



Energy & Marine Insurance Newsletter

April 2011

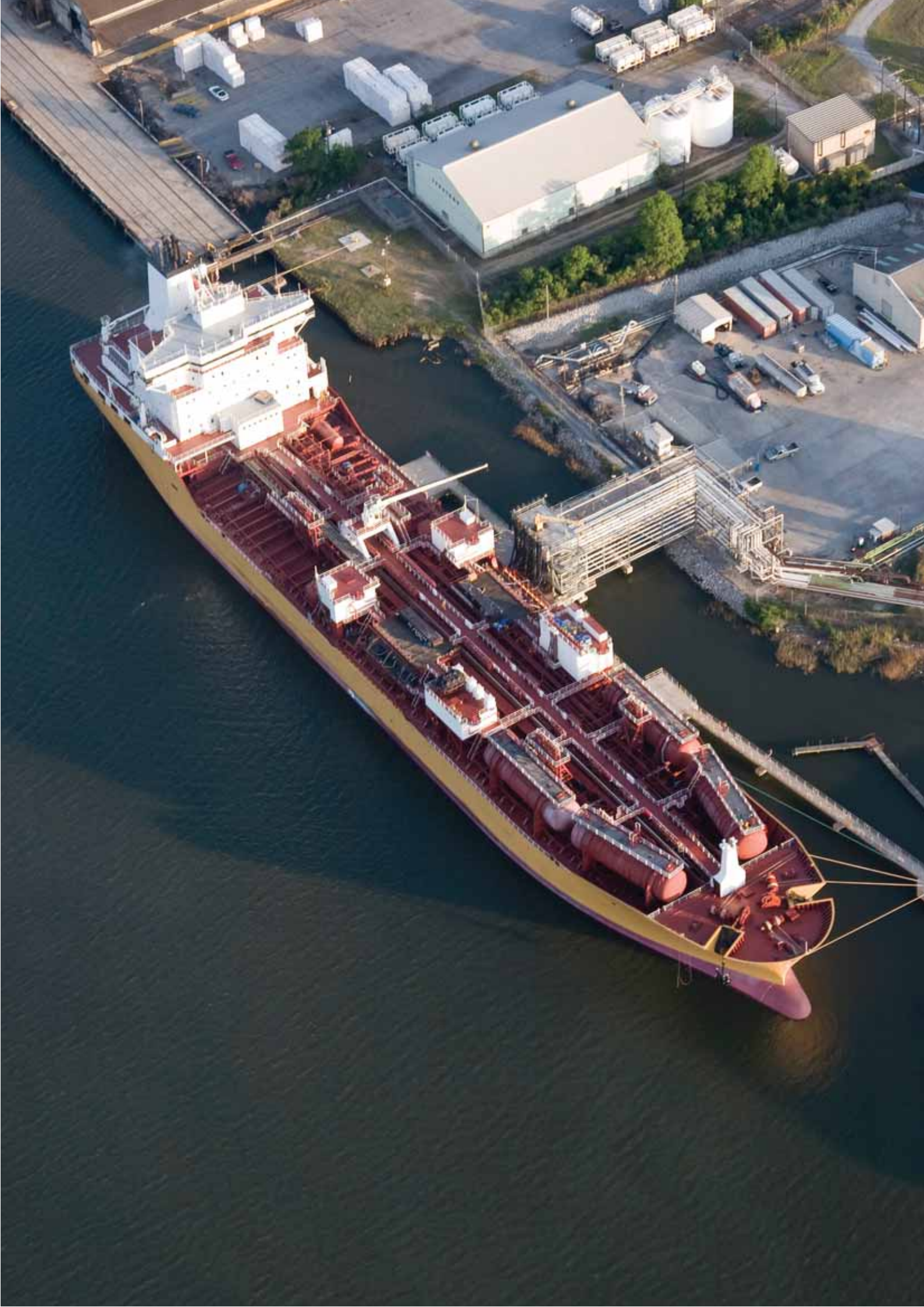
Lloyd & Partners Limited

Expertise • Commitment • Service

Exceeding our clients' expectations



**Lloyd &
Partners**
Limited





Index/Contents

We are pleased to provide our existing, and potential clients with our 2nd Quarterly Newsletter of 2011.

In addition to our regular features, in this edition we have a 'focus on' Well Examination and Assurance'.

We hope that readers will find this newsletter interesting and informative and would welcome any feedback you may have, positive or negative, which you can email to: jcooper@lloydandpartners.com or pass on to any of your usual LPL contacts.

If you are reading this in hard copy or have been forwarded it electronically, and would like to be added to our electronic mailing list please email jcooper@lloydandpartners.com.

REGULAR FEATURES

General State of the Market Overview	Page 2
Recent Quotes	Page 7
Market Moves / People in the news	Page 10
'What's New?' (New products and market developments)	Page 11
'Briefly' (News snippets)	Page 13
Update on Losses	Page 16
Security Ratings update	Page 18
Legal Roundup	Page 19

SPECIAL ARTICLES

1 / 1 Reinsurance Renewals	Page 23
Lloyd's Realistic Disaster Scenarios	Page 24
US Oil Spill Legislation update	Page 26
'Focus on': Well Examination and Assurance	Page 29

General State of the Market Update

As the first quarter of 2011 comes to a close, the world continues to witness the apocalyptic human tragedy unfolding in Japan as the impact of the earthquake, tsunami, and possible nuclear disaster unrelentingly take their toll, with over 20,000 fatalities expected.

The earthquake measured 9.0 on the Richter scale and released ten thousand times more energy than the recent earthquake in New Zealand. The quake and ensuing tsunami have resulted in the decimation of entire regions, with severed gas lines feeding the fires sweeping through parts of the country. At least one refinery has been destroyed with operations suspended at several others, and the country faces the possibility of a grim nuclear disaster following severe damage to some of the reactors at the nuclear power plants resulting in potentially lethal radiation leaks.

Catastrophe modeler AIR estimates a loss from the earthquake alone of USD 35 billion, whilst Eqecat's initial estimate is an overall economic loss of not less than USD 100 billion.

Of course it is too early to tell how the tragic events of earlier this month will impact the insurance world in general. Although there is a robust local market that will be hit hard, the Japanese also have a long history with reinsurers and the Japanese treaties are some of this market's longest-standing contracts. A number of insurers have already released loss estimates (even as major aftershocks occur), suggesting the impact on the reinsurance community will be devastating.

ENERGY

Upstream

Although there is likely to be an immediate hardening across the general property market which had previously been in freefall, the impact on the upstream market is likely to be more muted as the rating environment following the Macondo loss in April last year has remained fairly disciplined across the upstream portfolio.

Japan is likely to ultimately have an affect on the upstream markets, largely from a macro perspective, as the underwriting community in general is still reeling from the cost of Chile, Australia, and New Zealand, but we do not believe the event is in itself market-changing. We believe that Japan, against the backdrop of the other recent natural catastrophes, and following the North Sea FPSO loss reserved at circa USD 800mm will definitively strengthen the existing resolve to maintain the firm rating environment that currently exists in the upstream market.

With regard to developments in the Gulf of Mexico, although the drilling moratorium was lifted in October, only two deepwater permits have been issued so far, both in the last few weeks, and for wells where drilling had been suspended immediately after the Macondo incident.

Munich Re have announced that their much hyped USD 10 billion facility for deepwater will be available when drilling resumed in the Gulf of Mexico. The theoretical capacity is likely to be provided on a project basis by the Munich Re and other large European reinsurers, possibly in conjunction with capital markets, and will attach excess of USD 1.5 billion. The extent to

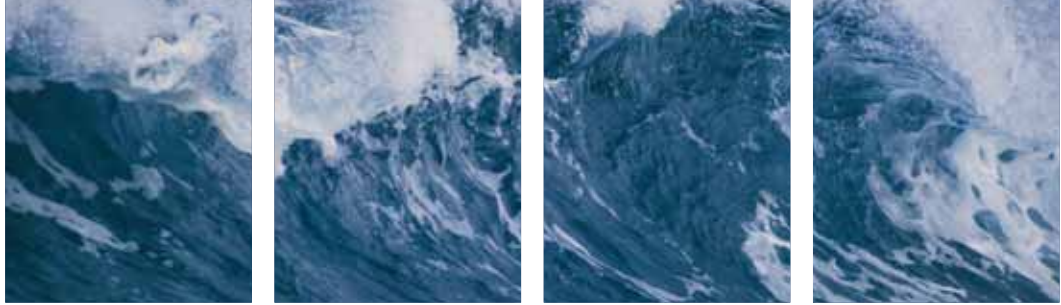
which there is demand for such a project and at what price, remains to be seen.

In the liability markets, supply remains tight with the recent withdrawal of Torus in Bermuda only serving to further limit the already severely pared back capacity following the Macondo incident in April 2010. We estimate that the working capacity has more than halved the USD 1.5bn that was available in the first half of last year. Pricing in this arena continues to attract the most meaningful percentage increases. The most dramatically impacted sector of this market remains OPA certification, where pricing has spiked due as much to the limited number of markets prepared to offer the cover as to the Macondo event. Although the current legislation is unchanged with the top limit currently mandated USD 150mm, final legislation on the issue is still to be determined by the US government.

Midstream / Downstream

As anticipated, the pricing impact from the Treaty market at 1st January on mid and downstream direct insurers was muted.

As such, the continuing oversupply of capacity within the market means there has been little to no brake on the prevailing downward trend in rates during the 1st Quarter. The increase in worldwide commodity demand and spiking oil prices, however, is ensuring a certain level of capital expenditure and earnings growth. This translates to increased values being declared to insurers albeit with the resultant premium being depleted by the erosion of base rates. One significant dynamic becoming more evident is that a number of insurers continue to concentrate on pursuing market share and maintaining premium income whilst others



look to hone their risk selection with a decreasing premium base. It is clear individual underwriting strategies are more accentuated as insurers seek to ride out the bottom of the cycle. This fragmentation of market approach has a clear effect on the pricing of risks requiring substantial marketing and capacity against those that do not.

Beneath the seemingly placid surface is a new undertow. There have been a number of severe catastrophic losses such as the flooding in Australia, earthquakes in New Zealand and Japan and the tsunami that followed the latter thereafter. This will impact the major reinsurers but inevitably their losses will be in filled by other markets. A corresponding impact on clients with Cat exposed operations is likely. Less obvious but worth equal consideration is the frequency of non Cat losses that are now impacting onshore books. Setting aside headline losses such as the January Upgrader fire in the Canadian Oil Sands there have also been a significant number of incidents likely to give rise to claims in the USD10-USD100 million range. These are less easily perceived by buyers because the losses span a number of energy sectors and geographical regions. The result, however, being that by the advent of the 2nd Quarter many onshore insurers will be looking at materially poor 2011 results and a bleak outlook for the remainder of the year. It would be easy for buyers in the current market environment to feel it's business as usual but clients requiring larger capacity plays or more tailored coverages should take a cautious view; those buyers outside of that category can continue to make hay, as the sun will shine for a little longer.

MARINE

Over-capacity of marine cover has been a common theme in the market for the last 12 months. However much marine insurers may complain about poor margins, the class clearly remains globally attractive and new market entrants are seeking to participate. Of course, the arrival of additional capacity brings more pressure to bear on existing markets, leading in turn to further complaints about margin levels. And so it goes on...

The softening of the market could be counter-balanced by external factors such as reinsurance rates. The impact of the Deepwater Horizon loss is moving into to the marine insurance market business cycle, and will be exacerbated in due course by the earthquake in Christchurch, and earthquake and tsunami in Japan. The gravity and extent of these recent natural catastrophes indicates the effect on the insurance market could be profound.

For now, however, marine market cover remains competitive. High capacity levels are not restricted solely to insurers. World fleet trading levels are up, and with the recent news of increased capital investment aligned with substantial newbuilding orders, there seems to be little sign of abatement of the growing capacity in shipping.

The 2011 Protection & Indemnity (P&I) renewals occurred with less fanfare than has been the case for the last few years. This was due, in large part, to the generally benign renewal conditions existing throughout the International Group. The recapitalisation of the clubs, which has taken place via various methods since the turn of the millennium, has had a calming effect

which has been most welcome. The recent reduction in International Group (IG) Pool claims, when taken in concert with revitalised financials, has put the IG back on to its more traditional steady path. Were it not for the review by the European Union, the immediate future of the IG would seem comfortable by comparison with the last 10 years. The IG member clubs have previously demonstrated that they can adequately defend themselves at Government level, but the general expectation is that structural change of some kind is likely to be visited upon the Group by the EU Commission. As the year develops, so it is hoped that a clearer picture will emerge regarding expectations for the 2012 renewal.

POWER

Power underwriters faced downwards pressure on rates for the duration of 2010 as the property market continued to soften due to the high levels of available capacity.

Inter Hannover, who were previously a bit part player in the power market, entered the fray in a big way by forming a 'Power Alliance' with Ascot. The combined Power Alliance line size is USD 150 mm, thus contributing significant new capacity to the London power market.

Increased capacity from some existing markets and new entrants added to the over supply of capacity and therefore we expect the London power market to remain competitive in 2011 despite the fact that they have already experienced a series of large losses in early 2011 / late 2010, that comes at a time when insurers are concerned that a number of their clients have aging equipment as well as

maintenance budgets impacted by the current economic environment.

It is too early to be accurate with the quantum involved but two of the most severe losses have been: In excess of USD 200 mm, (South Africa) steam turbine loss and more than USD 100 mm, (Panama) hydro tunnel collapse. Other significant power losses have occurred in Oklahoma USA, Venezuela, Thailand, Ecuador and the UK.

Combustion turbine technology remains a focal point for underwriters who are scrutinising certain technologies in particular:

GE LMS100

Although component parts are all tried and tested, some underwriters are taking the view that this technology is prototypical as the 'sum of the parts' are unproven and they have had early life problems. The lead machine (in terms of running hours) has had outer band distress.

Siemens 501

Hook fit wear problems on 501F's and G's. Siemens have resolved this by using a compressor design from the German SGT5-4000F. Most of the fleet in operation have now had the upgrades necessary, underwriters are looking to ensure that this work has been done.

These machines are designed to run at base load but problems have been encountered when they have been used as cycling or peaking units by some operators.

GE LM6000

Reliable and proven technology when operated correctly. However underwriters have experienced losses from this technology and will be looking out for the following in



particular: Run as peaking units and not base load production, issues with gear box and seals – generally not an issue if TIL's have been complied with, part of a lease pool agreement.

GE 7FA / 7B / 9B

This technology (particularly the 7FA's) is still coming under a lot of scrutiny by underwriters. They are looking to ensure that the right levels of maintenance and TIL compliance are in place as a number of new losses have recently been reported. These are generally compressor failures with losses in the USD 10 million to USD 15 million range.

Other Industry specific hot topics include:

- Increased costs of raw materials leading to potential under-valuation for replacement / new plant
- Limited availability and capacity of the Original Equipment Manufacturers, leading to increased lead times for replacement plant and consequently longer Indemnity Periods
- Speculation on fuel costs and availability of generating capacity which could lead to volatility of wholesale energy prices and potential increased Business Interruption exposures
- Transparency and understanding of Long term Service Agreements
- Transparency and understanding of Power Purchase Agreements and relevant BI exposures.

MINING

Modest reductions were being achieved on mining accounts in the 4th quarter of 2010. Whilst some Insurers are holding out against reductions and requiring technical merit to reduce pricing, their approach is against the general market trend.

Where 'modest' limits are required there are new capacity options which enable a change market if required to achieve maximum savings. However, whilst these lower limit contracts present the opportunity to remarket, the majority of buyers have experienced the market peaks and prefer to continue partner relationships with a smoother approach through the cycle.

The market position with regards to recent loss activity is unclear. As with the main Property account we enter a period of the unknown and uncertainty whilst loss from the Queensland floods are assessed and the market reaction considered. In addition there has been a recent significant loss in Canada of around USD 200mm.

The general feeling is that a review of coverages given in Queensland is quite likely but depending on quantum there could be a push from Insurers from an increase in premiums across the board to replenish balance sheets.

There is also a focus from mining underwriters now on accumulation of Contingent Business Interruption exposures, e.g. Ports etc which could present a real challenge as commodity prices continue to soar. This will lead to capacity crunch in certain areas, e.g. Antofagasta in Chile which is not only cat prone but an industry bottleneck.

Recent Quotes

The following are 'sound bites' taken from speeches, statements or articles by prominent market figures about the insurance market and whilst we have tried not to take their words out of context, the excerpt may not be the entire speech or article.

Tom Bolt Lloyd's Director of Performance Management

"How important is it for syndicates to focus on underwriting discipline? In the first half of the year I've seen statistics which show a 6% increase in capital in the insurance market. The underlying economy, at least in the West, seems to be smaller and therefore there's less business. Some underwriters have commented that it's an unusual time where even though prices are going down a little, the original insureds are keeping bigger retentions and buying less or differently. So in your recipe for what 2011 looks like you have a greater amount of capital trying to be serviced, a smaller amount of demand in terms of less insurance and reinsurance being purchased, a few more market participants depending on which part of the market you're talking about, and most importantly, very little investment return to speak of. There's not much room to take care of things other than to get it right on underwriting. You could hope for luck but the smarter underwriters will be managing their books down. We've looked at the top ten and the bottom 10 syndicates over the past years since 1993. The key difference is that in the soft years 1998 to 2001, the top 10 syndicates reduced their participation in the market. And

in the boom years post 9 / 11 they really pushed it up and wrote a lot in the market. The bottom 10 seem to have had a fairly straight participation all the way through and it seems to have affected their results. That's a fairly compelling message when you're considering how you address the market in 2011 as the various segments get softer and softer."

David Croom-Johnson, active underwriter at AEGIS London

"Students of insurance history will know that there are relatively few single insurable events that prove to be market changing. Big catastrophes such as wind storms or earthquakes of course have the power to turn premium rates upside down but a single loss rarely warrants a place alongside the worst that nature can summon. Step forward then one of the few exceptions to the rule; Deepwater Horizon has already had an impact akin to that of say, Piper Alpha (another rare exception), in what it has done to the market in terms of rates and in setting in motion a fundamental reappraisal of how the market aggregates its exposures. From a first party perspective, the appetite to supply cover has reduced since the Deepwater Horizon spill with at least one market having already pulled out and a consequent hardening of rates for




offshore covers such as physical damage and control of well. The historical inadequacy of the premium pot and its inability to sustain the offshore industry's losses has been well and truly brought home (if other major incidents such as Aban Pearl and West Atlas had not already made the point). Arguably when you turn to third party losses, the market shift has been even more pronounced as practitioners have started to respond to the lessons learnt from the scale of their aggregate exposure to the incident. Deepwater Horizon has highlighted a particular market failure to understand the full potential for aggregation of third party liabilities as offshore owners, operators and contractors find themselves at the centre of a feeding frenzy of lawyers and multiple class actions. A drilling contractor might not be surprised to be sued under the terms of their drilling contract, for example, but when they find themselves on the end of a writ from the Governor of Alabama or a class action on behalf of Alabama restaurant owners, the alarm bells start to ring over where liability starts and where it finishes. This changed understanding of the overall exposure that businesses working offshore face has led to a real questioning from insurers' internal management as well as capital providers and regulators as to whether capital should indeed be employed in the offshore market. In response insurers have remodelled their exposures to a Deepwater Horizon style event while Lloyd's has asked insurers to justify their strategy when it comes to offshore underwriting. The levels of scrutiny

have intensified. Insurers, including AEGIS, have generally now reduced the capacity that they are willing to allocate to any one platform. If the lasting lessons of Deepwater Horizon are a better understanding of insurers' aggregate exposures and more realistic pricing, then that can only be a good thing for the long term sustainability of the offshore insurance market. In the longer term, Deepwater Horizon will undoubtedly lead to fundamental changes in drilling practices in the Gulf of Mexico with changes to the Oil Pollution Act expected and all the attendant additional liabilities that that might bring. Anyone who expected a swift end to the matter following the successful capping of the well might be reminded that, 23 years after the Exxon Valdez spill, the last claim has only just been settled. We are entering into a period of enormous uncertainty which could mean it's 10 years before it is known where the final liabilities for Deepwater Horizon will lie. Its lasting legacy for the insurance industry, however, has already started to take shape."

Roger Giddings, head of Ace's global energy division

"The chance of an estimated maximum loss (EML) is much higher in the offshore energy industry, yet the price of insurance for that sector does not correlate with the risk. The refinery industry generally sees an EML event as a one-in-10,000-year loss. There are very few EML events in that market, but then look at offshore and it's a very different story. Onshore EML events are much, much more uncommon and the prices for onshore volatility



are more closely aligned, but offshore is significantly underpriced. The sinking of a rig is an EML event, and last year alone there were two, with the Deepwater Horizon in April and the loss of the Aban Pearl in the Caribbean Sea just weeks later. Deepwater Horizon brought property claims of USD 560mm to the market, while the loss of the Aban Pearl hit the sector with a further USD 235mm. There have been other EML losses throughout the years, so the offshore line is far more volatile and the EML event is far more likely to happen offshore. What we are being reminded of is that the offshore market is about volatility. The whole energy market is volatile, but offshore even more so. The offshore line encompasses multiple lines – drilling, construction, general liability, mobile rigs – there are lots of risks. There are a lot more moving parts on the offshore side and we are exposed to more risks offshore. Onshore is just property and business interruption. What you must not lose sight of is in the background you have the run-of-the-mill attritional losses going on and the offshore line is far more active in attritional losses as well. Despite losses, there's no dilution of appetite for the class, and what drives pricing is capacity – capacity trumps losses."

Robert Hiscox, chairman of Hiscox

"General insurance is a great business as there is an insatiable and constantly growing demand for it. What drives rates up and down is supply of capital in the industry, combined with management weakness. A small example of management weakness: the premium for piracy of ships in the Gulf of Aden can be calculated very roughly by relating the number of journeys through the gulf to the number of successful kidnaps by pirates. We had built a rating for this and were trading successfully when the competition decided to under-cut our rates by about 50%. At the same time, the pirates doubled their demands. How can any management allow an underwriter to compete at a quarter of the rates of the established market? We have continued to quote the sensible rate which effectively leads to our retreating from the business. We will be back when our competitors realise their folly and withdraw from the market, as some already have."



Market Moves / People in the News

Richard Bridges has resigned from Chubb, to join the marine team of the Mitsui syndicate at Lloyd's.

Dermot Dick has resigned from his position of CEO at Q-Re in Qatar to join XL Re Europe in London.

Grant Smith has joined the QBE syndicate's liability team from Travellers.

Lydia Ross is joining CV Starr's liability team from Catlin.

Daniel Dobisz has resigned from Brit to join Mark Edmondson in the marine team at Chubb.

Richard Rea is joining the Skuld syndicate 1897 from Navigators to write their marine liability account.

Greg Walters is leaving the onshore energy team at QBE syndicate to join Liberty.

Robert Fellows is leaving the onshore energy team at CV Starr syndicate to join the QBE syndicate.

Chris Jones is joining Kiln from QBE to write international casualty business including construction, mining and natural resources.

Brian Randall has resigned from the Watkins syndicate to take up a position with Brit in Lloyd's.



What's New?

(NEW PRODUCTS AND MARKET DEVELOPMENTS)

Anemos and **OCIL** have announced a new facility to help offshore energy companies reduce and manage their named windstorm retentions. The offshore named windstorm deductible buyback facility has limits of up to USD 5 million per occurrence and in the aggregate for the Insured's interest. Coverage is for physical damage and operators extra expense for offshore platforms, rigs and pipelines operating in the Gulf of Mexico. Loss of profit, business interruption and third party liability are excluded.

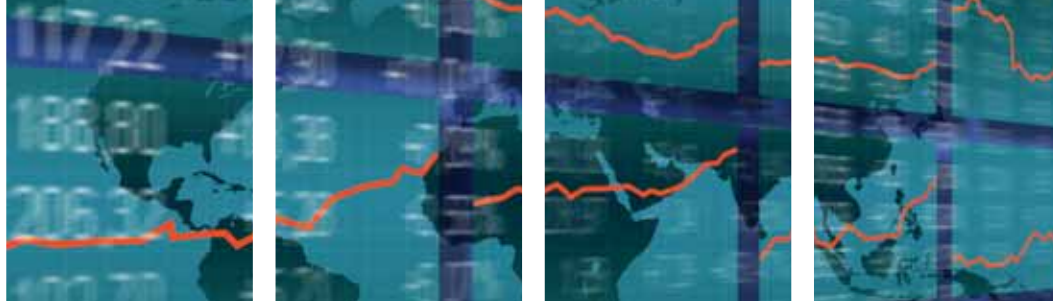
The North of England P&I Club have announced plans for a new fixed-premium product operating on a conventional subscription basis, to cover hull & machinery, increased value, loss of hire and war coverages, and is due to be launched in July this year.

Renewable energy insurer **GCube Insurance Services** have increased their limit for solar projects to USD 500mm (from USD 300mm) through their "SolarPro" product.

The Lloyd's Market Association (LMA) issued a press release after the March **Lillehammer Energy Claims Conference** advising that the LMA Energy Claims Group had presented their revamped 'Terms of Engagement for Energy Loss Adjusters' at the Conference. The new terms of engagement will bring increased transparency to the claims process and with it, the potential for more efficient claims handling. Commenting on the new terms of engagement, Richard Foulger, Head of Claims for AEGIS London and Chair of the LMA Energy Claims Group, said: "The original draft of the 'Lillehammer Terms of Engagement for Energy Loss Adjusters' was introduced in 2004 to help

improve the claims experience in the offshore energy sector. While not mandatory, the original terms of engagement have been successful in helping to enhance claims standards. The redrafted terms will bring more clarity to the loss adjuster's role which, in turn, will give underwriters an opportunity to improve the claims process further. Ultimately the insurance buyers in the offshore energy sector, for whom a claim is the ultimate demonstration of the quality of their insurance product, should benefit through a better claims experience." Geoff Jones, Property & Energy Claims Manager at Catlin Underwriting Agency and Deputy Chair of the LMA Energy Claims Group added: "We think that the revised document provides greater clarity of the respective roles in the claims handling process. This in turn should lead to a product that is to the mutual benefit of all parties." The 2010 Terms of Engagement can be downloaded from the Lillehammer Conference website www.energyclaims.net

A USD10bn insurance facility for deep-sea offshore drilling in the Gulf of Mexico is close to completion, according to Munich Re. Munich Re board member Torsten Jeworrek told an insurance trade conference in Munich that "When drilling resumes, the cover will be there." The facility first mooted at the Monte Carlo Rendez-Vous in September last year in the aftermath of the BP Macondo disaster was originally proposed as USD20bn but that has seemingly been reduced now to USD10bn. Jeworrek added that the "The point is it is cover for a specific project, as opposed to the traditional method of granting cover to a company." According to Munich Re, exploration, development and production is included,



covering clean-up costs, losses from damage to biodiversity, property and financial losses of companies involved and has a deductible of USD1.5bn. Whether or not their will be interest from oil companies if and when this product is finally launched is to be seen.

Torus has withdrawn from underwriting excess liability risks in Bermuda with immediate effect, but will continue to offer existing liability products provided by its casualty units in the US and London. The company stated the reason for this decision as being the fact it will be increasingly difficult to achieve the necessary scale and returns for Bermuda within an acceptable time frame in the face of continuing rate deterioration and increasing excess capacity.

JLT's Political Risk team have recently added a publication to their **World Risk Review** entitled "The Changing Political Risk Landscape of the Middle East & North Africa". World Risk Review is a free information service provided by JLT to help corporations, banks and other organisations involved in international trade. It provides short to medium term assessment of the level of risk associated with a range of political and economic perils that could cause financial loss, by monitoring 53 international sources of independent, verifiable data and expert advice from a distinguished advisory board, rating 197 countries and territories using nine perils under the broad categories of Political Violence, Trading Environment and Investment Environment, and is the most comprehensive risk assessment tool of its type. The World Risk Review is free to clients and prospective clients through subscription on www.jltgroup.com/worldriskreview

The Dodd-Frank Act comes into force in the US from 21st July 2011, which incorporates, amongst banking and other financial institution regulations, an **overhaul of the US Surplus lines laws**, with the aim to have a more consistent approach to insurance laws which currently vary considerably from State to State. Under this new act only the Insured's 'Home State' will be responsible for collecting taxes (rather than paying taxes in all the States where risk is located). The Home State's licensing laws will also prevail over any other. The 'Home State' is where the 'nerve centre' of a corporation is located – i.e. where the decisions are made. We understand that there is a raft of legislation going on within individual States to try and protect their relative positions and ensure they maintain the income from their surplus lines taxes, so it is possible that if these succeed the simplified process could be made complicated again. Another important factor of the Dodd-Frank Act is the introduction of a common 'Independently Procured' definition which allows commercial purchasers exemption from the Surplus Lines Laws. To qualify as a "commercial" purchaser (in all States) and to be allowed to procure independently "unlicensed (non-admitted)" insurers, the Insured must have a full-time Risk Manager and an annual premium spend in excess of USD 100,000, plus either a net worth in excess of USD 20mm, annual revenues in excess of USD 50mm, or more than 500 employees.



‘Briefly’

The UK Parliamentary **Energy and Climate Change Committee** have reported that they believe that the UK has high regulatory standards as exemplified by the Safety Case Regime that was set up in response to the 1988 Piper Alpha tragedy. However in their report to the UK Parliament, they state that the Government needs to ensure that offshore oil and gas exploration companies have considered high-impact, low-probability events as part of the process by which they obtain a licence to drill. As well as recommending that the Health and Safety Executive consider prescribing specifically that blowout preventers on the UK Continental Shelf should have two blind shear rams, the committee believes that should an oil spill resulting from drilling activities occur in the UK, there needs to be absolute clarity as to the identity of the responsible party, and liability legislation needs to ensure that those affected are compensated as soon as possible. Given the high costs of the Gulf of Mexico incident, the committee believe that the Offshore Pollution Liability Association (OPOL) limit of USD 250 million is insufficient. They have also stated that they are concerned that the voluntary requirement of OPOL membership (despite it being a pre-requisite of the licensing process) weakens any legal control over it, allowing polluters to claim that any damages to biodiversity and ecosystems are "indirect", and therefore do not qualify for compensation. Given the evidence available the committee concluded that there should not be a moratorium on deepwater drilling in the UK Continental Shelf and further concluded that any calls for

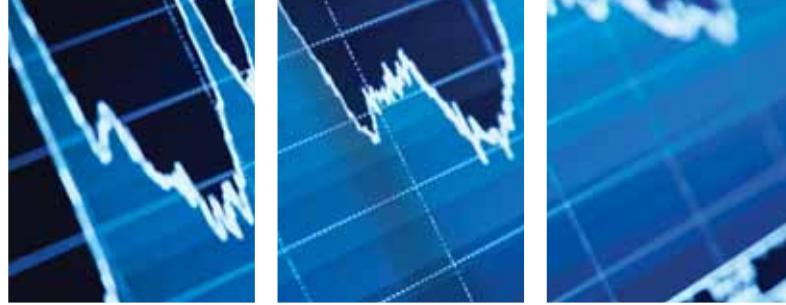
increased oversight of the UK offshore industry by the European Commission should be rejected in favour of multilateral approaches to regulation and oil spill response amongst those countries with a coastline that could be affected by an oil spill. Their full report can be downloaded from the following link:

<http://www.publications.parliament.uk/pa/cm201011/cmselect/cmenergy/450/45002.htm>

The cost of Piracy to the world economy in 2010 cost between USD 7 billion to USD 12 billion according to a study by the One Earth Future (OEF) Foundation to quantify the cost of piracy as part of its Oceans Beyond Piracy project. According to the report at the end of 2010, around 500 seafarers from more than 18 countries were being held hostage by pirates. The report states that over the past five years, ransoms paid to Somali pirates have increased from an average of USD 150,000 in 2005 to USD 5.4 million in 2010 and by the end of 2010, approximately USD 238 million was paid in ransoms to Somali pirates in that year alone. The report estimates that total excess costs of insurance due to Somali piracy are between USD 460 million and USD 3.2 billion per year.

The report can be downloaded from www.oceansbeyondpiracy.org/documents/OBP_Brochure_A4.pdf

The International Group of P&I Clubs General Excess of Loss reinsurance contract (GXL) and Hydra reinsurance programme for 2011 / 12 has been renewed with rate reductions for all vessel categories and a further reduction in the US oil pollution voyage surcharge. The Group has



decided with effect from 20 February 2011 to increase the excess point on the GXL contract from USD 50mm to USD 60mm. The resultant additional USD 10mm of retained risk within the Group pool will be 100% reinsured by the Group captive, Hydra Insurance Company Ltd (increasing the Hydra pool reinsurance layer to USD 30mm x USD 30mm, in addition to 25% of the first layer of the Group GXL program of USD 500mm x USD 60mm). In a press release the International Group reported that there has been significant improvement on prior year claims deterioration and that the favourable claims picture for the 2008 / 9 / 10 policy years is reflected in the renewal terms negotiated with the Group's reinsurers for 2011.

According to a statement by the international insurance think tank **The Geneva Association** the four biggest issues for insurance in 2011 are as follows:

Regulation: the association said they working with international regulators and standard setters such as the IAIS, the International Accounting Standards Board and others to help them tackle the complex questions of how to best regulate and supervise the insurance industry, and are achieving this through the provision of factual analysis and additional knowledge for these discussions with a view to achieving the most efficient insurance solutions in the future regulatory framework. Getting this next wave of regulation right is critically important, not only for the industry, but also for continued economic growth and development.

Financial stability: The association commented that the G-20 has tasked the Financial Stability Board with addressing and solving the problems surrounding the resilience of the global financial system. While systemic threats do not emanate from insurance activities there are a number of issues that remain poorly understood or simply have not been discussed but where important decisions will be taken by governments in 2011. The role of insurance companies that operate as financial conglomerates carrying out potentially systemically risky activities has to be properly addressed and the confusion surrounding Systemically Important Financial Institution (SIFI) identification and its consequences needs to be overcome. The differences between insurance and banking have to be taken into account appropriately in discussions about financial stability and any solutions need to be compatible with the distinct roles that insurers and banks play in today's economic systems. The key is to ensure that regulatory imprecision or overstretch do not hamstring a well functioning industry and damage societal interests.

Climate change: The association believes that the challenges to climate change are long and far reaching but there will also be opportunities. While government level talks have stalled and produced disappointing outcomes in Copenhagen and more recently Cancun,

the challenge of how to deal with threatening scenarios linked to climate risks remains.

Demographics: The association said a serious demographic challenge lies ahead for most societies. The shift towards longer life expectancy and ageing populations has not only a direct impact on the organisation of old-age security and health provision, it will also change the way in which societies look at risks, organise their infrastructures and generally deal with economic and other challenges.

Further details are available from www.genevaassociation.org

Risk Management Solutions (RMS) have released a revised US hurricane model, (version 11.0) warning that wind risk for all hurricane-exposed states is expected to increase on an industry-wide basis. However, RMS have stated that the model does not necessarily mean an increase in exposures across all portfolios. RMS said significant information gathered over several years had changed the modelling firm's view of a number of regions at risk from hurricanes in the US with Texas and the Gulf States now contributing more to the overall risk profile

than before. The change to the model is expected to lead to a rise in probable maximum loss values (PMLs) for risks across Texas and some other areas of the Gulf Coast. According to RMS, a considerable amount of data on building performance was derived from hurricane Ike, which revealed some unexpected trends in building performance.

York Specialized Loss Adjusting a division of New Jersey-based York Risk Services Group, Inc., has acquired BC Johnson Associates, a provider of specialized loss adjusting and risk assessment services to the global energy industry.

The European Commission has published a proposal for an **Omnibus II Directive** that will amend the Solvency II Framework Directive, to bring it in line with the EU's Lisbon Treaty and to take account of the EU's new supervisory structure. It also pushes Solvency II's implementation date back to 1 January 2013 and gives the European Commission powers to defer many parts of Solvency II for up to 10 years. Omnibus II has the same legal basis as the two directives it amends – the Prospectus Directive and the Solvency II Directive. Putting it into force requires agreement from the European Parliament and Council.

Update on Losses

2011 Energy losses of USD 10 million or more that we are aware of at the time of writing are as follows.

We also show the total of all claims under USD 10 million (with a minimum claim USD 1mm) to give an overall total for the year so far.

2011 MAJOR UPSTREAM ENERGY LOSSES (IN EXCESS OF USD 10,000,000 GROUND-UP)

Jan	Blowout	Gulf of Mexico Gas Well	*
Feb	Heavy Weather	Mooring Damage on North Sea FPSO	USD 800,000,000
Mar	Fire	Gulf Of Mexico Platform	*
To date	Total under USD 10,000,000	(Minimum of USD 1mm)	USD 6,000,000
		Total (known) for year (excess of USD1mm)	USD 806,000,000

Source: Market database/LPL market knowledge (as of 14 March 2011)

Figures shown as "(est)" are estimates from various press or market sources.

Figures do not take into account the effect of any self insured retention, deductible or policy limit and therefore losses are not necessarily those which insurance markets have actually suffered but give a rough guide to the overall magnitude of industry loss.

** Reports would suggest in excess of USD 10 million*

2011 MAJOR DOWNSTREAM/MIDSTREAM ENERGY LOSSES (IN EXCESS OF USD 10,000,000 GROUND-UP)

Jan	Fire & Explosion	Canadian Oil sands Facility	USD 1,210,000,000
Feb	Fire & Explosion	Texas Gas Processing facility	*
Feb	Fire & Explosion	Philadelphia onshore Gas Pipeline	*
Feb	Ice/Snow/Freeze	Texas Refinery	USD 43,300,000
Feb	Earthquake/Tsunami	Japanese refinery	*
To date	Total under USD 10,000,000	(Minimum of USD 1mm)	USD 1,000,000
		Total (known) for year (excess of USD1mm)	USD 1,254,300,000

Source: Market database/LPL market knowledge (as of 14 March 2011)

Figures shown as "(est)" are estimates from various press or market sources.

Figures do not take into account the effect of any self insured retention, deductible or policy limit and therefore losses are not necessarily those which insurance markets have actually suffered but give a rough guide to the overall magnitude of industry loss.

** Reports would suggest in excess of USD 10 million*



2011 MAJOR POWER LOSSES (IN EXCESS OF USD 10,000,000 GROUND-UP)			
Jan	Hydro Tunnel collapse	Panama Utility	USD 100,000,000 (est)
Jan	Steam Turbine failure	African Utility	USD 200,000,000 (est)
Feb	Fire & explosion	South African Power Plant	USD 150,000,000
To date	Total under USD 10,000,000	(Minimum of USD 1mm)	USD nil
		Total (known) for year (excess of USD1mm)	USD 450,000,000

*Source: Market database/LPL market knowledge (as of 14 March 2011)
 Figures shown as "(est)" are estimates from various press or market sources.
 Figures do not take into account the effect of any self insured retention, deductible or policy limit and therefore losses are not necessarily those which insurance markets have actually suffered but give a rough guide to the overall magnitude of industry loss.
 * Reports would suggest in excess of USD 10 million*

The following are some Marine Losses that have made the press this year.

2011 MARINE TOTAL LOSSES		
Jan	Kang Bong	Cargoship sank off China
Jan	Seiyoh	Chemical Tanker sank off Japan
Jan	Mapinduzi	General cargo ship sank off the Seychelles
Jan	AB 9	Asphalt tanker sank off Singapore
Feb	Gregoriy Petrovskiy	General cargo ship sank off Georgia
Mar	Rak Afrikana	General cargo sank off Somalia
Mar	10 total losses from Japanese quake/tsunami Estimated at USD300mm in all	

Security Rating Changes

The following rating changes affecting Insurers writing Energy & Marine business have occurred in the past three months or so.

Insurers Name	Previous Rating	Upgrade/ Downgrade	New Rating	Effective Date
Steamship Mutual Underwriting Association	S&P BBB+	Upgrade	S&P A-	22 December 2010
Tokio Marine & Nichido Fire Insurance Co. Ltd. (United States)	S&P AA	Downgrade	S&P AA-	27 January 2011
Chartis (all branches)	S&P A+	Downgrade	S&P A	28 February 2011
New Hampshire Insurance Co	S&P A+	Downgrade	S&P A	28 February 2011
Lexington Insurance Co	S&P A+	Downgrade	S&P A	28 February 2011

Note: The above are rating moves we thought warrant mention but are not necessarily all rating changes that have occurred in the past three months effecting Insurers that write Energy and Marine business and do not include changes in individual Lloyd's syndicate's rating (as Lloyd's as a whole continues to be rated as an overall entity).



Legal Roundup

COURT OF APPEAL UPHOLDS RULING IN FAVOUR OF INSURERS IN PIRACY CASE.

The case of *Masefield AG v. Amlin Corporate Member Ltd* concerned an insured cargo of bio-diesel on board a tanker bound from Malaysia to Rotterdam, seized by pirates in the Gulf of Aden. Shipowners paid an agreed ransom to the pirates and the vessel was released. She proceeded to Rotterdam where the cargo was safely discharged.

The Cargo owners (Mansfield) however pursued a total loss claim on their cargo insurance policy, in preference to taking delivery of the cargo. The question before the original trial court was whether seizure by the pirates amounted to a total loss, notwithstanding the subsequent recovery of the cargo.

The original trial court judgment in February 2010 denied the cargo owners claim for an actual total loss (ATL), noting an Insured could not be said to be "irretrievably deprived" of property if it was legally and physically possible to recover it, even though such recovery could only be achieved by disproportionate effort and expense, and the Insured had to establish that the recovery was not possible. Capture by pirates did not, of itself, constitute an actual total loss. The alternative "constructive total loss" (CTL) claim, also failed as it could not be said that there was a reasonable basis for regarding an actual total loss as "unavoidable", without which there could be no valid CTL.

The court also rejected the assured's alternative argument, that a release of the vessel in response to payment of a ransom should not be treated as a relevant or appropriate consideration when deciding whether a vessel and her cargo were irrecoverable, as payment of a ransom to pirates was against public policy and should be considered illegal. The court noted that payment of a ransom was not illegal, nor was it contrary to public policy.

At the Court of Appeal the Insured's argument was focused on whether there had been an ATL. The Insured argued that seizure by pirates automatically amounted to an ATL, as a rule of law. The Insured also argued that, seizure by pirates amounted to an act of "theft" within the English criminal law definition and since theft is an insured peril in its own right, an insured loss by theft occurred at the moment of seizure. As to public policy, the Insured conceded that the payment of a ransom was neither illegal nor was it formally contrary to public policy but nevertheless, it amounted to submission to extortion, and hence was so undesirable from the point of view of the public interest and universal principles of morality, that it could not form part of the Insured's duty to avert or minimise the loss (as required under the Marine Insurance Act), and if payment of a ransom could not be required of an Insured, as part of its duty under the Marine Insurance Act then it must follow that the ATL was suffered at the point when the vessel was seized.



The Court of Appeal dismissed the Insured's appeal on all grounds, upholding the decision of the trial judge on the question of the ATL, noting there was no rule of law that seizure by pirates equalled an ATL. On the theft argument, the Court of Appeal said this confused the concept of the "peril" with that of "loss". While theft was a peril insured against, what was required to pursue an insurance claim was the occurrence of a loss as a result of the said peril. There could be no loss without irretrievable deprivation. Regarding public policy in the context of an Insureds' duty under the Marine Insurance Act the Court of Appeal could find no universally recognised principle of morality to allow it to conclude that payment of a ransom was "beyond the pale" or "without any legitimate recognition".

THE UK SUPREME COURT UPHOLDS PREVIOUS APPEAL COURT RULING ON "PERILS OF THE SEA"

The UK Supreme Court has upheld the previous Appeal Court ruling in favour of the Insured in the case of *Global Process Systems Inc v Syarikat Takaful Malaysia Berhad* (the "Cendor MOPU" case).

The case involved leg damage to a jack-up rig being moved on a barge and insured as cargo under Institute Cargo Clauses (A), containing the standard exclusion in respect of loss or damage caused by "inherent vice or the nature of the subject matter insured".

The original court found in favour of insurers that the damage was the result of "inherent vice" however the Court of Appeal reversed the

decision, holding that the proximate cause of the loss was an insured peril in the form of a “leg breaking wave”.

In the further appeal to the Supreme Court, the court again found in favour of the Insured that the cause of the loss was an insured peril rather than inherent vice. In reaching their judgement the Supreme Court looked at the classic definition of inherent vice in the case of *Soya GmbH Mainz Kommanditgesellschaft v White* [1983] where it was held to be “the risk of deterioration of the goods shipped as a result of their natural behaviour in the ordinary course of the contemplated voyage without the intervention of any fortuitous external accident or casualty.” The Supreme Court relied and expanded upon that definition noting that the reference to “the ordinary course of the contemplated voyage” was not intended to embrace weather conditions foreseeable on such a voyage. Further, there is no apparent limitation in the qualification “without the intervention of any fortuitous external accident or casualty”. Thus anything that would otherwise count as a fortuitous external accident or casualty will suffice to prevent the loss being attributed to inherent vice. The Supreme Court also emphasised that the question of the proximate cause is to be answered, as in the case of *T M Noten BV v Harding* [1990] by “applying the common sense of a business or seafaring man”. Applying these principles, it was not possible to fit the facts of the case before them into any normal conception of “deterioration of the goods shipped as a result of their natural behaviour in the ordinary course of the contemplated voyage”.

The Supreme court stated that the loss had many obvious characteristics which one would associate with a fortuitous marine accident or casualty and that was how it should be seen. In particular, the breaking of the legs was neither expected nor contemplated. The fact that the legs were not capable of withstanding the normal incidents of the insured voyage, in particular the weather reasonably to be expected, did not make inherent vice the proximate cause. If that were the case, the cover would only extend to loss or damage caused by perils of the sea that were exceptional, unforeseen or unforeseeable. That would frustrate the purpose of all risks cargo insurance, which is to provide an indemnity in respect of loss or damage caused by, among other things, all perils of the sea. The Court therefore held that the proximate cause of the loss was a peril of the sea, for which the insurers were liable, and not inherent vice.

ONUS OF PROOF ON CARRIER TO SHOW GOODS LOADED IN GOOD CONDITION AND DISCHARGED IN DAMAGED CONDITION, IS THROUGH A CAUSE FOR WHICH THEY ARE NOT RESPONSIBLE FOR

In the case of *Exportadora Valle de Colina SA and others v A P Moller Maersk A/S*, involving claims for damage to refrigerated containers of grapes, the defendant carrier argued that where the loss could be attributed to the proper performance of the carrier’s duties under the contract of carriage, then the usual rule did not apply and it was for the claimant to establish what part of the loss was attributable to the carrier’s breach. The containers, packed by the claimants, were shipped on from Chile to



Europe on the terms of the defendant's standard bill of lading. The judge accepted on the evidence that the cargo had been shipped in sound condition and out-turned in damaged condition. Under the bill of lading, the carrier was relieved of liability for any damage caused by (i) insufficient or defective packing; (ii) handling or stowage of the goods by the shipper and (iii) inherent vice, and that if the carrier established that the loss or damage "could be attributed to one or more of" these causes, then it would be presumed that the damage was so caused and it would be for cargo interests "to prove that the loss or damage was not, in fact, caused either wholly or partly by one or more of these causes or events". During the period the containers were within the carrier's custody, there were a number of periods of "power-off" of the container refrigerating machinery. It was accepted by the claimant that there would have been periods of power-off that were necessary and permissible for operational reasons, such as loading and discharge and to allow for defrosting of the coils of the refrigeration machinery, but it was found that the actual periods of power off exceeded what was necessary or permissible or were unexplained. These excessive and unexplained periods of power off constituted breaches by the carrier of its obligations to care for the cargo and the claimants asserted that this had caused the damage to the cargo. On the facts, the judge concluded that the claimants had discharged this burden of proof by establishing on a balance of probabilities that the damage on

outturn was not caused by one of the three excepted causes. The judgment serves to confirm the established principles as to the party on whom the burden of proof lies in cargo loss and damage cases.

EXXON VALDEZ BACK IN THE COURTS

A marine biologist has succeeded in dragging this infamous case back in the courts to argue over the meaning of a special section in original 1991 agreement over the spill, that could cost Exxon Mobil a further USD 100 million plus interest. The original agreement contained a "reopener" provision, in relation to "unanticipated" environmental damages caused by the wreck, which spilled 11 million gallons of oil into Prince William sound 22 years ago. Judge H. Russel Holland of the United States District Court in Alaska, who presided over the 1991 agreement, surprised many people by ordering the parties to hold a hearing on the matter. Exxon Mobil which has already paid about USD 900 million under the 1991 settlement, said this latest action has no standing as whatever damage the sound still suffers is not unexpected and therefore does not meet the requirements of the reopener provision.



1 / 1 Reinsurance Renewals

It has been widely reported that general property and casualty reinsurance renewals at 1st January this year saw average rate reductions of around 5 to 10%, mainly due to a continued overcapacity in the reinsurance sector. This was despite the fact 2010 turned out to be the sixth worst year for natural catastrophe insured losses since 1980 – approximately USD 40 billion. The result could have been a lot worse were it not for the concentration of events in areas of low insurance penetration amid a sharp rise in the overall frequency of natural catastrophes. The reinsurance industry escaped significant losses from North Atlantic Hurricanes, with none making US landfall despite one of the most active seasons in the last 100 years, however the industry is looking at insured natural catastrophe losses in Chile of USD 8bn, New Zealand of USD 6bn, European windstorms of USD 3.3bn, US storms of USD 3.5bn. and Australian floods of USD 2bn.

AM Best have maintained a stable outlook for global reinsurance in 2011. However, as can be common place at this time of the year there is some talk of the sustained price cutting over the last few years beginning to squeeze insurers. Evidence such as the US P & C sector moving towards negative cash flow, reserve releases drying up and reversing into deficiencies, accident year loss forecasts and incurred but not reported claims increasing, deteriorating investment returns with the threat of inflation and another stormy hurricane season for 2011 forecast suggests rates, terms and conditions may start to harden, in a global sense, in 2012 or 2013.

The story at 1st January for the specialised upstream energy reinsurance sector however was very different, where most renewals saw an increase in cost.

The following are quotes from the prominent reinsurance brokers on upstream energy reinsurance renewals.

JLT Re

"Rate increases for upstream energy reinsurances varied from 10% to 30% increase, depending on the size of cedents' Deepwater Horizon loss"

Willis Re

"In the marine and energy market, the Deepwater Horizon loss has made an impact, though the ultimate loss to the global reinsurance market remains unclear. Unlike most other classes, pricing for marine has been flat, although marine accounts which include energy exposures or pure energy accounts are seeing significant rises (loss free plus 20% loss hit 30%-50%)"

Guy Carpenter

"Global Marine & Energy: up 25% to down 5%"

Aon Benfield

"The disparity between client expectation and reinsurers has increased: although reinsurers have been measured in their reaction to retention levels, pricing has been revised to cater for previously unexpected risk accumulations. For clients with energy and energy liability exposures, increases in reinsurance spend have been about 15%-25%.

1ST APRIL RENEWALS

Although most treaty renewals occur at 1st January, 1st April is also a significant renewal date in the reinsurance market. It was too early at the time of writing to report on the impact on those renewals of the Japanese earthquake and tsunami, but we expect it to have been relatively significant, based on the mood of reinsurers shortly after the event. We will report further on this in our next edition.

Lloyd's 2011 Realistic Disaster Scenarios

Since 2003 Lloyd's Syndicates have been required annually to submit loss estimates for a variety of 'Realistic Disaster Scenarios' (RDSs) to the Lloyd's Performance Management Directorate (previously the Franchise Board) as part of their ongoing business planning. The annual exercise requires syndicates to estimate the level of loss they would incur from a variety of hypothetical scenarios using consistent methods and assumptions across the Lloyd's market.

The loss estimates from the RDS exercise 'stress test' the market's approach to aggregating catastrophes and large individual loss events. The individual syndicate results are used as part of the 'individual capital assessment' process in assessing compliance with the Performance Management Directorate's guidelines.

The 2011 Realistic Disaster Scenarios that impact Energy & Marine are as follows:

Gulf of Mexico Event

A USD 111.5bn (up from USD 111bn in 2010) Gulf of Mexico windstorm comprising Offshore Energy losses of USD 4.5bn (up from USD 4bn in 2010) out of a total insurable offshore loss of USD 11bn and mainland Property losses of USD 107bn, with a track running roughly South East to North West making landfall in the Galveston area.

Additionally syndicates are asked to provide details of total Named Windstorm aggregate sold in the Gulf of Mexico and an "as-if" loss assumption based on Hurricane Katarina gross and final net losses.

Additionally this year syndicates are being asked to include exposures to Certificates of Financial Responsibility (COFRs) under the Oil Pollution Act of 1990.

An additional RDS is to be provided if syndicates believe they have a potential material exposure to an individual mobile drilling rig.

Loss of major offshore oil & gas complex

The loss of a major bridge linked oil and gas complex, including property damage, removal of wreckage, liabilities and control of well expenses.



Marine Event

a) A fully laden tanker and cruise vessel colliding in Prince William Sound (assuming major oil spill plus 125 fatalities) and b) A US owned cruise vessel being sunk with 500 passenger fatalities.

Additional RDSs are:

Two Events

'Second event' loss based on a USD 36bn loss from a South Carolina hurricane in the immediate aftermath of a USD 78bn northeast hurricane occurring in same reinsurance year with short period between allowing no time to purchase additional reinsurance protection.

Florida Windstorm

USD 125bn Florida windstorm.

European Windstorm

Euro 23bn European windstorm

Japanese Typhoon

Yen 1.trn Japanese typhoon

California Earthquake

USD 78bn California earthquake

New Madrid Earthquake

USD 47bn New Madrid earthquake

Japanese Earthquake

Yen 5.trn (Japanese earthquake)

UK Flood

GBP 6.2bn flood loss from River Thames

Terrorism

2-tonne terrorist bomb blast at Rockefeller Center and Exchange Place Manhattan .

Aviation Collision

The Collision of two aircraft over a major city anywhere in the world with an assumed liability loss of USD 4bn.

Satellite Risks

a) A large proton flare causing loss of power to all satellites in geostationary orbit, and b) a generic defect of a particular satellite model/variant.

Liability Risks

Two internally modelled liability loss scenarios, (one professional and one non-professional if both classes written) such as a) Professional: mis-selling of a financial product, failure/collapse of a major corporation, failure of a merger, failure of a major construction project or recession related losses), b) Non-professional: Industrial/Transport incident or multiple public/product losses.

Political Risks

A major Political Risks loss based on, a) An economic downturn in South-East Asia, b) an economic crisis in South America, c) a Political crisis in the Middle East, and d) an economic downturn in Turkey and e) an economic downturn in the Russian Federation.

Alternative RDSs A&B

Two additional RDS identified from each syndicate's own exposures not already required in 1-16 such as an earthquake outside of California, New Madrid or Japan, a major flood incident, terrorism outside Manhattan, a pandemic, a "Selby" (rail crash) type liability loss, an accumulation of sports team members etc.



US Oil Spill Legislation Update

As reported in our October 2010 newsletter, just before the end of the 111th Congress, the US House of Representatives have passed a bill called the "CLEAR Act" that amongst other things removed the third party damages cap of USD 75mm under OPA and increased the maximum OPA Certificate of Financial Responsibility (COFR) requirements from USD 150mm to USD 300mm. This bill is still stuck in the Senate and has yet to be agreed by them in the 112th Congress. In the meantime further bills have been introduced / enacted as follows:

AMENDMENT TO THE OIL POLLUTION ACT OF 1990 (OPA90) FOR CARGO-OWNERS USING SINGLE HULL VESSELS

The Coast Guard Authorization Act of 2010, (CGAA), was signed into law on October 15, 2010, included an amendment to OPA90's liability provisions that for the first time extends OPA90 liability to the owners of oil cargo. The provision amends the OPA90 definition of the term "responsible party" as follows:

Section 1001(32)(A) of the Oil Pollution Act of 1990 is amended by inserting "In the case of a vessel, the term 'responsible party' also includes the owner of oil being transported in a tank vessel with a single hull after December 31, 2010 (other than a vessel described in section 3703a(b)(3) of title 46, United States Code)."

The exception for vessels described in title 46 pertains to vessels unloading oil in bulk at a deepwater port licensed under the Deepwater Port Act of 1974 or delivering vessels off-loading in lightering activities within a lightering

zone established under title 46 and which is more than 60miles offshore from the United States. The exception expires on January 1, 2015.

Because of OPA90's mandatory double-hull requirement and its phase-out schedule for most single-hull vessels by January. 1, 2010, the use of single-hull tank vessels in the United States today is the exception rather than the rule. However, this provision represents a significant change in the political compromise that was struck in OPA90, which did not include cargo owner liability. Now, for the first time, cargo owner oil pollution liability is enshrined in OPA90.

Oil cargo owners shipping oil on such vessels after December. 31, 2010, should ensure that they have adequate insurance arranged to cover their potential OPA90 liabilities.

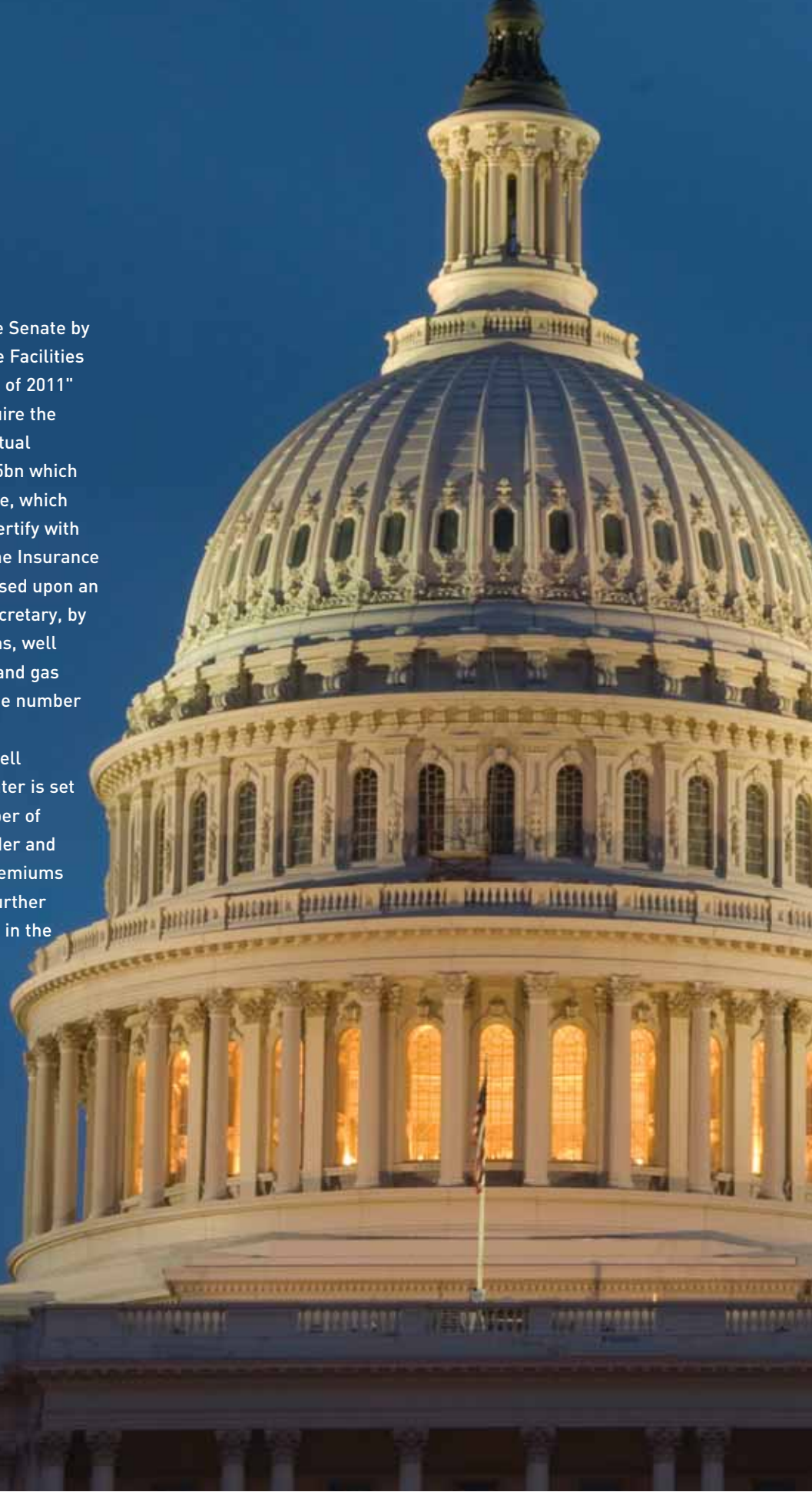
FURTHER HOUSE BILL

The US House of Representatives proposed legislation to reflect the recommendations of the independent oil spill commission tasked with investigating the BP Deepwater Horizon oil spill, and the practices of the oil industry. The bill, called the "Implementing the Recommendations of the BP Oil Spill Commission Act" also includes elements from the CLEAR Act that was passed by the House of representatives in July of 2010, including increasing the minimum and maximum Certificate of Financial Responsibility (COFR) from USD35mm / USD 150mm respectively to USD 105mm / USD 300mm as well as removing the current OPA 90 cap on "economic damages" of USD75mm.

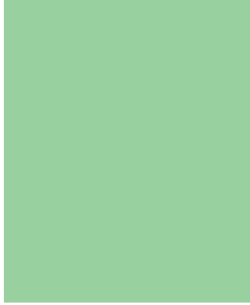


SENATE PROPOSED BILL

A new bill has been proposed to the Senate by Senator Landrieu entitled "Offshore Facilities Oil Spill Mutual Insurance Fund Act of 2011" which if brought into law would require the offshore oil industry to set up a mutual insurance fund for a limit of USD 15bn which would have a USD150mm deductible, which offshore operators would have to certify with commercial insurance coverage. The Insurance fund would consist of premiums based upon an amount to be established by the Secretary, by regulation, based upon water depths, well depth, proximity of the lease to oil and gas emergency response equipment, the number of regulatory violations, estimated hydrocarbon reserves, estimated well pressures, whether blowout preventer is set on the surface or subsea, the number of facilities operated by the lease holder and other appropriate factors. Initial premiums would fund at least USD 2bn with further additional premiums becoming due in the event of a loss incident.







Focus on: Well Examination and Assurance

TRANSPARENCY AND INDEPENDENT AUDITING IN WELL PLANNING AND OPERATIONS

INTRODUCTION

As the world's demand for hydrocarbon energy and by-product resources continues to grow, companies are driven to push the technical boundaries in the search to replenish diminishing reserves. Following the tragic events of the Piper Alpha (1988) disaster, many other lesser incidents globally and more recently the high profile, tragic events of the Banjar Panji 1 well (2006), Montara (2009) and most importantly Macondo (2010), regulatory bodies globally and industry leaders have been looking for independent transparent methods of auditing the well planning and operational process of production, and in particular drilling operations.

Well Assurance is an independent assessment by competent engineers of well integrity and well control carried out at each stage of the well lifecycle from the initial design by the Well Operator through the construction and production phases and ending with the assessment of the design of the well's eventual permanent abandonment.

The process, ideally, provides independent assurance to the Well Operator's Board of Directors about the status of the wells under their control, which in turn can be used by the Operator to provide external evidence to such organisations as regulators, financial and insurance organisations to demonstrate that well integrity is being adequately managed and independently checked.

Independent, in this case, means that the examiner is independent of the Well Operators' line management responsible for well design or operations management. The reporting chain for the independent examiner is an essential element of assurance. Often this is achieved by the Well Operator's Safety and Environment management function having some control over the reporting function for the examiner and being made aware of any significant issues that arise during the assurance process. Ultimately a Board member with responsibility for safety governance can therefore be linked to the process.

DEVELOPMENT HISTORY OF WELL EXAMINATION AND ASSURANCE

Well Assurance is a subset of any Quality Assurance process typically based on the ISO 9000 Quality Standard but in this case applied to a high hazard industry process where safety critical design and operations are required to be independently reviewed.

Recently requirements to carry out examination and assurance stem from Regulation, as in the UK (see below), or more recently on the US Offshore Continental Shelf where rules have recently been introduced concerning the assurance of critical well designs and certain equipment by independent professional engineers following the Macondo well blowout.



The Australian Government are presently considering the following recommendation from the Montara well blowout Commission of Inquiry report¹:

“Well construction and management plans should include provision for an independent compliance review of well integrity (i) in the event of stipulated triggers; and (ii) at least once in the period between perceived achievement of well integrity and production. The independent compliance review should be undertaken by an expert who is not involved in the day today drilling operations”
[Recommendation 7]

WELL EXAMINATION IN THE UNITED KINGDOM

In the United Kingdom, Independent Well Examination is a statutory requirement by virtue of Regulation 18 of the Offshore Installations and Wells (Design and Construction, etc.) Regulations (DCR) enacted in 1996.

The history of this Well Examination regulation is linked to the Piper Alpha enquiry aftermath. Lord Cullen’s Recommendations following the disaster left open the Certification of Fitness regime put in place following the Sea Gem disaster in 1965. However the new regulations emanating from the disaster included a requirement under DCR for an independent verification regime for all Safety Critical Elements on an offshore installation replacing the Certificate of Fitness regulations. This was mirrored by the new independent examination requirements for wells in the DCR Regulations.

To quote the Health and Safety Executive’s DCR Well Examination Regulation’s guidance²:

“The examination required by the regulation is intended to assure the well-operator that the well is designed and constructed properly, and is maintained adequately. It is essential for the examination to demonstrate that the pressure boundary of the well is controlled throughout the well’s life cycle and that the pressure containment equipment that forms part of the well is suitable for this purpose”

Examination is therefore limited to the well’s pressure boundary.

WELL ASSURANCE

The objective of the assurance process, like Well Examination, is to provide independent assurance that the pressure boundary of the well is controlled throughout its life and the pressure-containment equipment that forms part of the well is suitable for this purpose.

However the extent of the assurance process is wider than that of the well examination process required by the UK regulation in order to encompass critical equipment, systems and personnel competence relating to well construction. Clearly some recent incidents are indicative of competence, management systems and equipment failures as well as design failures.

¹ Report of the Montara Commission of Inquiry. June 2010

² DCR Guidance to Regulation (page 15)



To quote some of the findings of the Montara well blowout Commission of Inquiry report³:

1. **The acts and omissions of the operators' personnel, both on the rig and onshore, were directly responsible for the creation and non-detection of the defective cemented casing shoe. [Finding 4]**
2. **The failures to ensure that a test of the cemented casing shoe was carried out were contrary to sensible oilfield practice, and were also contrary to the operator's own Well Construction Standards [Finding 10]**
3. **It is likely, if a test had been carried out, it would have confirmed the unreliability of the cemented casing shoe as a barrier. In any event, remedial action could and should have been taken, in which case the Blowout would not have occurred. [Finding 11]**
4. **A factor which is likely to have indirectly contributed to the Blowout is that a sufficiently detailed risk assessment was not undertaken in relation to the general topic of use of Pressure Containing Corrosion Caps (PCCCs) as secondary barriers against a blowout. [Finding 25]**

Therefore the Well Assurance process is designed to encompass other factors beyond the well pressure boundary.

Well Assurance, like Well Examination, is carried out on behalf of the Well Operator's senior management so that they can be

confident that high hazard (as opposed to high risk) well designs (equipment) and operations will be planned and carried out in accordance with Good Oilfield Practice.

CONCLUSION

There are assurance systems available, but has the awareness and availability of such systems been fully communicated to the regulatory bodies and industry leaders globally? Furthermore are the supporting services in the financial and legal services markets fully conversant with these systems and their availability?

Authors: Paul Jardine and Peter Robinson

The above article was co-authored by Paul Jardine founder of Global Forage Limited (www.globalforageltd.com), a niche Oil and Gas Management Company specialising in Well Planning & Operations Management, Dispute Resolution and Arbitration technical expertise and Control of Well Surveys, based on 27 years practical experience.

Paul's contact details are as follows:

*p.jardine@globalforageltd.com
Global Forage Ltd
Mob: +33(0)621201964
Fax: +33(0)562492965
Tel: +33(0)979688011
Res: +33(0)562993240*



About Lloyd & Partners

Headquartered in the City of London, Lloyd & Partners is an independent specialist insurance broker at the forefront of the insurance industry.

We operate in four main sectors offering in-depth sector expertise and an extensive range of insurance solutions for:

- Cargo, Specie & Fine Art
- Casualty, Healthcare & Professional
- Energy & Marine
- Property

Lloyd & Partners is organized into client-facing business teams and is housed in One America Square, enjoying a prime City of London location. With Lloyd's of London in close proximity, we are in a perfect position to take advantage of one of the most well established insurance markets in the world.

Every broker and client we serve receives the ongoing benefit of our whole-team approach. This approach is unusual in our industry. Most insurance broking firms of our size and position assign clients to a single contact. But from the start, we give you access to every member of the sector team you work with. This means you can tap into a far wider network of knowledge and assistance. It also means our teams can be more easily available to you when you need them.

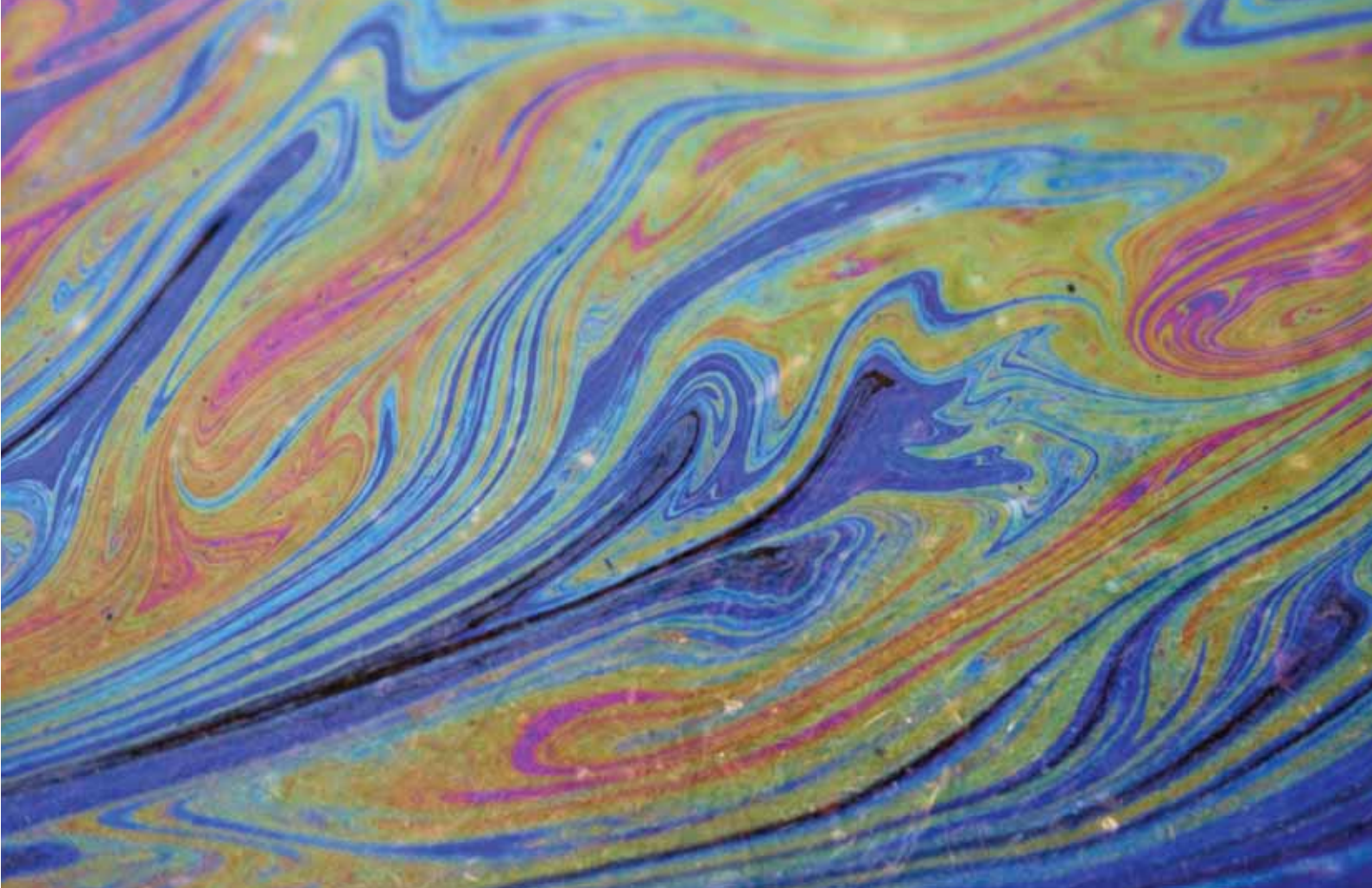
This high standard of service flows through our entire organisation: our shared goal is to always exceed your expectations. In accordance with this principle, we only focus on sectors where we can develop and maintain market leadership. And we will only take on projects and clients for which we know we can do the best job possible.

Lloyd & Partners is also responsible for the management of JLT Park Ltd, the Bermudian broking operation, which has expertise in the fields of Property, Casualty and Professional Liabilities, Healthcare and Construction.

Lloyd & Partners is a wholly owned subsidiary of Jardine Lloyd Thompson Group plc. In addition to the broking operations listed above, we provide wholesale services for JLT-owned operations in Australasia, Asia, Canada and Latin America.

Please visit our website www.lloydandpartners.com for more details.





This newsletter is compiled and published for the benefit of clients of Lloyd & Partners Limited. It is intended only to highlight general issues relating to the subject matter which may be of interest and does not necessarily deal with every important topic nor cover every aspect of the topics with which it deals. It is not designed to provide specific advice on the subject matter.

Views and opinions expressed in this newsletter are those of Lloyd & Partners Limited unless specifically stated otherwise.

Whilst every effort has been made to ensure the accuracy of the content of this newsletter, neither Lloyd & Partners Limited nor its parent or affiliated or subsidiary companies accept any responsibility for any error, omission or deficiency. If you intend to take any action or make any decision on the basis of the content of this newsletter, you should first seek specific professional advice and verify its content.

Registered Office:

One America Square
London EC3N 2JL

Registered in England No. 02005745

Vat No. 244 2321 96

T: 44 (0) 20 7466 6500

F: 44 (0) 20 7466 6565

www.lloydandpartners.com

A Jardine Lloyd Thompson company.

Lloyd's Broker.

A company incorporated with liability limited by shares.

Authorised and regulated by the
Financial Services Authority.

© Lloyd & Partners April 2011.

All rights reserved. 263175



**Lloyd &
Partners
Limited**