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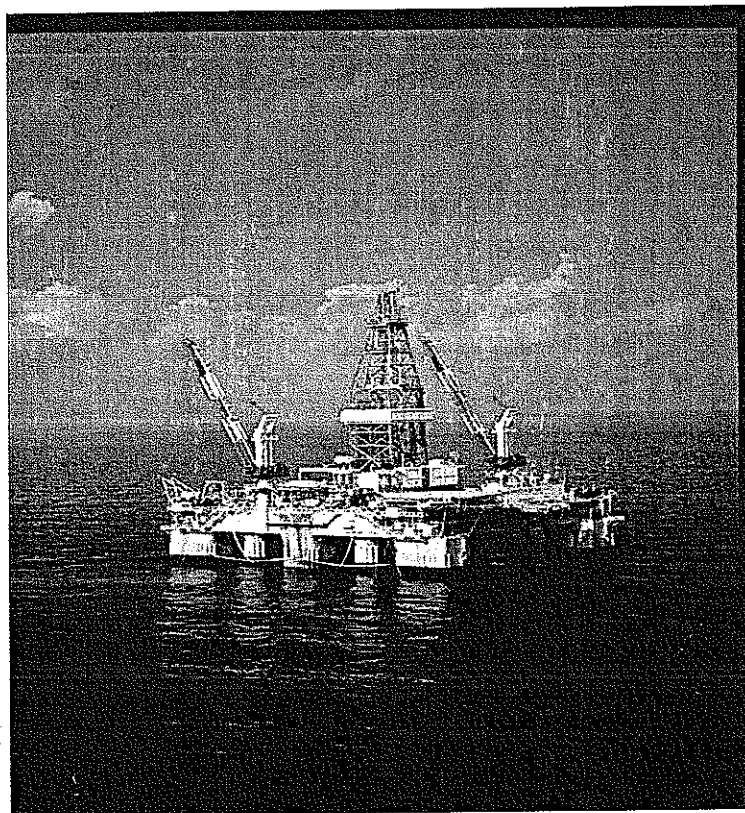
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# OIL, GAS AND ENERGY RESOURCES



# SECTION REPORT

OFFICIAL PUBLICATION OF THE OIL, GAS AND ENERGY RESOURCES LAW SECTION OF THE STATE BAR OF TEXAS  
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# AFTER THE STORMS: IMPORTANT INSURANCE CONSIDERATIONS FOR THE ENERGY INDUSTRY FOLLOWING HURRICANES KATRINA AND RITA

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## Introduction

Hurricanes Katrina and Rita caused immense devastation to both life and property in the Gulf Coast region. Though the damage inflicted by these storms was widespread, the energy sector in particular suffered heavy losses to key assets and the revenue streams generated by those assets. While conditions are improving, numerous challenges lie ahead as the industry continues to repair and rebuild in the aftermath of these catastrophic events. Fortunately, many energy companies have insurance coverage available to assist them during the recovery process. This article is designed to present an overview of some important considerations for assessing, preserving and maximizing the insurance claims that arise from these storms.<sup>3</sup>

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<sup>3</sup> We concentrate mainly on first-party property losses instead of third-party liability claims, though both have arisen in the wake of these natural disasters. Because of our focus, it

Section I of this article will begin by describing these storms and their specific impact on the energy industry. In Section II, a brief review of some insurance fundamentals, both generally and for the energy sector in particular, is presented. Treatment will also be given to some specific energy policy provisions in order to analyze these issues in context. Section III provides a discussion of how to assess the available coverage, how to preserve it, and how to maximize the potential recovery. Finally, Section IV of this article concludes with some practical ideas that will hopefully help to protect the industry against losses from future storms.

## I.

### The Hurricanes and Their Aftermath

Katrina has been tagged as the costliest catastrophe in the history of America.<sup>4</sup>

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is crucial to note that first-party policies are much more likely to vary between one policy and the next. Sometimes these variances can be significant and often such policies contain one-of-a-kind manuscripted endorsements. Consequently, this article identifies key issues that are likely to arise in most cases, though the insured should carefully study its specific policy in order to determine the impact of these issues in any individual case. Note also that, since this article is being written for the Journal of the Oil, Gas and Energy Resources Law Section of the State Bar of Texas, we concentrate on Texas law throughout this paper. Many concepts are fairly standard from jurisdiction to jurisdiction, but there are variances on occasion. Thus, the law applicable to a given insurance problem should be checked carefully in order to be sure of the correct rule.

<sup>4</sup> *Preliminary Estimate Puts Insured Losses From Hurricane Katrina at \$34.4 Billion: ISO Property Claim Services*, available at: [http://www.iso.com/press\\_releases/2005/10\\_04\\_05.html](http://www.iso.com/press_releases/2005/10_04_05.html) (last visited Nov. 12, 2005). Other estimates have reached as high as \$40 to \$60 billion in insured losses, and more than \$125 billion in total economic losses. Rupal Parekh, *Katrina Insured Loss as High as \$60 Billion: RMS*, available at <http://www.business>

Simply considering the magnitude of the destruction these storms left in their wake is mind-boggling. To discuss it in terms that give full appreciation for these losses is difficult to do well, if at all. Nevertheless, this section will describe the storms generally, and then focus on some of their lasting impacts.<sup>5</sup>

1. **A Brief Review of These Hurricanes and Their Impact in General Terms**

Hurricane Katrina began as "Tropical Depression Twelve," forming over the Bahamas on August 23, 2005.<sup>6</sup> The next day, it became Tropical Storm Katrina. The day after that it became Hurricane Katrina and made landfall in southern Florida, causing relatively minor damage.<sup>7</sup> It then began to barrel through the Gulf of Mexico. On August 26, the National Hurricane Center predicted it would strike the town of Buras, Louisiana.<sup>8</sup> On August 28, Katrina became a Category Four hurricane. Less than seven hours later, it reached Category Five.<sup>9</sup> The next morning, Katrina came ashore with 145 m.p.h. winds. Hurricane force winds extended outward 120 statute

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insurance.com/cgi-in/news.pl?newsId=6286&print=Y (last visited Sept. 9, 2005).

<sup>5</sup> Katrina had such an impression on some members of the media that the storm was nominated for Time magazine's "2005 Person of the Year." See *Can Katrina be Time's Person of the Year?*, available at <http://www.msnbc.com/id/10048523/print/1/displaymode/1098/> (last visited Nov. 15, 2005).

<sup>6</sup> *Hurricane Katrina Timeline*, available at [http://en.wikipedia.org/wiki/Timeline\\_of\\_Hurricane\\_Katrina](http://en.wikipedia.org/wiki/Timeline_of_Hurricane_Katrina) (last visited Nov. 13, 2005).

<sup>7</sup> *Id.*

<sup>8</sup> *Id.* This prediction was off by just 18 miles. Three days after this forecast, Katrina made landfall just outside of Buras.

<sup>9</sup> *Id.*

miles, battering Louisiana and Mississippi.<sup>10</sup> Katrina then made a third landfall a few hours later near Pearlinton, Mississippi, packing winds of 125 m.p.h. After Katrina passed, things began to worsen as the levees protecting New Orleans started to fail.<sup>11</sup> At this point, the world watched while the media provided constant coverage of conditions in New Orleans as they continued to deteriorate.

Less than one month later, on September 24, Rita came ashore at the border between Texas and Louisiana.<sup>12</sup> A Category Three hurricane at the time, it had winds of 120 m.p.h. and a storm surge of ten feet.<sup>13</sup>

President Bush called Katrina one of the greatest natural catastrophes ever to hit the United States.<sup>14</sup> When the two storms are taken together, they are, from property and economic points of view, the greatest natural disasters ever. In terms of lives lost, Katrina's official death toll stands at 1,302.<sup>15</sup> Of course, several other hurricanes have inflicted larger casualties.<sup>16</sup>

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<sup>10</sup> *Hurricane Katrina*, available at [http://en.wikipedia.org/wiki/Hurricane\\_Katrina](http://en.wikipedia.org/wiki/Hurricane_Katrina) (last visited Nov. 13, 2005).

<sup>11</sup> *Id.*

<sup>12</sup> *Hurricane Rita*, available at [http://en.wikipedia.org/wiki/Hurricane\\_Rita](http://en.wikipedia.org/wiki/Hurricane_Rita) (last visited Nov. 13, 2005).

<sup>13</sup> *Id.*

<sup>14</sup> The President apparently contemplated invoking the federal Insurrection Act, so he could send in troops without state and local consent. See 139 U.S. NEWS & WORLD REPORT, Sept. 26, 2005 at 38; see also "Now the Rebuilding Begins," 376 THE ECONOMIST, Sept. 17, 2005 at 29.

<sup>15</sup> "Hurricane Katrina," available at [http://en.wikipedia.org/wiki/Hurricane\\_Katrina](http://en.wikipedia.org/wiki/Hurricane_Katrina) (last visited Nov. 13, 2005).

<sup>16</sup> KERRY EMANUEL, DIVINE WIND: THE HISTORY AND SCIENCE OF HURRICANES (2005). The author is a Professor of Earth, Atmospheric, and Planetary Science at MIT. Support for the

More than five hundred thousand jobs have been lost due to Katrina and Rita.<sup>17</sup> New Orleans restaurants are just now—circa mid-November—beginning to reopen. Many Mississippi casinos were completely destroyed, as were many hotels along the coast.

Total insured losses from Katrina alone were conjectured to be at \$35+ billion, and this was done within a week of the storm hitting.<sup>18</sup> Rita has added to that number in substantial ways, and storm-loss estimates tend to rise over time. By early October, the Katrina-caused insured losses were estimated at \$40-\$55 billion.<sup>19</sup> Uninsured losses will at least double the above numbers.

## 2. The Hurricanes' Impact on the Energy Sector

Losses in the petroleum industry were also enormous. Almost two months after Rita made landfall, 51% of the oil production and

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assertion for which this is a footnote may be found throughout the text, but there is a table as Appendix I, which is a table entitled "Notable Tropical Cyclones," i.e., hurricanes, and it lists a number of large casualties. *Id.* at 262-266. The 1900 Galveston storm was the worst in this country, with eight thousand to twelve thousand deaths while the 1970 storm in Bangladesh was the worst, in recent times anyway, with an estimated five hundred thousand fatalities.

<sup>17</sup> Martin Crutsinger, *Buying More, Selling Less*, HOUSTON CHRONICLE, Nov. 11, 2005 at D1, D4.

<sup>18</sup> David Lenckus & Mark A. Hofmann, *Katrina Ravages Coast*, BUSINESS INSURANCE, Sept. 5, 2005 at 1. See Ellen Kelleher, *AIG Estimates \$1.1bn Loss After Katrina*, FINANCIAL TIMES, Sept. 21, 2005 at 19.

<sup>19</sup> Lavonne Keykendall, *Katrina Will Dig Deep Into Insurers' Pockets*, WALL STREET JOURNAL, Oct. 8, 2005 at C3. This number tops 1992's Hurricane Andrew, and it does not include Rita.

45% of natural gas production in the Gulf remained off-line.<sup>20</sup>

Katrina shut down a large number of Gulf Coast refineries, oil production on land near the Gulf, production in the Gulf, and shipments coming into the country through the Louisiana Offshore Oil Port. The region produces 1.5 million barrels of oil and ten billion cubic feet of natural gas a day. As everyone knows, energy costs jumped in the weeks following these storms.

Some oil platforms off the coast sustained severe physical damage. A few of them floated away; most have been found though some have not. One oil platform in the making broke loose in dry dock and smashed into the Cochran-Africatown USA Bridge over the Mobile River in Mobile, Alabama. There has also been substantial concern over the network of offshore pipelines, especially since it sustained substantial damage from Hurricane Ivan in 2004.<sup>21</sup> After Katrina, there were six serious oil spills. Rita brought at least four more.

Rita itself inflicted heavy damages. The Coast Guard has said that nine semi-submerged rigs broke loose from their moorings and were adrift. Rigs cost between \$90 million and \$550 million to construct, "depending on their sophistication and depth of water in which they will drill." It can take three years to design and build a rig, but only hours for a hurricane to destroy it.<sup>22</sup>

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<sup>20</sup> Tom Fowler, *Despite Storms, Work Continues on Gulf Oil Fields*, HOUSTON CHRONICLE, available at: <http://www.chron.com/cs/CDA/printstory.mpl/business/energy/3445778> (last visited Nov. 12, 2005).

<sup>21</sup> For a map of the pipelines, see THE ECONOMIST, Sept. 3-9, 2005 at 31.

<sup>22</sup> Carola Hoyos, *et al.*, *Rita Causes Record Damage to Oil Rigs*, FINANCIAL TIMES, Sept. 26, 2005 at 1.

In addition, Rita was in some ways worse than Katrina with respect to property losses, especially in the petroleum industry. Katrina destroyed 46 platforms and four rigs, as of October 2, 2005, while Rita destroyed 63 platforms and one jackup drilling rig as of that date.<sup>23</sup>

Rita also inflicted heavy economic losses: 23% of U.S. refineries lay in its path, and 16 were shut down in preparation for Rita; 605 platforms and 87 rigs were evacuated; and there were production losses of 1.4 million barrels of oil a day and six billion cubic feet of gas a day.<sup>24</sup> The Wall Street Journal remarked on September 22, 2005 that "[t]he energy industry has never seen anything like the 2005 hurricane season."

The impact on the insurance industry has been enormous. Oil companies in the Gulf of Mexico paid about five hundred million dollars in premiums for 2005. Insurance claims from the region are expected to be eight billion to ten billion dollars.<sup>25</sup>

Other ways of looking at insurer exposure are equally striking – some might even say shocking. In 2004, insurers paid \$27.3 billion for catastrophe<sup>26</sup> losses. This was an all-time record year. Unfortunately, it did not last long as the third-quarter of 2005 blew it away *all by itself*. That quarter *alone* saw catastrophe losses of \$40.8 billion.<sup>27</sup>

<sup>23</sup> David Ivanovich, HOUSTON CHRONICLE, Oct. 4, 2005 at B1.

<sup>24</sup> *Hurricane Rita: Paths of Destruction*, TIME, Oct. 3, 2005 (the pages used here were not numbered explicitly).

<sup>25</sup> Jim Armitage, LONDON EVENING STANDARD, Nov. 10, 2005 at 1 (the paper is quoting Charles Franks, a Lloyds underwriter).

<sup>26</sup> Losses from natural and man-made catastrophes are referred to in the insurance industry as "cat losses."

<sup>27</sup> See 150 press releases available at [www.iso.com/press/2005/02\\_09\\_05.html](http://www.iso.com/press/2005/02_09_05.html) and [www.iso.com/press/2005/11\\_07\\_05\\_2.html](http://www.iso.com/press/2005/11_07_05_2.html) (last visited November 9, 2005).

Thus, Q3 of 2005 accrued disaster losses at the rate of approximately \$444 million per day.<sup>28</sup>

Insurers are indicating that the price of energy insurance will have to go up, and insureds are expecting it. Unfortunately, the two storms came just before serious price negotiations for 2006 got under way.<sup>29</sup>

The same point applies to reinsurance for energy risks. Many reinsurers have taken substantial losses.<sup>30</sup> At least one carrier, Munich Re, has responded by increasing offshore premiums by four hundred percent.<sup>31</sup> Much like the price of crude oil affects the price of gasoline, as these pricing increases work their way down-market, the end result will be higher premiums for energy companies.

<sup>28</sup> These losses are so staggering that there is now talk of creating a federal catastrophe reinsurance program, similar to the one created for terrorist attacks after September 11. Allstate took out a full page advertisement in the New York Times, arguing that if San Francisco suffered an earthquake similar to the 1906 disaster, it could cost \$400 billion to rebuild the city as it stands today. NEW YORK TIMES, Nov. 14, 2005 at A7. This message is being urged not only by insurers. A fellow at the Brookings Institution is advocating a similar program. Mark A. Hoffman, *Feds Should Reinsure Major Catastrophes: Report*, available at <http://www.businessinsurance.com/cgi-bin/news.plnewsID=6719&print=Y> (last visited Nov. 14, 2005).

<sup>29</sup> Ulrike Dauer, *Oil-Rig Insurers Expect Price Jumps*, WALL STREET JOURNAL, Sept. 8, 2005 at A15.

<sup>30</sup> Patrick Jenkins, *Hurricanes Hammer Hanover Re*, FINANCIAL TIMES, Nov. 11, 2005 at 19.

<sup>31</sup> Patrick Jenkins, *Munich Re Lifts Oil Rig Rates 400%*, FINANCIAL TIMES, Nov. 8, 2005 at 22. See Ulrike Dauer, "Munich Re Offsets Storm Costs," WALL STREET JOURNAL, Nov. 8, 2005 at A10.

II.  
**Fundamentals of Insurance and Insuring  
the Energy Industry**

The proper handling of insurance issues in the energy sector, whether related to hurricane losses or otherwise, requires knowledge of both the insurance and energy industries, as well as the interplay between them. We will try to shed some light on that here. Accordingly, this section of the paper provides a review of some insurance fundamentals, both generally and for the energy sector in particular. A brief note before proceeding further is necessary. The losses sustained by those affected are too diverse to categorize. They are also too diverse to generalize. Therefore, we will not attempt to do so. Instead, we will provide a framework that can be used to handle any loss, and we will of course study some issues along the way that are likely to be important for claims arising out of Katrina and Rita.<sup>32</sup>

**A. Insurance – Some Core Concepts**

Reviewing how insurance works, how insurance policies work, and how to insure physical assets (such as a refinery) along with the revenue streams they generate is a useful exercise in light of the recent hurricanes, so we will start with that.

**1. The Nature of Insurance – Three Principles**

A good place to begin is by briefly examining three basic principles of insurance – fortuity, *contra proferentem*, and standardization. An understanding of these three concepts illuminates many other insurance issues.

**a. The Principle of Fortuity**

Insurance is the transfer of risk. The risks are essentially exposures to future harms and, therefore, the expenses and losses

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<sup>32</sup> As noted at the outset, we will emphasize property insurance since that is where much of the storm losses fall.

arising from those harms. Insurance policies are contracts, but:

Insurance is different. Once an insured files a claim, the insurer has a strong incentive to conserve its financial resources balanced against the effect on its reputation of a “hard-ball” approach. Insurance contracts are also unique in another respect. Unlike other contracts, the insured has no ability to “cover” if the insurer refuses without justification to pay a claim. [I]n a typical contract, the non-breaching party can replace the performance of the breaching party by paying the then-prevailing market price for the counter-performance. With insurance this is simply not possible. This feature of insurance contracts distinguishes them from other contracts . . . .<sup>33</sup>

This reflects the principle of fortuity.<sup>34</sup> According to this principle, only losses that are fortuitous from the point of view of the insured are insurable. In other words, most deliberate conduct of an insured that leads to an intended, or reasonably expected, economic loss for that insured is not insurable by the one who sustains it. Thus, one can insure against most fires, but not against one’s own arson. Further, one cannot insure against fires that either have occurred or are in the process of occurring.<sup>35</sup>

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<sup>33</sup> *E.I. DuPont de Nemours & Co. v. Pressman*, 679 A.2d 436, 447 (Del. 1996).

<sup>34</sup> A good discussion of this principle is contained in *Two Pesos, Inc. v. Gulf Ins. Co.*, 901 S.W.2d 495, 501-02 (Tex. App.—Houston [14<sup>th</sup> Dist.] 1995, no pet.).

<sup>35</sup> *Id.* More to the point for this article, one cannot insure against storm losses as the eye of the hurricane passes overhead.

**b. The Principle of Contra Proferentem**

Another fundamental principle is really a bedrock of contract law, but one that applies with special force to insurance contracts. It is the rule that all genuine ambiguities are to be resolved in favor of the insured.<sup>36</sup> This principle, stated differently, can be seen in the following passage:

[T]he objective of an insurance policy is to insure; courts should not construe policies otherwise unless the language clearly requires it.<sup>37</sup>

As long as the insured offers a reasonable interpretation, the rule applies even if the insurer's interpretation is more reasonable or where it is a more accurate reflection of the parties' intent.<sup>38</sup>

**c. The Principle of Standardization**

In order to price insurance correctly, insurers have to know about losses sustained by the relevant market, e.g., How many hurricanes have there been recently? What sorts of structures fare worst? Which ones fare best? And so forth. This is the

principle of standardization.<sup>39</sup> Insurers need to spread this data among themselves in order to maximize its adequacy. Furthermore, losses need to be categorized in standard ways so that data can be collected, kept, and shared. Some of that data has to do with the costs of losses and the costs of repairing, replacing, rebuilding, etc. The need for standard data virtually ensures that *standardized concepts* must be used in various policies. Standard concepts can be, most probably, maximally used for collecting, storing, sharing, and putting to economic use information only if there is also a widely used *standard vocabulary*. That is exactly the way the insurance industry works, and has worked, not only for decades, but for much longer periods of time.

As a consequence, the language of insurance policies is quite often much the same. This is part of the reason why many states require insurers, approved to do broad business in that state, to use standard forms for their policies.<sup>40</sup> Even surplus lines insurance carriers, i.e., carriers not licensed completely to do business in a given state, but often registered in a limited fashion anyway, use form contracts closely resembling the forms used by approved carriers. This is significant – even carriers that are not required to use standard forms very often do.<sup>41</sup>

Not all insurance contracts are comprised entirely of standardized forms. The bigger, more diverse, and/or more complex the business, the more likely it is that some

<sup>36</sup> See, e.g. *Barnett v. Aetna Life Ins. Co.*, 723 S.W.2d 663, 665 (Tex. 1987). It follows, then, that the "purpose of an insurance company is to indemnify its insureds." *American Home Assurance Co. v. Unauthorized Practice of Law Committee*, 121 S.W.3d 831, 845 (Tex. App.—Eastland 2003, pet. granted).

<sup>37</sup> *Warrilow v. Norrell*, 791 S.W.2d 515, 524 (Tex. App.—Corpus Christi 1989, writ denied)(citing *Goswick v. Employers Cas. Co.*, 440 S.W.2d 287, 289 (Tex. 1969)).

<sup>38</sup> *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Hudson Energy Co., Inc.*, 811 S.W.2d 552, 555 (Tex. 1991). In addition to this case, there is a long history of ambiguity in petroleum policies, dating back almost to the Civil War. See *Weisenberger v. The Harmony Fire and Marine Ins. Co.*, 56 Pa. 442 (Pa. 1867)(where it was decided that oil in barrels is not the same as oil in tanks and that lard oil is not the same as refined oil).

<sup>39</sup> A good discussion of this concept can be found in the Appleman insurance treatise. See 16 Eric Mills Holmes, APPLEMAN ON INSURANCE LAW & PRACTICE §117.1 (2d ed. 2000).

<sup>40</sup> The word "policy" in this context comes from an Italian word meaning "promise."

<sup>41</sup> All insurance policies should be carefully read – we will make this point several times in this article. But insureds should be extra careful to read surplus lines policies very closely – even more closely than other policies.

significant portion of the insurance contracts it buys will not be in a standard form.<sup>42</sup>

With these background concepts in mind, reviewing the basic structure of a typical insurance policy is a logical next step.

## 2. NAVIGATING THE COMPONENTS OF A TYPICAL POLICY

**THOUGH THERE IS SOME VARIANCE, AN EXAMINATION OF MOST INSURANCE POLICIES TYPICALLY REVEALS A FAMILIAR FORMAT WITH THE FOLLOWING COMPONENTS.<sup>43</sup>**

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<sup>42</sup> Sometimes business insurance policies are extensively non-standard—although almost never totally unique; these are called “manuscript” or “manuscripted” policies. As one can easily imagine, totally unique and therefore completely manuscripted insurance policies would be very expensive, since the insurer would have less, little, or perhaps no comparative data. In the not so distant past, some insurers tried to call standard insurance policies manuscripted policies by having them typed rather than printed. Such a marketing device was a way to increase prices while increasing the impression of something like personal attention.

<sup>43</sup> There are two other documents that are not part of the insurance policy, exactly, but which are closely related to it. One of them is the *policy binder*. This is a temporary insurance policy that is used as both a commitment paper and appropriate evidence until at least the declarations page is issued. The other is the *certificate of insurance*, which is a single sheet of paper issued to an insured by someone who has appropriate authority from the insurer—often a managing general agent or some other intermediary the insurer often deals with—stating that such-and-such type of insurance exists with this-and-that insurance, and stating that the number on the policy is #VMXYZMSQ. Contractors often need to provide such certificates to those for whom they are working, e.g., oil companies, and subcontractors often need to provide them to contractors. Sometimes those who have to turn over certificates of insurance provide policy binders, if they just acquired coverage, but they are not the same

### a. The Declarations Page

The declarations page is a roadmap for the policy, and it contains vital information. Usually, it identifies the named insured, the insurance company that issued the policy, the dates of the policy period, the types and amounts of coverage provided, and a schedule of forms. Listing the forms that should be attached to the policy allows the reader to determine if the policy is complete.<sup>44</sup>

### b. Insuring Agreements

The insuring agreements provide the substantive grant of coverage. They describe what is covered by the policy, and under what circumstances. Without satisfying an insuring agreement, no coverage will attach. In other words, an

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thing. A policy binder is, or is equivalent to, a temporary insurance contract. A certificate of insurance is not. See, e.g. *TIG Ins. Co. v. Sedgwick James of Wash.*, 184 F. Supp. 2d 591 (S.D. Tex. 2001).

<sup>44</sup> Sometimes the declarations page designates the inclusion of a given form, but the clerks putting the policy together miss it, as do the monitors at the insurer, at the intermediary, and at the insured’s risk management department. Usually that problem can be corrected easily, but only when it is spotted before a loss occurs. After a loss, these types of mistakes can become fertile ground for litigation. Often when an insurance contract begins, the body of the policy itself is created later—sometimes months later. Occasionally, the policy is not created at all during the relevant coverage period. This is precisely what happened in the *Exxon Valdez* case, and the absence of the actual wording of the manuscripted parts of the policy lead to a lengthy and high-stakes lawsuit. The same was true of the insurance for the World Trade Center in the aftermath of September 11. See *SR Int’l Bus. Ins. Co., Ltd. v. World Trade Center Properties, LLC*, 381 F. Supp. 2d 250, 253 (S.D.N.Y. 2005).

insured must make an initial showing that the loss is covered by the policy.<sup>45</sup>

**c. Exclusions**

Exclusions carve out certain claims from what may be otherwise covered under the insuring agreements.<sup>46</sup> They serve various purposes, including coordination of coverage with other policies (such as workers' compensation exclusions in a commercial general liability policy), contractual adoption of certain common-law rules such as fortuity, and to eliminate certain categories of claimants such as other insureds. Because they restrict coverage, exclusions are strictly construed.<sup>47</sup>

**d. Definitions**

Policies, of course, are created using words. Sometimes these words need to be defined in order to express thoughts with precision. The presence of definitions is sometimes very helpful.<sup>48</sup> Usually, defined terms are

<sup>45</sup> *Telepak v. United Servs. Auto. Ass'n*, 887 S.W.2d 506, 507 (Tex. App.—San Antonio 1994, writ denied).

<sup>46</sup> As in every other industry, exclusions can be extremely complicated in energy industry property policies. See *S. W. Energy Corp. v. Continental Ins. Co.* 974 P.2d 1239 (Utah 1999), dealing with an exclusion regarding a storage tank leak caused by rust or corrosion afflicting the tank. Arguments about exclusions in petroleum policies have been around a long time. *Smiley v. Citizens F. M. & L. Ins. Co.*, 14 W. Va. 33 (1878), which concerned fires caused by explosions.

<sup>47</sup> *Gulf Chem. & Metallurgical Corp. v. Associated Metals & Minerals Corp.*, 1 F.3d 365, 369 (5<sup>th</sup> Cir. 1993)(noting that, where an ambiguity exists, the policy should be construed strictly against the insurer and liberally in favor of the insured and that "an even more stringent construction is required" where the question "involves an exception or limitation on [the insurer's] liability. . .").

<sup>48</sup> Courts recognize the importance and centrality of definitions as well as their dangers. In one case, a policy insured against direct physical loss or damage caused by "cyclone,

identified through **bold** or underlined print. Occasionally, they are CAPITALIZED. Words used in a policy are given their ordinary and generally accepted meaning "unless they are defined in the policy . . ." <sup>49</sup> Counsel should always study defined terms very carefully, for a thorough definition can negate coverage as well as, if not better than, any exclusion.

**e. Conditions**

Conditions serve important functions. They outline the respective rights and obligations of the parties, and can be perilous if ignored. They include things such as notice, cooperation, and other items associated with investigation of the claim as well as the handling of certain contingencies such as bankruptcy, the presence of other insurance or claims by other insureds. Conditions can also come in the form of warranties.<sup>50</sup> Like any other contract term,

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windstorm and hail." The question was whether a rig suffered damage from a windstorm. Here is what the court said: "In the absence of a definition or limitation of the subject, a 'windstorm' must be taken to be a wind of sufficient violence to be capable of damaging insured property either by impact of its own force or by projecting some object against the property, and in order to recover on a windstorm insurance policy, not otherwise limited or defined, it is sufficient to show that wind was the proximate cause of loss or damage notwithstanding other factors contributed to loss." *Kemp v. Am. Univ. Ins. Co.*, 391 F.2d 533 (5<sup>th</sup> Cir. 1968). Litigants will likely see a lot of this case in Katrina and Rita losses. It tends to suggest that wind will override flood, despite the fact that insurers say again and again, if flood caused the loss, then it is not covered.

<sup>49</sup> *Prudential Ins. Co. of Am. v. Uribe*, 595 S.W.2d 554, 563 (Tex. Civ. App.—San Antonio 1979, writ ref'd n.r.e.).

<sup>50</sup> Warranties are found in a variety of places in property insurance policies—indeed, almost anywhere. If they are manuscripted, they are often among the endorsements. They are commonly found in policies covering the petroleum industry. See *Hilton Oil Transport v. T.E. Jonas*, 75 F.3d 627 (11<sup>th</sup> Cir.

conditions can be waived. They will be discussed in more detail later.

f. **Endorsements**

Finally, many policies contain endorsements that are attached to the main form. These may be in front of the main body or at the back. Each one may be on a different page, some of which is printed, and some of which is not. There may be a signature slot for someone to sign, which is often not signed by anyone.

Sometimes endorsements add provisions to the policy, whether it be the identity of some insured, a new insuring agreement component, a completely new additional insuring agreement, some new exclusion, or some new condition. Other endorsements delete parts of a policy, whether part of the insuring agreements, one or more exclusions, a condition, and so forth. Still other endorsements do both: they both subtract and add. Not all endorsements are in the original policy when it is first put together. Sometimes they are added during the life of the policy. Often this involves the elimination of named insureds, or their addition, and/or the addition or deletion of property insured.

When reviewing a policy, it is important to consider the impact, if any, of the endorsements on a given fact situation. Endorsements to a policy "generally supersede and control over conflicting printed terms within the main policy."<sup>51</sup>

3. **THE (GENERAL) DISTINCTION BETWEEN FIRST PARTY AND THIRD PARTY COVERAGE**

Business insurance comes in many diverse species, though as already discussed, much

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1996)(reversing a summary judgment for the insured in a case against Lloyds of London since deciding whether an insured's managing director deliberately or intentionally breached a trading limits warranty was a fact question for trial).

<sup>51</sup> *Mesa Operating Co. v. Cal. Union Ins. Co.*, 986 S.W.2d 749, 754 (Tex. App.—Dallas 1999, pet. denied).

of each type is at least somewhat standardized. Often all insurance is divided into "first-party insurance" and "third-party insurance." As a very general rule, policies that protect the company's assets against loss or damage are considered "first party" coverage. Policies that protect the company against liabilities to a third party are considered "third party" coverage. One Texas court put the matter this way:

In first-party insurance coverage, the insured is covered for his own loss. In third-party insurance coverage, the insured is covered for his liability to another for their loss.<sup>52</sup>

Of course, this is only a general rule, and not an absolute one. For instance, there are many "package" policies that contain both first party and third party coverages. Thus, while the distinction between first and third party coverages is important, it must be considered in terms of the coverage at issue, not simply by the type of policy involved.<sup>53</sup> As already indicated, we are mostly interested in the property insurance aspects of the recent hurricanes, but there will also be some discussion of liability issues as appropriate.

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<sup>52</sup> *Warrilow v. Norrell*, 791 S.W.2d 515, 527, n.2 (Tex. App.—Corpus Christi 1989, writ denied).

<sup>53</sup> Even some traditional liability policies, like the "Commercial General Liability" policy for example, contain first party coverage, such as the "reasonable expenses incurred by the insured" provision in the "Supplementary Payments" section. Arguably, the duty to defend is also first party coverage. An insurer's duty to defend is extremely important to most businesses, and energy companies are no exception. See *Griffith Oil Co., Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 789 N.Y.S.2d 352 (N.Y. App. Div. 2005); see also *Transcontinental Pipe Line Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 378 F. Supp. 2d 729 (M.D. La. 2005) involving the duty to defend in part from a pipeline leak.

#### 4. THE BASIC COMMERCIAL COVERAGES (AND A FEW NOT-SO-BASIC ONES)

For almost every company, and especially energy companies, protecting the assets of the business is of paramount importance. This section addresses some of the issues involved in covering company property. Before discussing substantive coverages, though, an important distinction among property policies must be noted. Generally, they come in two types – “all risk” or “named perils.” The Fifth Circuit described this distinction as follows:

A “named peril” policy is to be differentiated from an “all risks” policy. “A policy of insurance insuring against ‘all risks’ creates a special type of coverage that extends to risks not usually covered under other insurance; recovery under an all-risk policy will be allowed for all fortuitous losses not resulting from misconduct or fraud, unless the policy contains a specific provision expressly excluding the loss from coverage.”<sup>54</sup>

Stated differently, under an “all risk” policy, the loss is covered unless caused by an excluded peril. A “named peril” policy is the opposite – the loss is excluded unless caused by a covered peril. Most commercial property policies are “all risk,” while the “named perils” variety is usually reserved for specialized hazards, such as flood insurance.

The foundation for protecting most of the company’s property is, naturally, the “commercial property” policy. It is usually a good starting point for protecting the real and personal property used by the insured in its business activities as well as the income derived from the use of that property. In addition to the basic insuring

<sup>54</sup> *Ingersoll-Rand Fin. Corp. v. Employers Ins. of Wausau*, 771 F.2d 910, 913 (5<sup>th</sup> Cir. 1985)(quoting *Dow Chem. Co. v. Royal Indem. Co.*, 635 F.2d 379, 386 (5<sup>th</sup> Cir. 1981).

agreements, such policies often contain “extensions of coverage” that provide coverage for specific items, such as valuable papers, debris removal, expediting expense, and other soft costs.

##### a. Protecting Company Property

First and foremost, property policies generally pay for “direct physical loss or damage” to covered property. Typically, this includes real and personal property of the insured. It also usually includes personal property of others in the “care, custody or control” of the insured, or in an insured building. This provides coverage for personal property not owned by the insured, such as the personal effects of the insured’s employees.

Attorneys handling claims involving commercial property losses – especially storm losses as with Katrina and Rita – need to pay special attention to the doctrine of concurrent causation. In the course of a thorough policy analysis, the lawyer should focus on the cause of the loss to assess whether any specific exclusions may negate coverage. In particular, the lawyer should carefully study the introductory language to the exclusionary provisions. Concurrent causation language commonly found preceding the listed exclusions can sometimes create obstacles to obtaining coverage for losses caused by multiple perils. A recent example of concurrent causation language can be found in *Wong v. Monticello Ins. Co.*,<sup>55</sup> where the policy stated:

##### B. Exclusions

1. We will not pay for loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded, regardless of any other cause or event that contributes concurrently or in any sequence to the loss.<sup>56</sup>

<sup>55</sup> 2003 WL 1522938 (Tex. App.—San Antonio Mar. 26, 2003, pet. denied).

<sup>56</sup> *Id.* at \*1 (emphasis original).

The validity of these clauses in Texas has been recently reaffirmed by the First Court of Appeals in *Valley Forge Ins. Co. v. Hicks, Thomas & Lilienstern*.<sup>57</sup> Another court offered the following comment:

Anticoncurrent causation provisions, such as the one at issue here, have appeared in recent years in response to the concurrent causation doctrine, under which some courts have found that insurers are "obligated to pay for damages resulting from a combination of covered and excluded perils if the efficient proximate cause is a covered peril." [A]nticoncurrent causation provisions in insurance contracts avoid application of the doctrine by expressly stating that a loss is excluded from coverage if it results from a combination of covered and excluded perils.<sup>58</sup>

It is clear though that the plain language of these clauses requires that the loss be caused by two or more causes – one covered and one excluded. In any event, understanding the policy and the cause(s) of the loss is crucial to dealing with this issue when it arises.

<sup>57</sup> 2004 WL 2903521 \*4-5 (Tex. App.—Houston [1<sup>st</sup> Dist.] 2004, pet. denied).

<sup>58</sup> *Preferred Mut. Ins. Co. v. Meggison*, 53 F. Supp. 2d 139, 142 (D. Mass. 1999) (citation omitted). At least a handful of states have refused to recognize these clauses based on public policy reasons. See, e.g., *Howell v. State Farm Fire & Cas. Co.*, 218 Cal. App. 3d 1446, 1456 (Cal. Ct. App. 1990) ("... the State Farm policies would deny coverage whenever an excluded peril is a contributing factor to the loss. Since, in most instances, an insurer can point to some arguably excluded contributing factor, this rule would effectively transform an 'all-risk' policy into a 'no-risk' policy."); *Safeco Ins. Co. of Am. v. Hirschmann*, 773 P.2d 413 (Wash. 1989)(en banc); *Western Nat'l Mut. Ins. Co. v. University of N. Dakota*, 643 N.W.2d 4 (N.D. 2002).

Following a significant loss, a primary objective is to move towards restoring the company's property and operations back to pre-loss conditions as soon as possible. Sometimes, however, perfect replication of pre-loss conditions is not possible. A recent Texas case illustrates this point. In *Republic Underwriters Ins. Co. v. Mex-Tex, Inc.*,<sup>59</sup> a leaky roof covered a mall with commercial and retail businesses. Although it had been repaired, the roof continued to leak.<sup>60</sup> While considering whether to replace the roof, a hail storm caused further damage to the roof. Despite a question as to how much additional damage the storm caused in light of the pre-existing damage, both the carrier and the insured eventually agreed that the roof would be replaced and that the insurer would pay for it. Prior to this agreement, however, the insured, fearing that delay would cause further damage, went ahead and replaced the roof before the parties had agreed on replacement.<sup>61</sup> The insured submitted a net claim for \$179,000, but the insurer refused to pay that amount, concluding it could have replaced the roof for \$145,000.<sup>62</sup> Since both sides agreed that the roof needed to be replaced, the insured was entitled to coverage for a roof of "like kind and quality" and one "of comparable material and quality."<sup>63</sup> The court noted that even the insurer acknowledged that in some cases an exact replacement cannot be found and "something substantially similar" must be used instead. Although the insured's choice of a new roof was slightly different than the previous one, testimony established that it was similar in both cost and quality.<sup>64</sup> Concluding that the policy obligated the

<sup>59</sup> 106 S.W.3d 174 (Tex. App.—Amarillo 2003) *rev'd on other grounds*, 150 S.W.3d 423, 427-28 (Tex. 2004).

<sup>60</sup> *Id.* at 176.

<sup>61</sup> *Id.*

<sup>62</sup> *Id.* at 176-77.

<sup>63</sup> *Id.* at 178-79.

<sup>64</sup> *Id.* at 180-81.

insurer to pay for a comparable roof, and that such a roof was in fact installed by the insured, the court affirmed the judgment for the insured. *Mex-Tex* demonstrates that the policy language can provide the insured with some flexibility as it begins the process of restoring its property to pre-loss conditions.

**b. Protecting Company Income**

Known as “business interruption” coverage, this type of coverage is different from most property coverages as it is not designed to provide money to repair or replace any particular property. Rather, it is intended to provide protection to the insured from disruptions in business due to covered perils that damage property crucial to the insured’s business. In effect, this coverage supplements the insured’s lost income while the damaged property is being repaired, rebuilt or replaced. Stated differently:

[T]he purpose of a business interruption policy is to indemnify the insured for loss caused by the interruption of a going business due to the destruction of the building, plant or parts thereof.<sup>65</sup>

Although actual policy language can vary, mere “slowdown” in productivity is typically not enough to trigger business interruption losses. For example, the policy in *Quality Oilfield* provided coverage for “loss resulting directly from the necessary interruption of business caused by damage to or destruction of real or personal property. . . .”<sup>66</sup> The insured suffered a theft loss of critical data and engineering drawings that reduced its ability to perform its operations. Because the policy did not define “interruption of business,” the court had to determine whether a mere “work slowdown” was enough or if an actual

<sup>65</sup> *Quality Oilfield Prods., Inc. v. Michigan Mut. Ins. Co.*, 971 S.W.2d 635, 638 (Tex. App.—Houston [14<sup>th</sup> Dist.] 1998, no pet.) (citation omitted).

<sup>66</sup> *Id.* at 637.

“suspension of operations” was required. After stating that it was an issue of first impression for the Texas courts, the Court looked to other jurisdictions and ultimately concluded:

[A]fter considering the policy as a whole and persuasive authority from other jurisdictions, we find that “interruption of business” is an unambiguous term meaning “cessation or suspension of business.” Therefore, Quality was not entitled to business interruption coverage for the work slowdown it experienced and we find the trial court did not err in granting Michigan’s motion for summary judgment.<sup>67</sup>

Losses that do not directly affect the insured’s property but do affect the property of certain key suppliers or customers might be covered under “contingent business interruption” coverage.<sup>68</sup> As the Seventh Circuit noted:

Regular business-interruption insurance replaces profits lost as a result of physical damage to the insured’s plant or other equipment; contingent business-interruption coverage goes further, protecting the insured against the consequences of suppliers’ problems. Regular business-interruption coverage did [Archer Daniels Midland Company] little good in 1993, for the flood largely spared its plants, but contingent business-interruption coverage was just the ticket.<sup>69</sup>

<sup>67</sup> *Id.* at 639.

<sup>68</sup> Based on the facts involved and the language of the policy, it is also possible that such losses are covered under the primary business interruption provisions. For just such a case, see *Zurich Am. Ins. Co. v. ABM Indus., Inc.*, 397 F.3d 158 (2d Cir. 2005).

<sup>69</sup> *Archer Daniels Midland Co. v. Hartford Fire Ins. Co.* 243 F.3d 369, 371 (7<sup>th</sup> Cir. 2001). Unfortunately for ADM, it later found out that it

Business interruption and contingent business interruption coverages are so important that, depending on the facts, having adequate protection might mean the difference between a (relatively) smooth resumption of operations and no resumption at all.

**c. Extensions of Coverage**

Almost all property policies contain certain "extensions of coverage" in addition to the main coverages. A leading authority on insurance terminology defines "extended coverage" as:

[a] CLAUSE found in an insurance policy that will provide additional coverage for RISKS to be insured other than those covered under the basic policy's PROVISIONS.<sup>70</sup>

There are many different coverage extensions. Here are some of the more common ones:

- ❖ Valuable Papers and Records;
- ❖ Accounts Receivable;
- ❖ Pollutant Clean-up;
- ❖ Debris Removal;
- ❖ Expediting Expense;
- ❖ Property in Transit; and
- ❖ Claim Preparation Expense.

There are three keys to dealing with extensions of coverage. First, the insured must carefully assess whether they apply

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did not have contingent business interruption coverage for the 1993 flood in the upper Mississippi River basin that inundated approximately eight million acres of farmland and was the single largest flood in the nation's history. The court noted that the company's desire to save \$19,000 in premiums by switching carriers cost ADM \$50 million in uncovered losses, because the replacement insurance it purchased did not cover the contingent business interruption losses ADM sustained as a result of the flood. *Id.* at 370-71.

<sup>70</sup> Harvey W. Rubin, *Dictionary of Insurance Terms* 167 (4th ed. 2000).

with respect to a given loss. Second, the insured must determine if there are internal sublimits applicable to these coverages that reduce the amount of money available for a particular extension. Finally, careful attention must be paid to whether the extensions are part of, or in addition to, the main limits of the policy.<sup>71</sup>

**B. Insurance for Energy Companies**

The vast field of business insurance consists of two broad groups: insurance most businesses need, and highly specialized insurance geared towards only one type of industry. Obviously the energy industry needs many of the same types of insurance contracts other industries need, in addition to coverage for its own peculiar risks. In terms of common insurance coverages, they include at least the following:

- ❖ Property coverage, including both physical damage to the insured's property and its disappearance;<sup>72</sup>

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<sup>71</sup> On this last point, the Minnesota Court of Appeals noted that:

When an extension of coverage provision states that extensions of coverage apply "as an additional amount of insurance," the amounts listed under that section are in addition to the base policy amount.

*Metalmasters of Minneapolis, Inc. v. Liberty Mut. Ins. Co.*, 461 N.W.2d 496, 498 (Minn. Ct. App. 1990).

<sup>72</sup> See *Globe & Rutgers Ins. Co. of City of N.Y. v. Prairie Oil & Gas, Co.*, 248 F. 452 (2d Cir. 1917), a classic insurance case concerning, among other things, the value of insured oil which was destroyed by fire after having been piped: (1) Was the transportation charge part of the insured actual case value? (2) Was the claim property made? (3) Could the insurer replace the oil itself and pay for the destroyed tank? (*Actual cash value* is now, and has been

- ❖ Business interruption and contingent business interruption insurance;<sup>73</sup>
- ❖ Boiler and machinery property insurance, which covers complex machinery;<sup>74</sup>
- ❖ Standard liability insurance (sometimes with a duty to defend and sometimes not—very large businesses often like to run their own defenses);<sup>75</sup>
- ❖ Builder's risk insurance;<sup>76</sup>
- ❖ Workers' compensation insurance (which is usually required by state law);
- ❖ Employment Practices Liability insurance, which is designed to cover the employer's mistreatment of its employees, e.g., by discrimination, something that is not covered under the CGL policy but can be added by endorsement;
- ❖ Fiduciary liability insurance for pensions and other employee benefits plans;
- ❖ Auto insurance, which includes both property and liability insurance;
- ❖ D&O liability insurance, which played a significant role in the civil actions brought against Enron and its management;
- ❖ Kidnap and ransom insurance;<sup>77</sup> and
- ❖ Life insurance for senior management (also known as "Key Person Life Insurance").

for 100 years, a key concept in all property insurance.).

<sup>73</sup> See *Great Northern Oil Co. v. St. Paul Fire & Marine Ins. Co.*, 227 N.W.2d 789 (Minn. 1975); see also *Nat'l Union Fire Ins. Co. of Pittsburgh v. Anderson-Prichard Oil Corp.*, 141 F.2d 443 (10<sup>th</sup> Cir. 1944) concerning a "use and occupancy policy" insuring an oil refinery against loss of net profits plus overhead expenses caused by fire.

<sup>74</sup> Nowadays this is sometimes added into ordinary property coverage by endorsement, while for years it was completely separate; sometimes machinery is covered by other kinds of property policies, see *National Surety Marine Ins. Corp.*, 211 S.W.2d 567 (Tex. 1948).

<sup>75</sup> For an example of its application to the energy industry, see *Mayronne Mud & Chem. Corp. v. Travelers Indem. Co.*, 168 F. Supp. 800 (E.D. La. 1958), aff'd 272 F.2d 710 (5<sup>th</sup> Cir. 1959).

<sup>76</sup> *Offshore Prod. Contractors, Inc. v. Republic Underwriters Ins. Co.*, 910 F.2d 224 (5<sup>th</sup> Cir. 1990), involving offshore pipeline project where the insurer, the insured, and the broker were all involved and the broker had liability.

There are others, of course, but these are among the most common. Many industries need all, or most, of these protections. The energy industry is no different.

Here are a few examples of coverage at least some energy companies need that lots of other businesses do not need:

- ❖ Maritime coverage for tankers and/or cargo;<sup>78</sup>
- ❖ Blowout and "control of well" coverage;<sup>79</sup>

<sup>77</sup> The existence and terms of this coverage is usually kept secret since they could be an incentive to kidnappers.

<sup>78</sup> See *Armada Supply Inc. v. Wright*, 665 F. Supp. 1047 (S.D.N.Y. 1987), aff'd in part and rev'd in part, 858 F.2d 842 (2d Cir. 1988)(concerning the contamination of fuel oil while in shipment as well as a sue and labor clause).

<sup>79</sup> There are many blowout cases. Such cases may be the most common source of insurance

- ❖ Longshoreman and Harbor Workers Compensation insurance (which is like workers' compensation coverage);
- ❖ Seaman coverage (also like workers' compensation coverage);
- ❖ Property insurance for rigs and other off-shore assets;
- ❖ Pollution liability coverage.

Now that a review of some basic coverage concepts has been completed, we can turn to a specific example of an energy policy for further insights. For this reason, it is a good idea to discuss what a petroleum industry property policy looks like.

### C. The OIL Standard Policy

The form we discuss is used by members of OIL.<sup>80</sup> Because of its common use, the "Oil

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claims in the energy industry. Not all cases can be cited here, *but see Equity Oil Co. v. National Fire Ins. Co. of Hartford*, 247 F.2d 393 (10<sup>th</sup> Cir. 1957), for a rather simple case based on evidence, and *Georgia Home Ins. Co. v. Means*, 186 F.2d 783 (5<sup>th</sup> Cir. 1951), for a policy with difficult language.

<sup>80</sup> OIL's membership includes most, though not all, of the largest energy concerns in the world, as well as a good number of smaller ones. OIL (Oil Insurance Limited) really is part of three related companies. 16 member companies set it up as the energy industry's captive mutual in 1972. Since then, it has grown to 85 members. *Welcome to OIL Insurance Limited*, available at <http://www.oil.bm.oil/index.html> (last visited Nov. 15, 2005). OIL provides a number of energy-specific coverages, including first-party property coverage, well control insurance and pollution liability. OIL's sister company, sEnergy provides business interruption and property insurance to the industry. *Welcome to sEnergy Insurance, Ltd.*, available at <http://www.oil.bm/senergy/index.html> (last visited Nov. 15, 2005). sEnergy was formed during the "hard" market of 2002 following the September 11 attacks, as well as other factors affecting the insurance industry. OCIL (Oil Casualty

Insurance Limited Insurance Policy," is a good one to review.<sup>81</sup>

Because of its length and difficulty, the policy will only be described in part. For the exposition being provided here, the most important definition is that of the term "occurrence." That term is central to many liability policies where it means, in part, *an accident including continuous or repeated exposure to substantially the same harmful conditions*. That is **not** the meaning of the term here. The definition of "occurrence" in the OIL policy is, in part:

The word "**occurrence**" wherever used in this policy, and in the endorsements hereto, means an event or a continuous or repeated exposure to conditions which commence during the term of this policy and cause personal injury or

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Insurance, Ltd.) was formed in 1986 and it provides excess liability for the energy sector. *Welcome to OIL Casualty Insurance, Ltd.*, available at <http://www.oil.bm/ocil/index.html> (last visited Nov. 15, 2005).

<sup>81</sup> It is an extremely complex property and liability policy which is, without any of the available ten (10) endorsements, 17 single-spaced double-columned pages. It utilizes technical industry terms on significant occasions, so that whoever is working on the policy must know a fair amount about the oil industry, or have easy access to someone who does.

The structure of the policy form is relatively standard. There are a list of named insureds, definitions, three insuring agreements, 33 exclusions (some of which are long and complex, while some of which are short and simple), several exclusions included in the insurance agreements, a substantial number of conditions, and a specification of insurer liability (which is somewhat unusual though quite clear). The problems with the policy are that: it is not an easy read; the number of exclusions is unusual; and the definitions do not all appear on the same list. Some of them are set forth in the "Conditions" section, and it is difficult to see what the point of this organization might be.

bodily injury or loss or damage to property . . . .<sup>82</sup>

The key word here is “event,” as opposed to “accident,” and it is connected to property losses but not to liability losses, in any central way, although it plays a role in an exclusion which is written into one of the insuring agreements. This use of “occurrence” is very unusual; it is usually the other way around. Still, in litigating a coverage dispute, lawyers will need to be skeptical about whether uses of “occurrence” in liability policies—even umbrella policies—will be particularly helpful in understanding and explicating the term “occurrence” in an OIL policy.

**a. Insuring Agreements**

There are three numbered insuring agreements in a section bearing that exact title. The first provides, in relevant part:

[T]he Underwriter does hereby agree . . . :

1. To indemnify the Assured for all risks of direct physical loss or damage, caused by an occurrence, to property of any kind or description wherever located, owned by the Assured . . . or to non-owned property in which the Assured has an insurable interest.<sup>83</sup>

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<sup>82</sup> OIL Policy, at D-1-10. Because this policy is as complex as it is, our “summary” of it will be an over simplification. We will leave some things out. We are not trying to be misleading, but not everything can be said all at once. Let our implied-by-omissions distortions stand for an important lesson. If a lawyer is working on coverage in a policy, s/he needs to study the whole thing. Important, or at least relevant or applicable, points can be tucked away in odd places. Not everything on the fifteenth or fiftieth line of a paragraph or section is unimportant.

<sup>83</sup> OIL Policy, at D-1-5.

The second provides indemnity for “sue and labor” expenses, well control costs, debris removal expenses, and redrilling costs.<sup>84</sup>

The third insuring agreement provides liability coverage, which is not our focus here. Thus, we now turn to some relevant exclusions.

**b. Key Exclusions**

As noted already, there are 33 exclusions in the OIL policy. Not all of them will be discussed here. Instead, we focus on a handful of particular relevance to storm losses.

Exclusion E-8 excludes property damage “caused by or resulting from inherent defect, wear and tear or gradual deterioration, or from expansion or contraction due to changes in temperature,” and so forth.<sup>85</sup>

E-9 excludes coverage for “repairing or replacing that portion of property which is

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<sup>84</sup> This is an interesting case of the significance of the importance of coverage analysts knowing the meaning of industry words. Neither “redrilling” nor “batch drilling” is defined here. Part of this, and problems like these, have been a problem from time to time in coverage litigation. The meaning of the term “redrilling,” for example, was important in *Mobil Exploration & Producing U.S. Inc. v. Certain Underwriters Subscribing to Cover Note 9503317(A)*, 837 So.2d 11 (La. App. 2003, writ denied). This was a suit involving Lloyds of London.

<sup>85</sup> This exclusion closely resembles those often seen in property policies. There is considerable case law with respect to some of its concepts, e.g., *inherent defect* and *wear and tear*. Not everything about these ideas is well explored in the case law, even though it has been developing for many years. For example, the phrase “wear and tear” is usually taken to be a single term. This tendency toward automatic acceptance is not necessarily correct. Something has suffered from wear and tear only if it is worn and torn. These are two things. Arguably there are really separate meanings to the two ideas, which we do not attend to much. What is a tear when contrasted with a wear? No case examines any such problem seriously.

defective in design, workmanship, or material." Exclusions like this are quite common in many parts of insurance life.

E-10 excludes coverage for destroyed property when the insured knows of the damage to it, and does not try to save or preserve it in a reasonable manner.

E-11 is extremely important. It excludes coverage for business interruption, its close relatives, and extra expenses. Similarly, E-11 also excludes "other consequential loss extending beyond direct physical loss or damage to the property insured" under the policy. Thus, the OIL standard policy provides no business interruption coverage whatsoever. That coverage must be obtained in another policy, either through sEnergy or other insurers.

So much for exclusions. Obviously, they complicate even more the already complex insuring agreements. At the back of the policy, on its very last page, there is a helpful diagram showing which exclusions apply to which insuring agreements. This sort of thing is very rare in insurance policies of any kind.

### **c. Conditions**

There is also a section on how to calculate the value of losses. It is part of the "Conditions" section. Interestingly, as a general rule, most insurance policies do not spell this sort of thing out in detail. As with others, this section of the policy is simple in some places (e.g., the aesthetic value of property is not covered) and complex in others (e.g., the nature and timing of "repair and replace" expenses).

Another unusual feature of the "Conditions" section is a section of aggregate limits. The meaning of "aggregate" is quite different in this policy than in most others. Basically the aggregate limit of the OIL policy applies to any one occurrence that injures more than one insured. Thus, it is the number of claims from insureds for one occurrence which are aggregated and limited. The Board of Directors of OIL decides from time to time what that limit will be, and the

amount is not explicitly included in the policy as part of the contracts. Currently, it is one billion dollars per event.<sup>86</sup> On September 22, 2005 the OIL Board of Directors created an "incurred but not evolved" reserve for Katrina of one billion dollars. Consequently, OIL's one billion dollar aggregation limit is all that it will pay for Katrina losses. This amount will be divided among those shareholders who suffered Katrina losses according to a formula in the policy.

Another unusual feature of the "Conditions" section is that the contract provides for dispute resolution through arbitration. This condition entails that there will be almost no reported judicial opinions involving coverage disputes between OIL and its insureds. Very few American insurance policies contain arbitration provisions. Most property policies contain mandatory appraisal provisions having to do with valuing damaged property, and these resemble arbitration in some ways. These policies, however, are not actually a species of arbitration itself, as we discuss elsewhere.

One final unusual clause in the "Conditions" section is a "Choice of Law" clause. Most American policies do not contain such clauses, and there are a good number of cases deciding this issue. There are no well established, "black-letter" rules regarding

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<sup>86</sup> This aggregate limit approach derives from the fact that OIL is a special insurance arrangement. It is not simply selling insurance to those who want to buy it. It is a group of large companies creating and funding insurance for a group of entities doing roughly the same thing. Such an approach to the business of insurance has been around for a long, long time. It is used in the maritime industries. It is used widely by local governmental agencies, schools districts, hospital districts, and so forth. In general the policies are not greatly different from those "issued" by completely private and independent insurers, although group insurers like OIL often have a more explicit sense of loyalty to their insurance "customers" than completely separate, commercial-only insurers explicitly do, though this is not supposed to be true.

this matter in insurance. Often it depends upon where the occurrence and/or the injury or damages took place. This policy specifies that New York law applies. That is something of an advantage to the insurer. International policies often specify that English law applies, and when they contain arbitration clauses, they specify London as the location for the arbitration.<sup>87</sup>

Analyzing a commonly-used policy is helpful to gain an understanding of the way coverage works, but that is only part of the process necessary to maximize an insurance recovery from a catastrophe loss. The next section addresses these issues in greater detail.

### III. Strategic Coverage Issues for Handling Hurricane Losses

Hurricanes Katrina and Rita were immensely powerful storms that left unprecedented damage in their wake, and the vast array of energy infrastructure in the Gulf Coast region was hit particularly hard. The insurance aspect is just one component of many that must be addressed in the restoration process. Unfortunately, insurance claims arising out of catastrophic events such as these storms can be incredibly complex. However, a systematic and disciplined approach to handling the coverage issues will help to ensure the maximum possible recovery in the shortest period of time.

This section addresses these issues, beginning with the assembly of a team that is equipped to handle significant catastrophe losses. Once the team is in place, attention can be turned to the

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<sup>87</sup> See *Edinburgh Assurance Co. v. R. L. Burns Corp.*, 479 F. Supp 138 (C.D. Cal. 1979), aff'd in part and rev'd in [minor] part, 669 F.2d (9<sup>th</sup> Cir. 1982). In this case English law is held to apply to a platform loss in the Mozambique Channel off the coast of Madagascar. The case nicely illustrates the profound and complex relationship between insurance and offshore oil production.

coverage assessment phase, the loss assessment process, the preparation and presentation of the insurance claim, the avoidance of common pitfalls along the way, and resolution of the claim.

#### A. Assembling a Claim Team

For minor losses, if the company maintains an accurate and up-to-date inventory of its property, then handling an insurance recovery can be a relatively simple matter. If, on the other hand, the loss is large and complex, then it is usually a good idea to assemble an inter-disciplinary team to properly manage the process.

In most cases, the team should be comprised of both internal and external members. Internally, key personnel should be drawn from the operations, legal, risk management, and financial departments. External members include coverage counsel, disaster recovery specialists, forensic accountants, claim preparation experts, and other similarly skilled professionals with the needed expertise for a comprehensive assessment and quantification of the loss.

#### B. The Coverage Assessment Phase

Assessing possible coverages is critical to maximizing the insurance recovery. The insured must review all policies that may provide coverage. If the policies themselves were lost or destroyed as a result of the storms, then copies should be requested from the broker(s) or carrier(s) involved. Once all relevant policies have been identified, notice should be given to each carrier that may owe coverage.

##### 1. Finding Coverage

Counsel can assist the process by engaging in a thorough and comprehensive analysis of the policies. This includes reviewing the insuring agreements, coverage extensions, applicable deductibles, self-insured retentions and sub-limits, relevant

exclusions and exceptions thereto, definitions, endorsements, and any other pertinent provisions bearing on the loss.

Coverage under other policies held by the insured should also be explored, such as package policies, inland marine coverage, boiler & machinery coverage, and other policies that may provide protection. Even coverage under policies held by other parties should be investigated where the company is an additional insured or where its property is in the control of third-parties.

## 2. Preserving Coverage

A careful review of the policies will not only make the insured aware of its rights under the policies, but its obligations as well. These usually include duties such as notice, proof of loss, cooperation, mitigation of losses, and preservation of the insurer's salvage and subrogation rights.

Attention to these rights at the very beginning, and throughout the claim process, is essential in order to avoid jeopardizing an otherwise covered loss.

## 3. Maximizing Coverage

It is vital to explore all possibilities in order to obtain the largest possible insurance recovery. This includes maximizing coverage under various provisions and coverage extensions such as "extra expense," "expediting expense," "service interruption," "civil authority," "debris removal," "ingress/egress," and "valuable papers." Importantly, the insured's property need not have been damaged for certain coverages such as "contingent business interruption." Preparing the claim with each of these coverages in mind will ensure the fullest possible recovery.

With a thorough understanding of the insured's rights and duties, attention can be turned to the loss assessment phase.

## C. The Loss Assessment Process

One of the first steps following a loss is to begin the process of assessing the damage. Determining the nature and extent of the loss is crucial not only to preparing the claim that will ultimately be submitted to the carrier but also to the process of rebuilding, repairing and returning operations to normal as soon as practicable.

A successful recovery in a first-party loss often depends on thorough documentation. Inventory of all property that was destroyed, damaged, lost or stolen is a good place to begin. While damage assessment activities are under way, key financial records should be pulled to the extent possible. These include items such as property valuation records, asset inventories, records of revenues and profits from affected locations, production records and other financial data that can support claims for property damage and business interruption losses. If such documentation was itself damaged in the storm, efforts to accurately reconstruct it should be made to the greatest extent possible.

It is also important to document the damage to covered assets using photographs and video, in addition to written reports of damage assessments.

Just as it is important to quantify the damage to the insured's property, it is also critical to keep accurate records of all monies expended in the efforts to bring operations back up to speed. Various extensions of coverage such as "soft costs" or "claim preparation costs" may provide some coverage for these expenditures.

## D. The Claim Process

Most claims are resolved long before reaching litigation. Thus, in order to be in a position to provide full assistance, counsel must be familiar with the claims process and be able to provide assistance in this arena. However, it is also important to remember

that litigation is always a possibility, even if a remote one. While the facts of the loss may be fixed, the actions of the insured and the insurer are not. Therefore, in addition to providing advice on the claim process and the parties' rights and obligations under the policy, the lawyer must also bear in mind that all conduct and communications may later become evidence in a subsequent coverage dispute. To the extent necessary, post-loss activities should be carefully documented.

## 1. The "Partnership" Approach

Though there is an alternative school of thought, it is our view that the insured should approach the claim process with a "partnering" mentality.<sup>88</sup> Insureds should understand that most adjusters handling losses from Katrina and Rita are literally overwhelmed with work. Compounding this problem is the fact that handling an insurance claim in the energy sector often requires a fair amount of specialized knowledge about the industry itself. For this reason, the insured should attempt to be helpful to the carrier in presenting the claim. Claims should be well-documented, based in reason and fact, and thoughtfully and logically presented. Claims having these characteristics tend to be more successful than those that do not. Claims having these characteristics also tend to be resolved quicker and less expensively than those that do not.

Not every aspect of a claim necessarily requires a dispute. Where there is clear entitlement to coverage, those issues should be agreed upon and resolved to allow the parties to focus on the issues where a true dispute exists. Advances against the ultimate loss payment should be requested if necessary or appropriate.

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<sup>88</sup> For a discussion that carriers should also approach the claim process in this way, see Michael Sean Quinn, *Look for Coverage!*, 27:9 INS. LITIG. RPTR. 461, 462-63 (2005).

Recognizing that the litigation process is always an option if a claim cannot be amicably resolved, aggressive claim presentation does not require unnecessary hostility or a combative approach to dealing with the carrier. Courthouses, however, are built for a reason. If the "partnership" approach is ultimately unsuccessful in providing the insured with the a full and fair recovery, then a coverage lawsuit can always be initiated later.

## 2. Two Key Loss Conditions

### a. Proof of Loss

Once notice has been given and the preliminary loss assessment has been performed, the insured should be prepared to begin the claim presentation process. Often, this includes the filing of a formal proof of loss. One Texas court recently explained:

The purpose of a proof of loss is to advise the insurer of facts surrounding the loss for which a claim is being made, and to afford the insurer an adequate opportunity to investigate, to prevent fraud, and to form an intelligent estimate of its rights and liabilities.<sup>89</sup>

As will be shown in the following section, however, the proof of loss requirement can also be a trap for the unwary.

### b. Appraisal

In addition to requirements such as notice and proof of loss, another key provision is the appraisal clause. It is often invoked where there is a disagreement as to the value of the loss. One Texas court stated:

The purpose of an appraisal provision is apparently to afford a

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<sup>89</sup> *In Re Republic Lloyds*, 104 S.W.3d 354, 359 (Tex. App.—Houston [14<sup>th</sup> Dist.] 2003, no pet.)(citations omitted).

simple, speedy, inexpensive and fair method of determining the loss or damage resulting from the happening of a contingency insured against.<sup>90</sup>

Recently, the Texas Supreme Court reaffirmed the use of appraisal clauses, stating:

This Court distinguished between appraisal and arbitration clauses over a hundred years ago. In *Scottish Union & National Insurance Co. v. Clancy*, we concluded that while arbitration determines the rights and liabilities of the parties, appraisal merely "binds the parties to have the extent or amount of the loss determined in a particular way." We held that appraisal clauses are enforceable. Texas courts have continued to recognize this distinction, as has the United States Court of Appeals for the Fifth Circuit. And Texas courts have enforced appraisal clauses since that decision.<sup>91</sup>

Most appraisal clauses allow each party to select one appraiser, and those two then jointly select an impartial umpire. Though selection of the party-appointed appraiser can be crucial to a successful outcome, a party should not use an appraiser paid on a contingency basis.<sup>92</sup>

Appraisal clauses are useful where the parties disagree on the value of the loss. Nevertheless, like any other contractual

<sup>90</sup> *Fire Ass'n of Philadelphia v. Ballard*, 112 S.W.2d 532, 534 (Tex. Civ. App.—Waco 1938, no writ).

<sup>91</sup> *In re Allstate County Mut. Ins. Co.*, 85 S.W.3d 193 (Tex. 2002)(footnotes omitted).

<sup>92</sup> See *Gen. Star Indem. Co. v. Spring Creek Village Apartments Phase V, Inc.*, 152 S.W.3d 733, 737 (Tex. App.—Houston [14<sup>th</sup> Dist.] 2004, no pet.).

right, they can be waived. It has been said that:

Provisions of an insurance policy requiring proofs of loss and appraisal are inserted for the insurer's benefit and may be waived by it.<sup>93</sup>

*Brodie* involved a residential fire claim, and the insured argued that the proof of loss and appraisal provisions had been waived by the carrier's conduct. The Court first found that the insurer waived the proof of loss provision because it demanded an appraisal.<sup>94</sup> Further, the Court then found the carrier failed to timely demand an appraisal, and that it did not demand an appraisal "in accordance with the terms and conditions of the policy."<sup>95</sup> Thus, the Court concluded:

It is our opinion that the procedure invoked by the Company was unwarranted and Mrs. Brodie was not required under the terms of the policy to submit to the delay, inconvenience, expense, and probable futility of such an appraisal.

\* \* \* \*

"This clause of the policy (appraisal) was inserted wholly for the protection of the insurer. \* \* \* But the insurer will not be permitted to use this clause oppressively, or in bad faith." [T]he insurer "must proceed promptly to take the necessary steps to have the amount of the loss adjusted as provided in the policy, \* \* \*." [M]rs. Brodie should not be maneuvered out of her right to recover the full loss by a demand that she submit to an

<sup>93</sup> *International Serv. Ins. Co. v. Brodie*, 337 S.W.2d 414, 415 (Tex. Civ. App.—Fort Worth 1960, writ ref'd n.r.e.).

<sup>94</sup> *Id.* at 415-16.

<sup>95</sup> *Id.*

appraisal which does not conform to the conditions set out in the policy.<sup>96</sup>

Thus, the carrier waived both the proof of loss provisions and the appraisal provisions. It is also important to note that some appraisal provisions are optional while others are mandatory. Nevertheless, even mandatory appraisal provisions can be waived.<sup>97</sup>

### E. Avoiding Common Pitfalls

There are a number of traps for the unwary that can present obstacles to a successful recovery in a first-party loss. Three broad categories are identified here.

#### 1. Proof of Loss

As noted previously, virtually every insurance policy contains a notice provision requiring the insured to notify the carrier under certain circumstances, including a loss. Almost all property policies also contain "proof of loss" provisions. Usually, these must be sworn to by the insured, and often they must be provided within certain time limits. The insured must be mindful of these requirements and their deadlines. If necessary, an extension of the deadline should be requested from the carrier and documented in writing.

If necessary, a proof of loss can be subsequently amended:

[S]tatements made in proofs of loss are not conclusive as to the claimant, provided they were made in good faith and without an intent or attempt to defraud the insurer. [I]t follows, therefore, that mere mistakes or bona fide errors in a proof of loss may be corrected unless the insurer has acted upon

<sup>96</sup> *Id.* at 417 (citations omitted).

<sup>97</sup> See, e.g. *Boston Ins. Co. v. Kirby*, 281 S.W. 275, 276 (Tex. Civ. App.—Eastland 1926, no writ).

the proofs in such a way that to permit correction would be inequitable. [T]hus, because statements in the proof of loss are merely prima facie evidence and not conclusive, the statements may be shown to have been an honest mistake or may be otherwise contradicted or explained.<sup>98</sup>

Although a proof of loss can be amended under appropriate circumstances, it is crucial that the insured have as complete an understanding as possible of the claim it intends to present so that it can ensure a full recovery of all covered losses. The importance of this point can be seen by reviewing *Cantu Servs., Inc. v. General Star Indem. Co.*<sup>99</sup> There, the insured shopping center suffered damages from a hail storm. After initial negotiations concerning the damage, the insurer accepted the repair estimate from the insured's roofing consultant. In the letter accepting the estimate, the insurer's adjuster, James Greenhaw, stated:

No other amounts such as interior or walkway ceilings would be added as not caused by hail damage to the roof.<sup>100</sup>

Two months later, the insured signed a sworn proof of loss verifying these damages and submitting a claim in accordance with the agreement. The claim was then paid by the carrier and accepted by the insured.<sup>101</sup> A year later, the insured gave notice of a claim to its new insurer for leaks in its roof. The subsequent carrier denied coverage on the basis that the damage happened in the prior policy period. The insured then made

<sup>98</sup> *Republic Lloyds*, 104 S.W.3d at 359 (citations omitted).

<sup>99</sup> 2003 WL 22211544 (Tex. App.—Fort Worth Sept. 25, 2003, pet. denied).

<sup>100</sup> *Id.* at \*1-2.

<sup>101</sup> *Id.* at \*2.

claims against both carriers, which were denied. After suit was filed, the insured dismissed the second carrier and proceeded solely against the first. The trial court granted summary judgment on the affirmative defenses of accord and satisfaction, acceptance of benefits and waiver. After reviewing the evidence, the Court of Appeals stated:

Greenhaw made it clear that no payment was being made to Cantu Services for any damage to the "interior or ceiling walkway" because that damage was "not caused by hail damage to the roof." Cantu Services accepted payment based on Greenhaw's assessment without disputing his assessment that damage to the interior or ceiling walkway was not covered because it was not caused by hail damage. Therefore, Cantu Services cannot now contend that General Star is also liable for this, or other damage purportedly existing during Greenhaw's second inspection. Cantu Services had the opportunity to dispute Greenhaw's second assessment and Arrington's calculations before accepting payment, but it did not do so.<sup>102</sup>

The insured then claimed that it was unaware of the other damage until later, but the court rejected this claim based on the fact that the prior inspection revealed no such damage, and the fact that the insured "implicitly conceded" that no other hail damage existed when it accepted payment for the initial claim.<sup>103</sup>

Thus, while a proof of loss is not necessarily final, acceptance of the insurer's offer can operate to foreclose further claims under certain circumstances. Consequently, the insured must be in a position to know the extent of its damage, or at least make sure

<sup>102</sup> *Id.* at \*3.

<sup>103</sup> *Id.* at \*3-4.

that it is not foreclosing the possibility of obtaining full coverage where the extent of the loss remains uncertain.

## 2. Preserving the Carrier's Rights

The insured must also preserve the carrier's rights. This includes cooperating with the carrier in the claim process, such as allowing inspection of the damaged property and the company's books and records, as well as submission to examinations under oath.

If the carrier has salvage and/or subrogation rights, those rights must also be preserved to the extent possible.

Finally, the insured must generally take all reasonable steps to protect property from further damage.

Violation of these rights might jeopardize coverage, and thus, they should be paid due attention following the loss.

## 3. Shortened Limitations Clauses

Many property policies attempt to contractually limit the time in which suit can be brought, sometimes using periods as short as 12 months from the date of loss. In Texas, any attempt to use a limitations period shorter than two years is void.<sup>104</sup> Nevertheless, insureds should be aware of these limitations and comply with them if they are enforceable. In simplest terms, do not assume that the standard limitations period applicable to contracts generally is applicable to a first-party property policy.

## F. The Litigation Approach

If the "partnership approach" does not result in the prompt and amicable resolution of the insured's claim, then the alternative is the "litigation approach." The space constraints of this article do not permit a thorough

<sup>104</sup> TEX. CIV. PRAC. & REM. CODE ANN. §16.070 (Vernon 1997).

discussion of the strategic aspects of litigating insurance coverage disputes, but we will sketch out a few brief thoughts here.

A "reservation of rights" letter is often a prelude to litigation. Though primarily employed in third-party cases, they are fast becoming a common tool used by carriers in the handling of first-party claims in order to identify certain coverage issues of concern.<sup>105</sup> If the carrier issues a reservation of rights letter, careful thought should be given as to what, if any, response is appropriate under the circumstances.

The use of a declaratory judgment action is another tool that carriers have increasingly borrowed from the third-party context.<sup>106</sup> More than two centuries ago, Lord Mansfield observed that "[m]ost of the disputes in the world arise from words."<sup>107</sup> This observation is particularly true in the context of insurance disputes. The declaratory judgment action is a useful tool for determining the respective rights and obligations under a given insurance contract where uncertainty exists. Essentially, it allows the parties to obtain a judicial declaration as to the coverage, if any, afforded under a policy for a particular claim. The "purpose of a declaratory judgment is to obtain a clarification of one's rights."<sup>108</sup>

<sup>105</sup> See, e.g. *Garvey v. State Farm Fire & Cas. Co.*, 770 P.2d 704, 706 (Cal. 1989).

<sup>106</sup> See *United States Aircraft Ins. Group v. Dwiggins, L.L.C.*, 2003 WL 22432915 \*3 (D. Del. Oct. 15, 2003). In fact, this procedural device has even been used in the litigation over whether the September 11<sup>th</sup> terrorist attacks involved one occurrence or two. See *SR Int'l Bus. Ins. Co., Ltd. v. World Trade Center Properties, LLC*, 381 F. Supp. 2d 250, 253 (S.D.N.Y. 2005).

<sup>107</sup> *Morgan v. Jones*, 98 Eng. Rep. 587, 596 (K.B. 1773).

<sup>108</sup> *J.E.M. & S.J.B. v. Fidelity & Cas. Co. of N.Y.*, 928 S.W.2d 668, 671 (Tex. App.—Houston [1st Dist.] 1996, no writ). Texas adopted the

In addition to settling rights with respect to a given claim, declaratory judgment actions can also be used for other purposes, such as obtaining a ruling as to whether a person or entity enjoys the status of an additional insured under the policy. Either party may file a declaratory judgment action, which leads to forum concerns.<sup>109</sup> If litigation appears inevitable, then careful thought should be given as to where and when a declaratory judgment action can and should be brought.

Aside from declaratory judgment actions, more traditional claims such as breach of contract and bad faith (both statutory and common law) should be considered, depending on the choice of law applicable to the dispute. Further, insureds should investigate whether the applicable jurisdiction has a "prompt payment" statute designed to deter "foot dragging" by carriers in the adjustment and payment of claims.<sup>110</sup>

All of these issues should be carefully considered in order to determine the most appropriate course of action if litigation is necessary.

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Uniform Declaratory Judgment Act in 1943, and it did not take long for its utility in insurance cases to become apparent. See *Barrett v. Safety Cas. Co.*, 179 S.W.2d 537 (Tex. Civ. App.—Dallas 1944, no writ).

<sup>109</sup> For example, in Texas an insurer may recover its attorney's fees in a state court declaratory judgment action, but Fifth Circuit law does not allow such a recovery. See, e.g. *Utica Lloyd's of Tex. v. Mitchell*, 138 F.3d 208, 210 (5<sup>th</sup> Cir. 1998).

<sup>110</sup> See, e.g. TEX. INS. CODE ANN. art. 21.55 (Vernon Supp. 2004-05), which provides an 18% penalty and attorney's fees, in addition to the value of the claim, if certain deadlines are not met. Note: this provision has recently been moved as part of the re-codification of the Texas insurance statutes. It is now found in §542.051, *et seq.*, of the Texas Insurance Code.

**IV.**  
**Storms on the Horizon –**  
**How to Plan for the Future**

The 2005 Atlantic hurricane season shattered existing records. It:

- ❖ had a record number of named storms (23);
- ❖ had a record number of hurricanes (13);
- ❖ had the most Category Five hurricanes in a season (three - Katrina, Rita and Wilma);
- ❖ had the strongest hurricane on record in the Atlantic Basin (Wilma);
- ❖ had a record number of major hurricanes making landfall (4); and
- ❖ was the costliest hurricane season in history.<sup>111</sup>

The future could even be worse. Hurricane experts have warned that the Atlantic Ocean may be entering a period of heightened activity that will increase not only the number of storms, but also their intensity. Based on historical trends, this natural cycle could last between 25 to 40 years.<sup>112</sup>

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<sup>111</sup> Hurricane Central, available at: <http://www.weather.com/newscenter/tropical/?from=wxcenter> news (last visited Nov. 13, 2005).

<sup>112</sup> The Hurricane Research Division of the National Oceanic and Atmospheric Administration (NOAA) has stated:

It is quite possible that the extreme activity since 1995 marks the start of another active period that may last a total of 25-40 years.

*Frequently Asked Questions: Hurricanes, Typhoons & Tropical Cyclones*, available at <http://www.aoml.noaa.gov/hrd/tcfaq/G4.html>

It also seems quite likely that the energy industry will continue to have an active presence in the Gulf Coast region, and there is evidence that this activity may even be expanding due to the stable political environment in the Gulf, despite the threat of hurricanes.<sup>113</sup>

While these are just predictions, it appears that the industry is on a collision course with future storms – ones that may even be more destructive than Katrina or Rita. If true, then preventive efforts take on greater importance than ever.

Insurance is frequently one of the most valuable assets a company has, but it is also one of the most neglected and least understood. To that end, this section presents practical tips to help prepare for the storms that will inevitably arrive in the future.

**1. Read the Policy**

This is important, because the policy is the contract that governs the rights and obligations of the parties. In fact, the insured has a legal duty to read the policy.<sup>114</sup> Consequently, even if the insured fails to do so, it will still be charged with knowledge of the policy's terms and conditions.<sup>115</sup>

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(last visited Nov. 12, 2005). See also *Hurricane Expert Predicts Years of More Storms*, available at <http://www.msnbc.msn.com/id/9417904/print/1/1displaymode/1098/> (last visited September 20, 2005).

<sup>113</sup> Tom Fowler, *Despite Storms, Work Continues on Gulf Oil Fields*, HOUSTON CHRONICLE, available at: <http://www.chron.com/cs/CDA/printstory.mpl/business/energy/3445778> (last visited Nov. 12, 2005).

<sup>114</sup> *Ruiz v. Gov't Emp. Ins. Co.*, 4 S.W.3d 838, 842 (Tex. App.—El Paso 1999, no pet.).

<sup>115</sup> *Id.*

2. **Read the Policy Again – and Again Once More**

This point is important enough to be repeated. In fact, it cannot be repeated enough.

3. **Loss Prevention is Best, But Loss Mitigation is the Next Best Thing**

Though it is almost always cheaper to prevent losses altogether, they occur despite these efforts. This is particularly true when dealing with Mother Nature. Absent withdrawal from coastal regions, hurricane losses simply cannot be prevented. They can only be mitigated. Thus, it becomes crucial to proactively manage these risks through a variety of tools, including insurance. But this can only occur if the insurance portfolio is routinely reviewed and kept up to date in order to fully protect the company. Similarly, a systematic and routine approach to updating the company's asset inventories ensures that all lost property can easily be documented in the event of a catastrophic hurricane loss.

4. **It (Almost) Never Hurts to Ask**

When considering whether to bind a proposed policy, review its terms carefully first. An experienced broker, along with coverage counsel, can assist in the determination of whether certain changes could make it more favorable. If so, then it is almost always beneficial to try to negotiate the policy's terms, as the insured usually has nothing to lose and much to gain.<sup>116</sup> Though policies are frequently offered on a "take it or leave it" basis, insurance companies do not always mean what they say.

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<sup>116</sup> There is, of course, a risk that a carrier would argue that active negotiation of the policy's terms results in the loss of *contra proferentem* should a dispute arise. Accordingly, insureds should be very careful to

5. **Review New Policies When They Arrive**

When a new policy arrives, review it to make sure that the coverage quoted is the same as what was actually provided. Do not assume that the policy was correctly prepared, especially where manuscripted provisions are present. Experienced coverage counsel can also be helpful here.

6. **Additional Insureds are Insureds**

When added to another's policy as an additional insured, the company should treat that coverage as if it were its own for one simple reason – it is. Thus, it should be routine practice to always ask for the actual policies from counter-parties instead of simply relying on certificates of insurance. It is always easier to fix problems before the loss happens than after the fact.

7. **Always Keep the Policies**

Since the insured has the burden of proving coverage, it is important to maintain copies of all policies. Additionally, apart from their evidentiary significance, ready access to all relevant policies is crucial in the aftermath of storms such as Katrina and Rita. Thus, as with any valuable papers, all policies should be safeguarded. Given modern information technology systems, an easy way to ensure this is to digitize all policies when they arrive so that they can be electronically archived with other vital business records in a secure location.

8. **Comply with the Policy – Coverage May Depend on It**

Compliance is critical, and coverage may depend on it.

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make sure that the objective sought to be obtained is balanced against the potential risk that might result.

Apart from conditions like notice and proof of loss, a cautionary tale concerning compliance with the policy's description of covered property can be found in *Evergreen Nat'l Indem. Co. v. Tan It All, Inc.*<sup>117</sup> In *Tan It All*, the policy provided coverage for the insured's "business personal property" located in or within one hundred feet of the described premises. Approximately \$45,000 of tanning equipment was stolen from one of the insured's trucks, which was parked some 280 feet from the actual suite occupied by the insured. Because the policy identified the actual suite used by the insured, the Court concluded that, in order for coverage to attach, the property must have been located in or within one hundred feet of the insured's suite. As the truck (and hence, the stolen property) was not within this limitation, then there was no coverage for the loss.<sup>118</sup> The difference between a covered claim and a non-covered claim in this case was 180 feet – a little more than half the length of a football field. Once coverage is in place, the insured should make every effort to ensure compliance with any limitations on coverage, or it should seek a suitable modification of the policy for instances where compliance is not possible given the particular circumstances surrounding the insured premises.

#### 9. Never Assume There is No Coverage

It is better to check and make sure. An initial determination of whether a potential claim exists under any given policy can usually be made within a couple of hours. This almost always is time well spent.

<sup>117</sup> 111 S.W.3d 669 (Tex. App.—Austin 2003, no pet.).

<sup>118</sup> *Id.* at 677-78.

#### 10. When You Think There is No Coverage, Look Again, and Then Look for Another Route

Sometimes it is easy to conclude that a given loss is not covered by a given policy. Occasionally, these determinations are wrong. When it appears that a loss is not covered, look again. Is there an ambiguity? If, after further review, the conclusion still remains the same, then look for another route. Is there another claim that can be made under the policy? Is there another policy that might respond?

#### Conclusion

The energy sector suffered heavy blows from Katrina and Rita. Though the recovery process is underway, there is still much work to be done. Using a strategic approach to maximize the available insurance recovery is one of the most important steps along the way. Hopefully this article will help shed light on that process, and also serve to better protect the industry from the storms that doubtlessly will arrive during the next hurricane season and in the years to come.