Public Consultation: Improving Offshore Safety in Europe

Joint response by Lloyd's, the Association of British Insurers and the International Underwriting Association

Introduction

We welcome the opportunity to contribute to the European Commission's consultation on Oil and Gas Offshore Safety. This response is being submitted on behalf of Lloyd's, the Association of British Insurers (ABI) and the International Underwriting Association (IUA).

Lloyd's is a society of underwriters that operates as an insurance and reinsurance market, based in London. Its aggregate gross written premium income in 2010 was £22,6bn, 80% of which came from outside the UK. Lloyd's registration number on the European Commission's Register of Interest Representatives is 07203323308-65.

The ABI is the voice of the UK's insurance and investment industry. It has over 300 members, which together account for over 90% of the insurance market in the UK and 20% across the EU. The ABI's registration number on the European Commission's Register of Interest Representatives is 730137075-36.

The IUA represents insurance and reinsurance companies in the international insurance and reinsurance market working in and through London. Its membership, consisting of 40 general insurers and reinsurers, makes up approximately 95% of the Company market. The IUA's registration number on the European Commission's Register of Interest Representatives is 58082761985-18.

Executive Summary

We do not believe that the Environmental Liability Directive (ELD) is an appropriate legislative instrument for improving offshore safety in Europe. The EU should instead focus on obtaining international agreement on a liability regime specifically designed to deal with the offshore oil and gas industry.

We believe that current legal arrangements regarding compensation for traditional damage caused by accidents on offshore installations are sufficient and that the Offshore Pollution Liability Agreement (OPOL) is a proportionate and reasonable approach to the determination of liability and of financial responsibility in the event of an offshore pollution incident.

A requirement for offshore participants to purchase insurance or other financial cover at levels reflecting the full cost of Deepwater Horizon could prove damaging to the competitiveness of the oil and gas sector as any lack of insurance capacity may result in only the very largest companies able to secure the required financial security from their own resources.

We have responded below on three of the specific consultation questions which are directly relevant to the UK insurance industry.

Consultation Questions

8. In your view, should the existing environmental liability legislation (Directive 2004/35/EC) be extended to cover environmental damage to all marine waters under the jurisdiction of the EU Member States?

No. We believe that if the Environmental Liability Directive (ELD) is extended in this way, it would be difficult to provide insurance for the costs of remedying this environmental damage.

The ELD already covers environmental damage to coastal waters and protected species and natural habitats caused by offshore energy extraction. Extending this coverage to marine waters would risk creating a large financial exposure for offshore operators that would be difficult to quantify and therefore to protect against. It would not materially enhance protection of the marine environment.

The ELD aims to prevent and remedy environmental damage through application of the "polluter pays" principle. Prevention of accidents causing environmental damage is a laudable objective of public policy, which, of course, insurers support. Remedying environmental damage is a more difficult concept, particularly in the context of an extensive and dynamic environment such as marine waters, in which the consequences of contamination depend on variable factors such as weather conditions. It is possible to envisage an operation to "clean-up" a contaminated site on land, much more difficult to see how a large area of ocean, such as was affected by the 2010 Deepwater Horizon incident in the Gulf of Mexico, could be restored to "its baseline condition", as the ELD requires.

We do not therefore view the ELD as an appropriate legislative instrument for improving offshore safety in Europe. Despite its commendable objectives, the ELD is a complex piece of legislation and there is a long way to go to develop market capacity within the existing legislative framework.

We suggest a two-fold approach.

First, the priority is prevention. The European offshore oil and gas industry must be subject to strict standards designed to prevent accidents likely to cause environmental damage. The European Commission's Communication "*Facing the challenge of the safety of offshore oil and gas activities*"[1] noted that:

> *"A number of particular best practices exist in Member States and industry already in relation to safety, preparedness and response."*

We believe that offshore activity in UK waters is subject to a regulatory regime that imposes appropriately strict standards on operators. A recent report by the House of Commons Energy and Climate Change Committee[2] concluded that:

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[1] Com(2010) 560 final, published 12 October 2010

[2] UK Deepwater Drilling - Implications of the Gulf of Mexico Oil Spill published 6 January 2011

> *"…the UK has high offshore regulatory standards, as exemplified by the Safety Case Regime that was set up in response to the Piper Alpha tragedy in 1998. The UK regulatory framework is based on flexible, goal-setting principles that are superior to those under which the Deepwater Horizon operated."*

This does not mean that the UK regime cannot be improved and we note that, following the Deepwater Horizon incident, Oil and Gas UK (the UK offshore oil and gas industry trade association) established the Oil Spill Prevention and Response Advisory Group (OSPRAG), to review the industry's practices with respect to well control and oil spill response.

We agree with the Commission's aforementioned Communication, that *"…the challenge posed by the risk of a large offshore accident requires that state of the art practices become the norm throughout the EU and its waters."* We support efforts by the Commission to ensure that this is the case. It is important that intervention does not weaken existing robust regimes in countries with mature offshore industries, such as the UK, Norway, Denmark and the Netherlands. Rather than the imposition of prescriptive requirements, which may have precisely that effect, it is most appropriate for the Commission to encourage sharing of information between jurisdictions within and outside the EU on "best practice" within the industry.

Second, efforts to enhance the liability regime for the offshore oil and gas industry should not take the ELD as a starting point. Instead, the EU should focus on obtaining international agreement on a liability regime specifically designed to deal with the offshore oil and gas industry. There are several international conventions dealing with liability in relation to oil pollution, such as the International Convention on Civil Liability for Oil Pollution Damage (CLC) 1992, but they are restricted to pollution incidents caused by ships, so do not apply to the offshore oil and gas industry. EU waters are not only threatened by offshore activities within the territorial waters of EU member states. As the Commission's Communication recognises:

> *"Oil and gas exploration or production also takes place in the close vicinity of the EU, off the coasts of Algeria, Croatia, Egypt, Israel, Libya, Tunisia, Turkey and Ukraine…The EU needs to pay close attention to offshore areas adjacent to its territory where offshore drilling is growing and where an accident with any consequent oil spill could damage the environment and economies of several coastal Member States."*

It is therefore sensible to seek international agreement on oil pollution damage from offshore installations.

9. In your view, is the current legislative framework sufficient for treating compensation or remedial claims for <u>traditional damage</u> caused by accidents on offshore installations? If not, how would you recommend improving it?

We consider that current legal arrangements regarding compensation for traditional damage caused by accidents on offshore installations are sufficient.

As the Consultation Paper notes "*Responsibilities for traditional damage…are usually determined by civil courts or tribunals in accordance with national laws and/or case law following goals and principles defined at national level.*"

Consequently, there is no single legislative framework, rather a number of separate national liability regimes. Any deficiencies identified in a regime's ability to deal with claims arising from offshore installations are likely to reflect features of the overall regime, rather than issues specific to offshore claims.

Claims arising from accidents on offshore installations are likely to be complex. Typically, an offshore rig involves an operator and a number of different contractors and sub-contractors, often working for companies based in a range of jurisdictions. The forms of contracts between the parties vary and often incorporate indemnities, applying irrespective of fault, negligence or breach of duty. Each entity has its own liability insurance, with different insurers, which in turn are the subject of reinsurance arrangements.

The precise allocation of responsibility for an accident can therefore be difficult and can give rise to extensive litigation. A basic issue such as the jurisdiction in which legal action will be brought may not be straightforward and can take time to determine, with claimants aiming to commence legal actions in jurisdictions with claimant-friendly litigation systems and/or higher levels of compensation. In these circumstances, an important test of the liability system is whether claimants receive timely and appropriate compensation for their losses, irrespective of the existence of undetermined questions of ultimate responsibility.

To give an example: the *Piper Alpha* platform off Scotland was destroyed by fire and an explosion on 6 July 1988, resulting in the loss of life of 167 persons and 62 injuries. The operator of the platform was Occidental, whose parent company was based in Texas. Texas levels of damages being substantially higher than those in Scotland, levels of compensation were determined by what was called the "mid-Atlantic compromise", taking account of damage awards in courts in both jurisdictions. Occidental subsequently sought recompense from 24 different contractors in a total of 146 separate actions in Scottish courts, of which 7 were treated as test cases. The hearing lasted for 391 days between 1993 and 1996: the case then went to appeal, before it was finally determined by the House of Lords in 2002, 14 years after the event.

Three points are worth noting. First, the lengthy litigation arising from the event did not delay the payment of compensation to claimants. Second, although the event happened off the coast of an EU member state, the US legal system and levels of compensation available in US courts were a material consideration. US firms' significance to the energy sector means that this is a feature of litigation arising from accidents on offshore installations, restricting the impact of purely EU initiatives. Third, this litigation was not the inevitable result of the event but the consequence of choices and decisions made by the parties involved and their insurers and reinsurers.

Consequently, it is difficult to see how the EU could take action to improve compensation arrangements in the UK and we suspect that would also apply to other member states. Any proposals made would have to take account of existing legal provisions. For example, if, in order to reduce the possibility of extensive litigation, the EU sought to restrict parties' ability to bring legal actions it would be acting contrary to its duty to facilitate access to justice[3].

10. In your view what would be <u>the best way(s)</u> to make sure that the costs for remedying and compensating for the environmental damages of an oil spill are paid even <u>if those costs exceed the financial capacity</u> of the responsible party?

It must be recognised that insurance cannot provide a complete solution to this type of problem. Insurance may be available against some of the consequences of an oil spill. However, it will be subject to terms and conditions, including exclusions, at a premium that the underwriter views as reflecting the risk, but that a client may not be willing to pay, with limits on the amounts that can be recovered in the event of a claim. The product will reflect factors such as the insurer's capacity, reinsurance availability and the regulatory regime under which the insurer operates, including rules on solvency.

Imposing an obligation on the offshore oil and gas industry to purchase insurance at levels that insurers cannot provide or on a basis that insurers deem imprudent would create a substantial problem for the offshore industry, as non-compliance is inevitable. One consequence could be that offshore activity is restricted to the very largest firms, which can meet the requirements from their own resources. The Commission will be aware that BP is funding most of the costs of the Deepwater Horizon incident itself, without recourse to the international insurance industry. Of course, BP's financial resources are larger than those of even the biggest insurers. It seems perverse to transfer the risk from very robust entities such as major oil companies that have a great loss absorption capacity.

US legislators have been considering some of these issues since Deepwater Horizon. The US Oil Pollution Act 1990 imposes strict joint and several liability on operators of offshore facilities for damages up to USD75m and for removal costs. Deepwater Horizon has led to calls for the limit on damages to be increased to USD10bn, but legislators are concerned about the effect of such an increase on small and medium-sized firms within the US offshore energy sector. They see a risk that a limit at that level would force most such firms to exit the sector. No increase has therefore been made and the limit remains at its pre-Deepwater Horizon level.

Legal obligations to purchase insurance cover or to accept financial responsibility entail financial limits. Those limits should not be set purely in light of the exposures involved: if it is intended that the industry to whom the limits apply should purchase insurance (or other financial protection), it is important for policymakers to consult the insurance sector before setting the limits, to ensure that sufficient coverage will be available when required. London market energy insurers would be happy to meet with Commission officials to discuss these issues and to explain how coverage is currently provided.

Of course, this does not mean that consideration of the available options should be limited to what is already available. The insurance industry has a track record of coming up with innovative solutions for clients needs. For example, we note that Munich Re is proposing to make available a USD10bn facility for deep-sea offshore drilling in the Gulf of Mexico, intended to cover specific projects, with a deductible of USD1.5bn. Nevertheless, it cannot

[3] Treaty on the Functioning of the European Union, Article 67(4)

be assumed that cover at this level will automatically be available for all the offshore installations in European waters, nor that operators will either want or be able to pay the premiums required. Decisions on minimum levels of indemnity should be made on an informed basis, in the light of what insurers can provide to a complete sector.

We suggest that a good starting point for consideration of the issues raised by question 10 is assessment of the Offshore Pollution Liability Agreement (OPOL), in force since 1975. The UK Department of Energy and Climate Change will not issue a licence for exploration unless the operator is a member of the Offshore Pollution Liability Association Ltd, which administers OPOL. Furthermore, although originally limited to offshore facilities within the UK's jurisdiction, OPOL has been extended to offshore facilities within the jurisdiction of Denmark, Germany, France, Ireland, the Netherlands, Norway, the Isle of Man, the Faroe Islands and Greenland[4]. So offshore activity in the North Sea, where the vast majority of offshore installations in European waters are located (1,340 installations[5]) is already subject to a requirement of financial responsibility for the escape or discharge of oil causing pollution damage.

Under OPOL, operators agree to accept strict liability for pollution damage and the cost of remedial measures, with certain exemptions. Their maximum liability is USD250m per incident, made up of USD125m for pollution damage claims and USD125m for remedial claims, with an annual aggregate limit of USD500m. Parties agree to contribute to the payment of claims due from a party that fails to meet its obligations to claimants. Association members undertake to establish and maintain their financial responsibility to meet these claims by providing evidence of insurance, self-insurance or other satisfactory means, such as a surety bond or guarantee.

Anyone may make a claim if they sustain pollution damage resulting from an escape or discharge of oil and Governments and public bodies can claim for reasonable remedial measures taken to prevent, mitigate or eliminate pollution damage. OPOL defines "pollution damage" as direct loss or damage by contamination which results from a discharge of oil.

We consider that OPOL is a proportionate and reasonable approach to the determination of liability and of financial responsibility in the event of an offshore pollution incident. Nevertheless, we recognise that the Deepwater Horizon incident, for which BP included a charge of USD40.9bn in its 2010 accounts, suggests that OPOL's maximum liability of USD250m may be inadequate. However, in line with our previous remarks, requiring firms in the EU oil and gas industry to provide evidence of the financial capacity to meet claims on the scale of Deepwater Horizon would be a step fraught with consequences for the EU's energy sector.

The implementation of Solvency II, the EU's new financial and regulatory regime for insurers, from 1 January 2013 is likely to further restrict the availability of liability insurance for the offshore oil and gas industry. Solvency II is intended to align insurer capital requirements more closely with their risk profile. Insurers must calculate a Solvency Capital Requirement based on a 99.5% confidence level of remaining solvent within the next 12

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[4] OPOL does not apply in the Baltic or Mediterranean Seas

[5] European Commission Staff Working Document accompanying Communication *Facing the challenge of the safety of offshore oil and gas activities*

months. Solvency II's risk-based approach means that insurers must put up more capital if they propose to underwrite catastrophe-exposed business such as offshore liability. This may reduce the number of insurers willing to provide this type of business, and therefore the availability of the coverage.

A requirement for offshore participants to purchase insurance or other financial cover at levels reflecting the full cost of Deepwater Horizon could reduce the amount of offshore activity in European waters and restrict what there is to the very largest global energy firms, the only entities able to meet the requirement from their own resources.