker for failure to advise of what may be out there in the market, or failure to advise that you're underinsured, which is good news for brokers. And also, courts have held that a lot of those claims are already time-barred under the strict statutes that we have here in Louisiana, where you have to bring a claim against a broker within one year of the alleged wrongful act or three years at the outermost. And our judges are saying that the insured is deemed to know what they have in their policy, whether they have read it or not. So if they are complaining, for example, that the broker didn't tell them that they did not have excess flood insurance or flood insurance, or telling them that they were underinsured, the courts have said all you have to do is look at your policy to know that that issue was there. And if more than a year has passed, they said there is not a claim against the broker or agent. I think we'll see all of this evolve as we go forward and actually have cases dismissed. And we will see more artful pleadings, if you will. As the judges decide one argument, we will have a whole new round of arguments.

The other kinds of suits that we are seeing are class actions filed against the oil and gas industry. *Barasich v. Columbia Gulf Transmission Company* was

kind of the lead case here in Louisiana in the Eastern District.⁶ And in these class actions, plaintiffs attempt to blame the oil and gas companies for the property damage that was suffered by everybody in Louisiana due to the increased storm surge. The plaintiffs in *Barasich* were nine individuals who were from various parishes, St. Bernard, Orleans, and Jefferson, who suffered property damage as a result of Hurricane Katrina. But they wanted to represent anybody, persons, companies, anybody who suffered property damage as a result of the storm surge. And what they said was the enhanced impact of the hurricane winds and storm surge was a result of the wetland loss, which they claimed was attributable to the oil and gas industry's exploration and production activities.

The named defendants were several oil and gas pipeline companies which dredged canals in south Louisiana or installed the canals. And there were several of them named. And then they had the defendant class of everybody else. Then the next group of defendants were the exploration and production class. Several companies ranging from ExxonMobil to BP, who I represented, to Shell to Chevron were named as defendants, because they had drilled for oil and gas in the marshes of south Louisiana and/or had dredged access or pipeline canals in the area. And again, the plaintiffs wanted to go forward and have a defendant class of everybody who had ever drilled out there. And this wasn't limited in time, or really location, other than south Louisiana. The allegations were a little frightening, certainly for the defendants. Again, these were defendants who had allegedly dredged pipeline canals and access canals in the marshes of southeastern Louisiana. And it was no more specific than that, which I think in the end was probably helpful to our situation. The petition alleged or the plaintiff alleged that, overtime, the canals had eroded and continued to expand; developed breaks in the spoil banks; and became much larger than originally permitted and dredged. They also argued that the canals altered the hydrology of the marshes by the intrusion of saltwater that was leading to increased erosion. They complained that the defendants, all of them, had knowingly failed to maintain the canal within the banks, and had allowed saltwater intrusion which caused the canals to expand and upset the whole ecological function of the marshes, which again was stripping away the hurricane protection that the marshes and wetlands provided. They specifically alleged that, as a result of negligent oil and gas pipeline operations, over one million acres of marsh property had been destroyed, which was depriving the New Orleans area and the area that was hit by Katrina of its natural protection against hurricane winds and storm surges. And they continually referred to the saltwater intrusion. And in addition to alleging negligence in failing to maintain the canals, they also threw in there that just the presence of these canals themselves was now disrupting the natural processes and causing this erosion and loss of wetlands. And again, there was no limitation of time in their complaint, and these canals had been dredged for fifty years or more. Then they finally alleged that defendants' oil and gas pipeline canals are a—if not the—substantial cause of marshland loss in southeastern Louisiana and the damages resulting therefrom. And that was the basis of the complaint.

6. *Barasich v. Columbia Gulf Transmission Co.*, Nos. 05-4161, 05-4569, 2006 WL 3333797, at *1 (E.D. La. Sept. 28, 2006).

Plaintiffs were seeking—again, it’s very broad—class action status to represent any property owner who suffered damage. They wanted all damage, which would be all property damage, suffered by the folks whose property was hurt by the storm. But in addition, they were asking for restoration costs, which we understood to mean whatever it would cost to restore the canals to their natural state, plus legal interest and anything else the Court may see fit. So in looking at this from a defendant company’s perspective, it was a very scary proposition. On the one hand, it was interesting talking to people who read this. On the one hand folks said: “this suit is kind of a joke.” People were laughing and saying “they can’t really mean it.” But on the other hand, the plaintiffs did mean it, and they would stand up in court and say we have experts that are prepared to come in here to support everything that we have alleged. And there are plenty of books floating around out there. And the companies, they were facing pretty substantial damages if this suit continued on.

In response, a Motion to Dismiss was filed right off the bat. The motion basically asserted two grounds. And there were interesting debates about the two grounds. The first argument was a political question argument. It is something that I heard about in law school, and I don’t think I have ever been in a case where we were actually arguing it, and the judge made that comment several times herself. But there are cases out there, and we felt it was definitely supportable, and this was within the arena, and we felt that it was on very solid ground. In fact, many of us thought this was the better ground. And the argument is that when something has really been relegated to either the executive or legislative branch of the government, the Court shouldn’t get involved in trying to decide it. And what we argued here was that this situation where the federal government, for decades, from the beginning, has been intimately involved in directing development of the Mississippi River, particularly, and now more recently in coastal Louisiana, this is that kind of situation. And we went back to almost the beginning of this country where you had statutes, you had a Commerce Act, and you had these statutes which had Congress being so involved in enacting laws talking about how the law was going to regulate navigable waters of the country. Of course, we have the Corps of Engineers involved in all of this. The oil and gas canals have always been subject to permitting and comprehensive regulation. Before a canal can be dredged, the Corps has to approve it. They have to go through their own procedure to decide what the impact is, and they do that within guidelines that Congress has set up in regulations. And in addition to all of that, the federal government certainly is heavily involved in regulating the development, particularly of offshore oil and gas leases. The government sets the sale of the leases. Before they do that, they have to do all kinds of environmental impact statements and all kinds of other environmental reports. And right now, we are in litigation with Governor Blanco of Louisiana who brought suit against the Department of Interior to stop the oil and gas lease sales, saying that they didn’t do enough of an environmental analysis to let those sales go forward.

So the argument that was made in *Barasich* was that given the federal government’s particularly heavy involvement or substantial involvement in the regulation and management of the Mississippi River and the offshore drilling and the coastal wetlands, that this was clearly a political question doctrine case

which should not be decided by the Court. And the other argument that was made, and is a factual one, is that now we have the Breaux Act, which now that Congress has jumped into the whole restoration issue itself and set up an elaborate—well, it hasn't gone forward yet. But they have plans of how they are going to go about restoring the coastland. So that was laid out for the judge, and many of us thought that was really the ground that we were going to prevail on.

The second ground simply was that the complaint failed to state a claim under Louisiana tort law. And even though they had alleged negligence, they did not really allege and could not ever prove that these defendants owed a duty to protect the property owners who were damaged by Hurricane Katrina from that type of harm. And that the plaintiffs who lived in the New Orleans area were not connected enough in time and space to the defendant oil and gas companies who had performed these activities for fifty years throughout southeast Louisiana. And it posed the general question of: What is the duty? Was the duty imposed on these defendant oil and gas companies to protect these plaintiffs, again, who suffered Hurricane Katrina damage from this type of harm in this manner? In addition, the argument was made that the plaintiffs haven't alleged and cannot ever allege and prove the requisite element of legal cause. And again, this went back to the time and space argument that they would never be able to show that a defendant oil company's actions in dredging a canal in 1950 way down in Plaquemines Parish was what caused the damage after Hurricane Katrina. In addition, because plaintiffs had thrown in claims under Louisiana Civil Code Article 667⁷ and Article 2315,⁸ the argument was made that there can be no claim under those Articles. Article 667 deals with the duty you owe to your neighbor. The argument generally was made that those aren't neighbors. Again, somebody dredging down in Plaquemines Parish is not a neighbor of somebody in the New Orleans area. And then finally, the argument was made: look, you just can't have this kind of case with no individual plaintiff saying that that is the person that injured me, just this kind of industry group, market share type situation.

Just a couple of weeks ago, Judge Sarah Vance granted the Motion to Dismiss. So that's a sigh of relief. Judge Vance did that under the Louisiana tort law argument. She held that the plaintiffs had not stated a claim under Louisiana tort law, or really under any Louisiana law. And after going through a twenty-seven-page analysis on the political question doctrine, in which I think she probably addressed every case there was, she decided that the plaintiffs' claims did not fall within the political question doctrine. She concluded that the political question doctrine is reserved for situations involving foreign countries and things that implicated a national interest. She relied heavily on a Fifth Circuit case, which had rejected the political question argument, but only included a single canal. That is the way we distinguished it. So Judge Vance went off on Louisiana tort law and made some conclusions. Under Article 667, you can't have a claim unless it's really a neighbor. And a neighbor can't be somebody who is physically remote from you, that is hundreds and hundreds of miles away. And then she found, as a matter of law, that the plaintiffs could never prove that these defendant oil and gas companies owed a duty to these

7. LA. CIV. CODE ANN. art. 667 (1980).

8. LA. CIV. CODE ANN. art. 2315 (1980).

plaintiffs to protect them from this kind of harm. Or, that these defendants' conduct, which dated way back in time and far away in space, actually caused these plaintiffs injuries. She flatly rejected the notion that you can have this market share group theory of liability and that you can just lump everybody together and try to go forward. For the same reasons, she felt they couldn't just state a general tort claim under Louisiana Civil Code Article 2315. Notably, she relied on the Louisiana Supreme Court decision in *Terrebonne Parish School Board v. Castex Energy Inc.*⁹ In that case, which was between a lessor and a lessee, the Louisiana Supreme Court rejected an argument that the lessee was liable. The court specifically noted that if the contract or the lease didn't impose that obligation on the mineral lessee, the Court wasn't going to do that as a matter of general tort law unless the lessee's conduct was unreasonable. And there was no allegation here that this was at all unreasonable. Finally, she went back to just the failure to be able to link damage from an individual plaintiff to a defendant.

Interestingly, the Court specifically acknowledged a serious, serious problem with the loss of wetlands and coastal erosion, and raised the question that maybe left the door open for, perhaps, another type of suit. She suggests specifically that perhaps a more focused, less ambitious suit, probably focusing on somebody specific, who was proximate in time and space to the plaintiff, would withstand a Motion to Dismiss and stay in court.

At the moment, we don't know yet if the plaintiffs are going to appeal. We haven't heard from them. They have a couple more weeks to make that decision. They haven't moved to do anything in her court.

There is another suit that I call a copycat suit that was filed about three or four weeks ago, probably August 29th, that copies exactly these pleadings, which is also in Judge Vance's court. We all presume that that one will also be dismissed. Another suit, *Comer v. Nationwide Insurance Inc.*, had been filed in Mississippi right after Hurricane Katrina swept in.¹⁰ And this was another wide-ranging, broad, kind of scary suit. And in this one, the plaintiffs alleged that the oil and gas industry, naming specific companies, had caused all the property damage in Mississippi, because their operations resulted in emissions of greenhouse gases and caused global warming, which caused the hurricane winds to be stronger and the storm surge to be greater than it otherwise would have. In this case, Judge Senter, who is dealing with a lot of the hurricane cases on the Mississippi Coast, he on his own, in dealing with a preliminary issue, noted that the plaintiffs would face daunting evidentiary problems in this case to try to prove that these defendants caused global warming. And he has a whole litany of things that they would have problems with. But the plaintiffs are undeterred.

I briefly want to talk about and touch upon some issues with Entergy of New Orleans. This information is from Entergy's disclosures, primarily the bankruptcy proceeding, or in their public filings. There is no litigation; they are still adjusting the claim. Hopefully there won't be litigation. I want to point out, I got a letter—as most people here probably did, who live in New Orleans—yesterday from Dan Packer, in which he is writing to us telling us what Entergy

9. *Terrebonne Parish Sch. Bd. v. Castex Energy*, 893 So. 2d 789 (La. 2005).

10. *Comer v. Nationwide Mut. Ins. Co.*, No. 1:05 CV 436 LTD RHW, 2006 WL 1066645, at *1 (S.D. Miss. Feb. 23, 2006).

is doing. And in his letter, he notes that Entergy has approximately \$250 million of damage, which will be covered by insurance in Entergy's view. And then he goes on to talk about their quest to get some community development block grant funds. But in their filings and in their pleadings, and I think everything we have all seen, we all know that Entergy claims that it suffered a lot more in damage than the \$250 million he said is going to be insured. It could be over \$500 million, depending upon whose numbers we are looking at. Entergy's insurance program is not unlike the one Bill talked about. They had a primary layer through O.I.L.'s insurance program of \$250 million. And as Bill mentioned, O.I.L. has now said it's enforcing the aggregate limits, and they may only get fifty cents on the dollar at the end of the day, which means they would have only \$125 million of primary coverage. And the O.I.L. policy, again, only covers property damage, no business interruption. And it does specifically exclude the electrical transmission or distribution systems. And Bill is that 1,000 meters?

MR. ROTHHAMMER: 1,000 meters from the substation.

MS. BARRASSO: So we are missing a zero there. And as we said, O.I.L. has announced that it is going to apply the aggregate cap. So far, it's being predicted, or they may have said, it's going to be a payment of fifty cents on the dollar. And these excess policies that Entergy has do not have the language that would suggest that they are going to drop down. So there may be a big gap in coverage. They do have excess coverage and there are two policies, one from Underwriters at Lloyds and the other one is from a subsidiary of AIG. And these policies provide in the aggregate, \$150 million per occurrence, and have an annual aggregate of flood loss for \$150 million, again, according to Entergy's filings. Again, there is no litigation going on with Entergy, and communications are continuing, and hopefully it will all be resolved. Entergy is in a situation, as has been reported here today, of having just suffered huge losses and not having enough coverage, and obviously, looking for relief from various sources, including the federal government or the community development block grant funds. So that concludes my presentation. Thank you.

MR. GEARY: I'm sure people are getting hungry. But any questions for any of our speakers? Yes.

MR. HAMPTON CARVER: What is a CAT bond?

MR. ROBERTON: It's a marketing instrument used by a lot of reinsurers right now. They go into the capital market instead of the reinsurance market and buy a bond which responds to either one or several different traders. And if that trigger happens or triggers happen, then it pays. It's an insurance policy. But it's a capital market provided protection, instead of an insurance market provided protection. You buy it like you would buy any other type of bond.

MR. HAMPTON CARVER: Who issues it?

MR. ROBERTON: There are a variety of providers out there. Basically, some of the household names: JP Morgan, et cetera. There are also CAT bonds that are provided by insurance companies: AIG or the major providers. It's a capital market fund.

MS. BROWN: I want to thank our speakers who have come a long way to join us and have done a miraculous job explaining a very complex topic. I would like to thank all of you for coming and I thank the Jones Walker law firm

for hosting us today. For any of you that are not EBA members, it is an organization that is open not only to attorneys, but also non-attorney professionals in the energy industry. The EBA has seminars like this all over the United States. They publish the *Energy Law Journal* twice a year. Thank you for coming today.