



# Energy Market Review

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June 2005

Willis

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## Foreword



The hard market of the new millennium is at least one full renewal cycle removed, on the way to fading from painful memory. Competitive conditions - growing capacity and softening prices - have returned to most market segments. While there is still some pricing volatility, it is more often in a downward direction. Valuable extensions of coverage that had been stripped away are available again, subject to negotiation. The generally more hospitable environment has encouraged many to believe that a new equilibrium may be at hand or just around the corner. The marketplace seems to have settled into a comfort zone where favourable expectations have become the norm.

Do these developments represent a reliable return to business as usual for this historically cyclical industry? Our perspective has been and continues to be that such comfort zones can be quite temporal, and one should not be lulled into complacency.

Insurance is essentially a long-term business, employing the tools, machinery, science and art

of the law of large numbers, pools of data, actuarially determined loss expectancies, treaty reinsurance, facultative reinsurance, manuals, anecdotes and instincts to underwrite first party and third party risk - much of it 'long tail'.

But what of the architecture of the industry? Everything - well, almost everything - is set up on a short-term platform. Annual policies. Annual reinsurance contracts. Annual opportunities to re-price, offer more capacity, offer less capacity, or say good-bye altogether. What other industry provides capital or capital commitments that way?

On this page last October, we addressed single-site and aggregation risk. We asserted that growth of aggregation risk exposures and liabilities would continue to accelerate, far outpacing inflation and the ability of the commercial insurance marketplace to fund for them. The statement is not judgmental. It is simply a fact of life, a predictable consequence of the architecture of the industry and the nature of the risk. The seeds of destabilization are ever present.

It's fair to ask what can be done to change the paradigm, to offer insureds environments that are built on a longer-term platform. The excellent news is that it has already been done - by many, through the ages, up to and including the present day, with flags planted into the future. It's called mutualization.

Mutuals, voluntary assemblages of people, businesses, institutions and sometimes governments, are all about shared interests and commitment. In the context of insurance, they rely upon many of the same tools and machinery as the commercial insurance marketplace, but with major differences in duration of the commitment, sense of ownership and obligation, and degree of control.

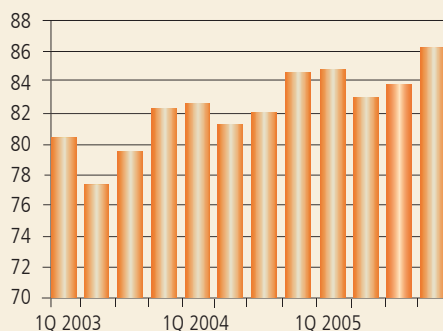
One need only look at the P&I clubs and OIL to find validation for the thesis that insurance mutuals, by their very nature and construction, can work successfully over the long haul.

Carriers in the commercial insurance marketplace carry many of the genes of mutuality in their DNA. And we do believe

that discrete changes can be made in the industry's business model to make it less susceptible to the kind of chaotic, seismic corrections we experienced in the last hard market. Despite best efforts, however, it will be a daunting challenge for the commercial insurance and reinsurance arena to reinvent itself. So we come back to the same forecast and advice we offered before: those firms that recognize the inevitable incapability of the marketplace to handle aggregation risk will lead the way in developing and promoting long-term alternative risk funding strategies.

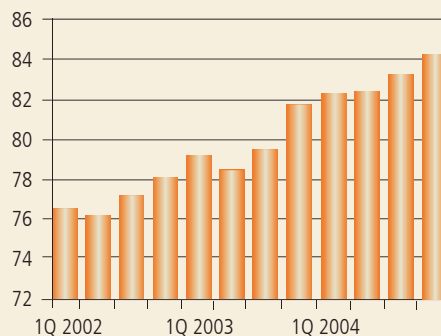
For the wide world of large companies whose risk profile, history and funding needs require long-term committed capacity, a new era in mutualization may be at hand.

**World Oil Demand (mb/d)**



Source: International Energy Agency

**World Oil Supply (mb/d)**



Source: International Energy Agency

## Market Overview

### Business as Usual?

Upstream exploration & production, onshore property and liability (the principal sectors of the energy market) continue to soften. While there have been some significant losses there are good reasons why these have not arrested the slide in rates.

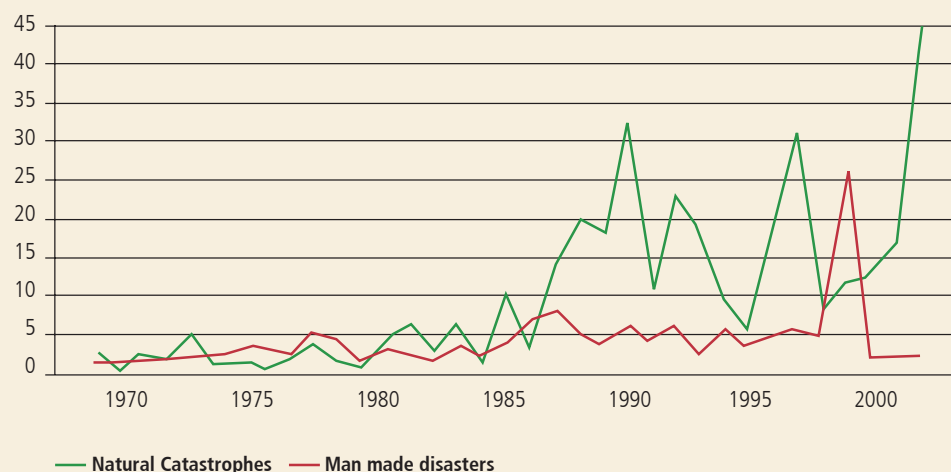
Outside of the Gulf of Mexico upstream E&P has been profitable. Some of the Hurricane Ivan loss was insured by the mutual OIL, and whilst varying degrees of premium rate increase for Gulf risks are being applied

depending on loss record, upstream rates in other areas continue to decline. However, capacity is becoming a problem for larger risks, and not only in the Gulf of Mexico. The outlook is far from clear, and a full-scale capacity crunch is a looming possibility.

Onshore property has also continued to be profitable, and even more than the upstream sector a major part of the losses has been swallowed by the mutuals, OIL and sEnergy, so their effect on the commercial market has been substantially diluted. In January 2005 a tar sands oil recovery unit in Canada suffered an explosion and partial shutdown leading to a business interruption loss which may eventually exceed US\$1 billion. sEnergy is the primary underwriter, but the commercial

### Catastrophes: Insured losses 1970-2004

US\$ bn, indexed to 2004



Source Swiss Re Sigma Research 1/2005

## Market Overview continued

market's participation on an excess basis is not evenly spread, and with many non-energy specific excess of loss insurers participating, some significant energy players have missed the loss altogether.

And the whole market avoided the Houston refinery explosion loss in March of this year as the assets and liabilities were self-insured.

The liability sector's cycle has traditionally lagged behind property but since April 2004 it too has started to soften, and the trend continues.

On the face of it then, energy insurance business is in its normal state: it is loss driven,

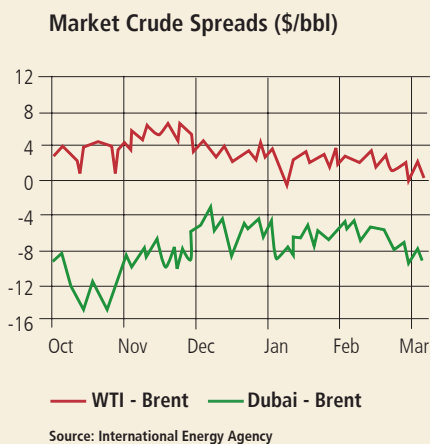
and, other than the industry-wide issue of historic under-reserving, there are no great dramas. This normality, however, belies the market's underlying fragility and potential for extreme volatility, as we shall demonstrate.

### Oil Price and Refinery Margins

Over the last few years of hard market conditions - of high premiums and high deductibles - the profitability of the business dramatically improved. But as much as the deletion of frequency claims through the imposition of lengthy waiting periods benefited this return to profit the main reason for the turnaround in the market's fortunes was an absence of catastrophe losses, whether man made or natural, at a time when market rates were at their peak.

The current oil price is higher and refinery margins are wider now than for many years. There is a logical connection between oil price, E&P activity and losses. However in recent issues of this Review we have also explored the potential correlation between refining margins and catastrophe losses in the refining sector, and have made a *prima facie* case suggesting a link.

Today, business interruption values are increasing rapidly, with multi-million dollar daily values not uncommon. If demand for oil increases at the same rate for the next few years then US\$70 - US\$80 per barrel is possible, and if refining margins similarly



## Market Overview continued

increase then we could reach a situation where business interruption may in some cases become uninsurable, or at least not economically desirable to insure.

To add fuel to the flames the parallel increase in steel prices over the last year creates further pressure, for not only do many assets probably require upwards revaluation (steel price increases have averaged 10-15%), but because of steel shortages the time to replace damaged plant and vessels is likely to increase, adding further to the potential business interruption loss.

In other words, exposures are substantially increasing while rates continue to decline. And whilst in all classes deductibles are more or less holding firm they are effectively being eroded by a combination of the above factors.

There is nothing surprising in this *per se*. Losses and premium rates, supply and demand, will drive the market, and the cycle will turn as it always has. The energy insurance sector being small but high profile is inherently volatile, and there should be no surprise if there is a sharp change in the market at some point.

What has however changed over recent years is the speed of response by the capital providers to changing market conditions. Management restructuring has meant that insurers and reinsurers are better positioned to take advantage of fast changing

circumstances; they are potentially more opportunistic, and can now transfer capacity quickly from one class to another.

The upshot of this new flexibility is that the market will become increasingly volatile, being marked by shorter and more violent cycles. Of course it all depends on losses, but with a continuing decline in rates profitability is bound to suffer, and a few losses could make the energy sector become rapidly unattractive. Any consequent collapse in capacity could be sudden and brutal.

### The Mutual Alternative

If the size of risks is much increased and capacity is suddenly slashed mutualisation would appear to be the obvious alternative to the volatile commercial market. Oil Insurance Limited (OIL) has proved its capability. Last year it suffered its worst result ever, but as in the past its rating model will allow it to recover its funding quite quickly. As an insurer of physical damage only, where the risk is relatively stable, OIL has shown itself to be a durable and credible insurer. True, rates have increased considerably over the last three years, but once the premium modifier has been applied they still appear reasonable, particularly where risks are exposed to natural catastrophe or where there is offshore accumulation.

Business interruption is another matter: it is extremely volatile, and the only mutual

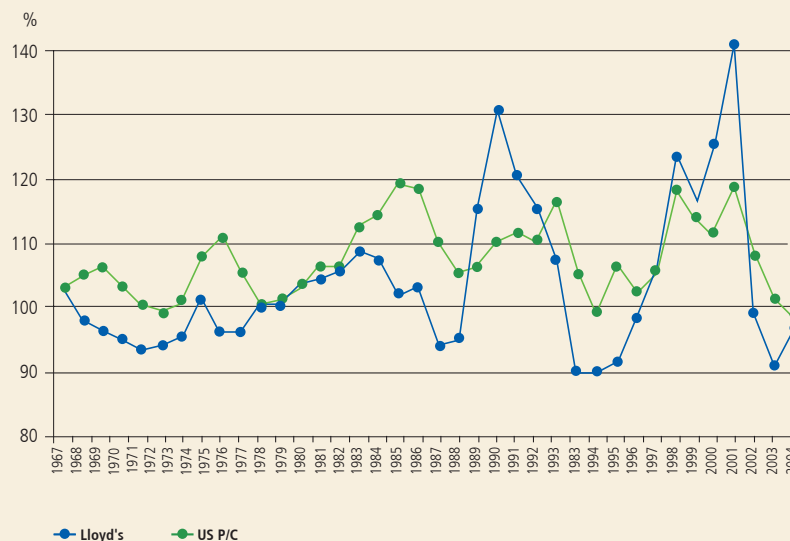
## Market Overview continued

alternative to the commercial market, sEnergy, is not as strong as OIL. With only 16 members, an expected loss ratio of 300% upwards, and speculation that a couple of existing members may leave, it may be hard to attract new members, and even if it can, the very volatility of the risk means that, unlike OIL, increased membership does not guarantee long term stability or success.

Right now sEnergy is not seen as an ideal alternative for the majority of clients; the deductible is too high for some, the limit too small for others, whilst many simply do not care for the idea of mutualisation of their earnings with some of their rivals.

We write in the Foreword to this issue that a new era in mutualisation may be at hand, but it is clear that not all of the pieces required to make such mutualisation an effective alternative are yet in place. Today the energy market can usually accommodate demand, but the combination of increasing volatility and exposure means that if conditions suddenly harden there may be no viable alternative to self-insurance for many, and the market, both commercial and mutual, will lose some of its bigger and better clients for good. The formation of a creative alternative that can offer additional and meaningful capacity would present a formidable challenge, but it would also provide a great opportunity for whoever attempts it.

### Lloyd's Combined Ratio vs US P&C Industry

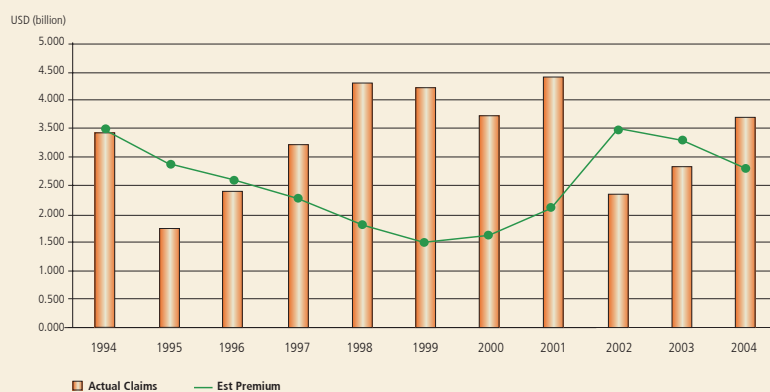


Source: Lloyd's / Insurance Information Institute

## Market Overview continued

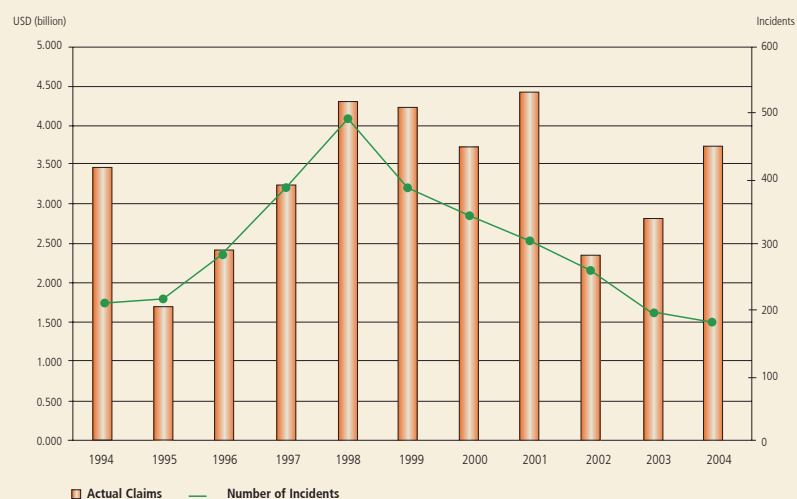
### Loss Statistics

Energy Losses 1994-2004 + Estimated Global Energy Premium



Source: Willis Energy Loss Database as at 18 March 2005

Energy Losses 1994 - 2004 Value & Frequency of Losses Excess of \$1M



Source: Willis Energy Loss Database

2004 Losses excess of US\$ 100 million

Year	Type	Sub Category	Land/Offshore	Location	Country	Actual Total Claim US\$
2004	Plant	Gas plant/trans	Land	South Australia	Australia	243,800,000
2004	Plant	Gas plant/trans	Land	Skikda	Algeria	470,000,000
2004	Plant	Chemical	Land	Illinois	USA	180,000,000
2004	Rig	Jackup	Offshore	Mediterranean	Egypt	290,000,000
2004	Plant	Chemical	Land	Dead Sea	Israel	125,000,000

Total Claims 1,308,800,000

Note: Excludes Hurricane Ivan losses  
Source: Willis Energy Loss Database

## Market Updates **Onshore Property**

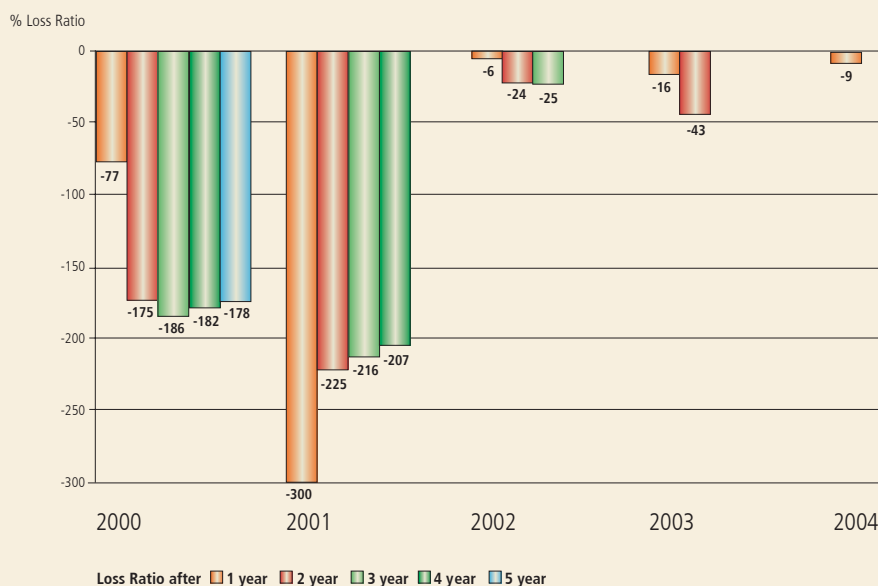
The onshore sector is beginning to display all the signs of a classic soft market, with competition for new business becoming increasingly fierce, and no end in sight to the continuing slide in renewal premium rates.

Whilst overall capacity has increased somewhat since our last Review there has been a willingness by the quota share market to make fuller use of its existing capacity to maintain premium volume, and this has had a greater effect on pricing than the modest increase in overall capacity would suggest. As quota share limits have increased, excess underwriters have

been squeezed out. These underwriters are increasingly being forced to compete for business in the facultative reinsurance market - a market virtually dead for the last three years, and whose renaissance is leading to opportunistic reinsurance buying by quota share underwriters, thus further driving down prices, particularly for new business.

All the signs are that the market will continue on its downwards path until losses start to bite. Losses are having an effect but it is not enough to arrest the slide. Although there have been some big losses over the last year, as we have mentioned in the preceding section, they have not been well spread among onshore energy underwriters, and new markets are

**Lloyd's Onshore Energy: incurred loss ratio development**



Source: Lloyd's

## Onshore Property continued

appearing to take the place of those few who have withdrawn or downsized their underwriting.

The effect of losses on the market is to an extent territorial. Some countries with bad loss records are being avoided, whilst others are being scrutinised. In addition, legacy composite underwriters who started 2005 with ambitious premium targets have since the beginning of the second quarter convinced their managements of the necessity of cutting back on growth forecasts. With less aggressive budgets they are able to drop renewal business that has become unattractive, and this may well be a reason why the market is not in complete freefall.

However, when it comes to new as opposed to renewal business there are no such restraints. Compliance with underwriting guidelines enforced by management on renewal business does not seem to be a factor in the pricing of new business. This has meant that rate reductions for such business vary wildly, and are often far in excess of the average reductions given for renewals.

Where does the market go from here? Much will depend on loss experience, although it is hard to imagine that there is a lot of fat left in rates, and as they reduce further it is likely that more insurers will cut back on their renewal book.

The following are some of the current key onshore property market indicators:

- **Capacity** - we estimate that economically viable capacity has increased in the period October 2004 to April 2005 by around US\$200 million, making a total of US\$2.2 billion. OIL and sEnergy provide an additional US\$250 million and US\$200 million respectively.
- **Rating** - price reductions for clean renewals are generally in the range 10% to 20%. Reductions for new business vary widely, and can in some cases be considerably greater than 20%

**Lloyd's Onshore and Offshore Energy and Control of Well: Combined Premium Development**

Premium £ millions after	2000	2001	2002	2003	2004
<b>1 Year</b>	272.3	315.1	549.4	563.8	451.6
<b>2 Years</b>	424.1	487.9	721.0	727.5	
<b>3 Years</b>	446.7	510.9	730.3		
<b>4 Years</b>	454.3	525.5			
<b>5 Years</b>	463.9				

Source: Lloyd's

## Onshore Property<sup>continued</sup>

- **PD Deductibles** - in general there is little movement in deductibles. Where the deductible is large (say US\$2.5 million or greater) there can be some opportunity to reduce the amount without penalty, although there is no appetite to reduce deductibles much below the US\$1 million level for larger risks.
- **BI Waiting Periods** - there is still market resistance to any reduction in waiting periods while there is a focus on BI, particularly because of increasing margins and while underwriters are testing new accumulation and risk profile models. There have been a few isolated cases of reductions from 60 to 45 days but these are rare, and only achievable where good contingency can be demonstrated.
- **Contingent Business Interruption (CBI)** - this is still an issue although the situation has eased somewhat. Larger sublimits are now possible depending on location, accumulation and information on suppliers and customers.
- **Policy Wordings** - the big issue over the next year or so will be "contract certainty" - in other words, the agreement of the policy wording prior to inception. Simple and logical as this may sound it is by no means easy to achieve, nor is it very common. This

is partly due to culture - to ingrained market practice - but in the case of onshore property it is in no small part due to the complicated nature and individuality of each client's wording. While both the broking and underwriting community are committed to achieving contract certainty as a priority, significant reform of how business is conducted in the marketplace will be required, and the scale of the challenge should not be underestimated.

## Market Updates **Upstream**

### Market landscape

Our last review was written just a few days after Hurricane Ivan wreaked havoc in the Gulf of Mexico. Very early estimates of loss were based upon helicopter flyovers and superficial loss adjustor inspections, and from this early position a loss of up to US\$1 billion was predicted. As we now know, the surface damage belied what had happened underwater where huge mudslides had caused subsea damage to pipelines and structures that would shut down much of the Gulf of Mexico production for several months. The combination of the additional physical damage and loss of production income is now believed to result in an overall insured loss of some US\$2.5 billion. Of course, not all of this loss was borne by underwriters, and we estimate that the combination of captive retentions and OIL brings the commercial market total down to around US\$1.7 billion.

Looking at the loss another way we have interviewed a fairly large sample of energy underwriters to get an idea of individual loss pictures. These underwriters included both Lloyd's and Company Markets, and the quoted figures are for Hurricane Ivan only. Underwriters' own statistics reveal that Ivan cost them between 15% and 90% of total upstream premium income for 2004, with an average of 67%. There are rumours of underwriters with losses exceeding 100% of

premium income, and of underwriters who have gone through the top of their reinsurance programmes, though not surprisingly there was nobody in our survey who was prepared to admit to either of these positions. The underwriter at the bottom of the range who reported a 15% loss was untypical, being considerably lower than everyone else in the sample. This was because this particular underwriter had a philosophy of not writing Gulf of Mexico risks, but even so they picked up some losses from "incidental" exposure of their client base.

Since the typical underwriter has an expense ratio of some 30% before a single loss hits the books then if nothing other than Ivan

### Estimated Global Energy Market Capacity \* Offshore/Upstream vs Onshore Property

	Offshore/Upstream		Onshore Property	
	\$Millions	%	\$ Millions	%
Lloyd's	1100	48	525	24
Companies	1200	52	1675	76
<b>Total</b>	<b>2300</b>	<b>100</b>	<b>2200</b>	<b>100</b>

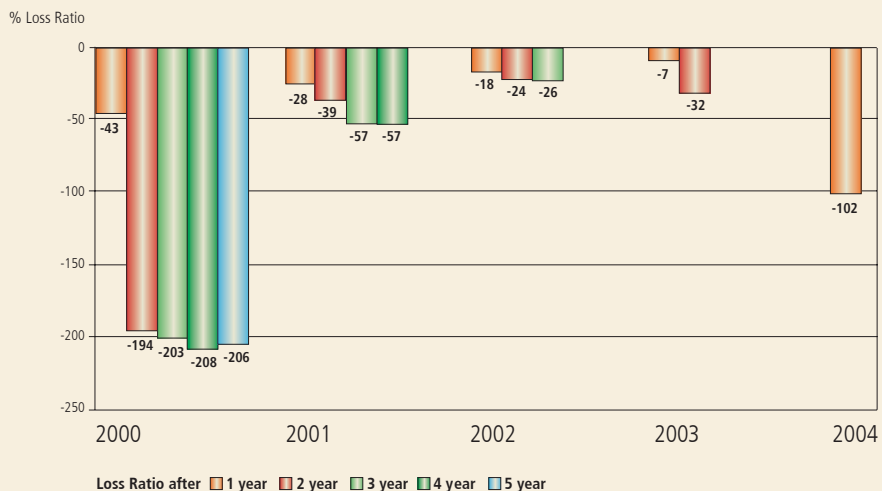
\* estimate of economically viable capacity. Theoretical maximum is considerably higher  
Note: OIL ans SEnergy add a further US\$ 250 million and US\$ 200 million for PD & BI respectively to the above totals.

Source: Willis Research

happened during the entire 2004 the result would have been more or less break even. We know, however, that there was significant attritional loss activity and also some medium to large losses during the year, so we can speculate that the undeveloped 2004 account is already in deficit. We can also see from the historical loss ratio triangulations produced by Lloyd's that despite the relatively good recent record the control of well and construction books in particular will continue to develop. The true picture will be impossible to determine in the short term owing to reinsurance recoveries and the fact that underwriters often report on an annually accounted as opposed to a year of account basis. Our view is that a comparison of pure 2004 year premiums written to losses paid is

already in deficit and that there is significant development to come. This should not come as a huge surprise in a year with a large hurricane loss, but if the non-Ivan losses develop significantly then 2004 could effectively be loss making even without a major event like Ivan. There are those that would suggest 2004 Lloyd's triangulations are headed for an ultimate deterioration to around 150%. If this is true, and if as mentioned above Ivan is reckoned to account for around 67% of premium income, then the remaining 83% plus underwriters' expenses could result in 2004 being a loss year even before Ivan is counted. This is despite the market being in what is considered to be a high price environment. (In case readers are confused by the Lloyd's section of this Review where 2004

Lloyd's Offshore Energy: incurred loss ratio development



Source: Lloyd's

is reported as a substantial profit for energy underwriters we would point out that Lloyd's results take into account both onshore underwriting and reinsurance recoveries as well.)

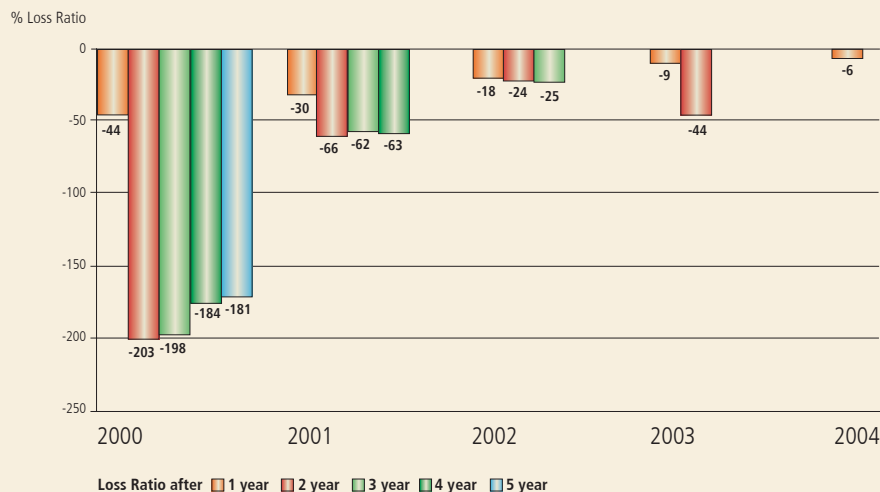
For 2004 OIL reported a record loss of US\$777 million. We do not attach tremendous significance to it being a record year as the numbers are affected by deterioration of a prior year, and of course include a hurricane. In particular, however, because the asset base is much higher than when the previous large loss years occurred, on a weighted basis it would almost certainly not be OIL's worst year. It is a loss nonetheless and one that will adversely affect members' insurance spend via the rating and premium plan.

**Capacity**

For a number of years the market has provided ample capacity for both single location and aggregation risk with very few locations or regions challenging capacity. The Hibernia platform has for some time been the peak risk on most underwriters' books, and stood out from the rest. In the space of a few short months all of this has changed and there are now a number of single location risks that are testing world capacity. On top of this the Gulf of Mexico is a story in itself that merits specific comment.

For single location risks several factors give rise to the upsurge in capacity demand. A strong oil price, a huge increase in steel prices, higher AFEs due to deeper water/deeper wells/record

**Lloyd's Control of Well: incurred loss ratio development**



Source: Lloyd's

rig rates and a stronger focus on contingency exposures have all led to insureds seeking significant increases in their sums assured/limits. This is occurring at a time when the industry is also building scaled-up platforms and FPSOs to exploit larger, deeper and more remote plays. The picture is often magnified for offshore construction where there is a much narrower market than for operational risks. This is because some underwriters either simply will not write the class or will restrict their capacity on multi-year policies. The result is that we are seeing a number of risks placed with restricted Schedule A amounts, and an increasing use of layering to extract the additional capacity from those underwriters who will not write construction on a quota share basis.

In the Gulf of Mexico clients face a capacity shortfall this year for a number of reasons. Firstly, insureds are buying more business interruption owing to the higher oil price; secondly, deeper, higher valued structures, steel prices, yard prices and vessel dayrates are all contributing to an increase in physical damage values; and finally, rig rates and deeper water/wells are giving rise to greater AFEs, leading many clients to buy more control of well coverage. This increase in demand comes at a difficult time. Lloyd's announced on 18 April 2005 its new Realistic Disaster Scenario (RDS) for the Gulf of Mexico. Underwriters are compelled to calculate their RDS and report to

Lloyd's and their capital providers in order to demonstrate that they are not overwriting, and can afford to pay in the event of a loss. Any breach of the limit set by the RDS would result in those underwriters not only being scaled back in what they can write but possibly also result in them being more seriously censured.

In the past the Lloyd's RDS for the Gulf of Mexico has been far less prescriptive than this year, and underwriters have had greater latitude to base their RDS on their own interpretation. Now there is a specified track for a storm, there are specified mobile and fixed units deemed to be in its path, and there is a specified amount of overall damage. Against this underwriters have to calculate the value of their own syndicate exposure to the storm. The early results of this have already meant that underwriters are being more selective about the risks they write in the Gulf and in many cases are restricting their line size even when they feel a risk is attractively rated. With world capacity estimated at not much over US\$3 billion for an aggregation risk (approximately US\$2.3 billion for a single location risk) and with several single deepwater locations with exposures in excess of US\$1 billion, the result is that we now have a capacity crunch. The issue is not confined to Lloyd's either as many other companies elect to use the Lloyd's RDS as their own measure of what their energy underwriters are exposing the company to.

Against this backdrop there are no immediate signs of significant new capacity coming in to the market. Glacier Re has started up and is writing some upstream business, and we eagerly await news of the return to the market of Steve Gargrave and Steve Warren, but otherwise new capacity is not rushing into the upstream sector and there is generally very little movement in existing underwriters' capacities.

### Cost

Broadly speaking Gulf of Mexico risks are paying rises that can range from 10% to 100% depending upon the loss picture and the capacity requirement. Outside of the Gulf rates are flat to down 10% with fluctuations depending upon loss record as well as odd regional variations. There are certainly signs that a number of underwriters are diverting some of their capacity away from the Gulf of Mexico in order to give geographical balance to their portfolio. This has led to intense competition for certain risks, but as a general rule the upstream market is still not witnessing the level of reductions evident in the downstream arena.

### Coverage

Every now and then a challenge comes along which presents an opportunity for the commercial market to either offer value or shoot itself in the foot. We have already discussed the increased appetite for business

interruption coverage and this is an area where the commercial market has potential to fill a distinct value gap. By definition business interruption is a bespoke product bought by different companies for different assets in different ways and for different reasons. It is a product which does not readily lend itself to homogeneity of form nor probably to mutuality. It is at least partly for these reasons that the take up of membership of sEnergy has remained small in spite of considerable desire for a BI product from the OIL membership.

Just when the market has a key differentiator, the Joint Rig Committee has announced the introduction of a new Loss of Production Income form. The new form was recently released to brokers, and the first rounds of panel discussion are taking place as we write.

Of course, the broking community will provide comment on the form itself, however our clear message to the underwriters will be to work with insureds on their bespoke solutions. The fundamental principles of the coverage are simple, the losses often less so and disputes may be aggravated by a failure to address some of the key issues in advance. In a difficult class therefore we applaud any effort to provide greater contract certainty. We would rather, however, have seen underwriters treat many of the features of the new form as their own checklist at the point of underwriting a risk. The principal issues are establishing the

## Upstreamcontinued

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measure of indemnity (whether an amount or a formula) in advance and (for underwriters) measuring the risk of contingencies and dependencies. We believe this is part of the underwriting process and that the introduction of a mandatory market form will lose the market business in an area where it currently has a competitive edge.

### Summary

Capacity has become the issue for an increasing number of risks and will continue to be so in the immediate future. For the average to small risk there is still ample capacity unless the risk is situated in an aggregation area such as the Gulf of Mexico.

There are few signs of new or additional capacity entering the market. 2004 will be a loss year which is likely to put off potential investment in the short term and may lead to some underwriters exiting the class. The key will be to watch the development of the Lloyd's energy loss ratio triangulation and, at a time when rates are regarded as being not far off their peak, to see whether the year will turn out to be a loss even before Ivan is included.

## Market Updates **Power Generation Utilities**

The market for power generation utilities shares many similarities with the onshore energy sector described earlier in this Review, and this section is a brief summary of some of its particular characteristics.

- **Capacity** has remained stable but insurers' appetite has increased. Insurers are prepared to allocate more capacity to their target business. Risks in catastrophe areas remain a major concern.
- **Rates** are on average 40-50% down from the market peak in 2002. Claims experience has been good and rate reductions for risks with good risk management and reasonable claims experience are still available.
- **Deductibles** - Downwards pressure on deductibles continues but is being resisted by insurers, in particular on business interruption policies, though in a few cases insureds have been able to improve retention levels.
- **Coverage** - Insurers are maintaining a tight grip on policy wordings, closely controlling the extent of cover they are prepared to offer.
- **Technology** - There are fewer new models and fewer issues to concern insurers as more units become proven. However, technology issues continue to arise periodically, keeping the issue to the forefront of underwriters' minds. New technology is therefore less of a concern now than last year and defects clauses are in consequence not as common today. However, as manufacturers develop more efficient units, defects clauses could become of increasing concern for those units that are considered to be prototypical.
- **Risk Engineering** - There is a much bigger focus on risk engineering. More insurers are undertaking surveys, giving them greater comfort in their underwriting and helping them to allocate more capacity to the right risks. Insurers are also offering more risk engineering services to insureds.

## Market Updates **Third Party Liabilities**

### **Liability**

The tragic event at the BP plant in Houston in March was a further demonstration of the inherent hazards of energy operations even in the best managed organisations. This event will probably have little or no direct impact on the insurance market as BP are reported not to buy catastrophe insurance. However it illustrates why the energy liability market continues to lag behind the softening in other sectors.

Liability market rates as a whole peaked around the first quarter of 2004. In the October 2004 Review our prediction was that overall liability rates would fall between 10 and 15 percent through the 2004/2005 renewal season. This has proved to be about right, and this trend is continuing as we move further into 2005.

While we had expected that insurers would aggressively seek market share and therefore accelerate the liability market softening, there are certain factors which are preventing this from happening. One of the market issues continues to be the small number of primary and umbrella liability carriers who will write

energy risks. For insureds with US or even other North American exposure, much of the worldwide marketplace takes a cautious underwriting stance. We are seeing tempered reductions in the primary and umbrella area, perhaps as much as 10% off expiring pricing. In the higher excess layers stronger reductions can be achieved. It should however be noted that Lloyd's and certain UK companies have not been as aggressive in following the market down as their counterparts in continental Europe, US, and Canada.

Whilst overall pricing discipline is under attack, insurers (with an eye on their re-insurers and capital providers) are attempting, with some success, to hold the line on cover. Terrorism exclusions and the introduction of silica exclusions are recent examples of this trend. Asbestos remains a no go area.

Underwriters continue to be very conscious of past poor loss ratios and are also mindful of continuing claims inflation in the liability sector. This is being caused by a steady rise in the average levels of legal awards, and by the introduction in many countries of "No win, No fee" contingency fee arrangements, which mirrors the situation in the US and is fuelling a "compensation culture" worldwide.

To some extent, competing forces continue to operate as insurers try to reconcile their desire to maintain underwriting discipline and long

## Third Party Liabilities<sup>continued</sup>

term profitability against the need to compete in order to meet their immediate premium income targets. It is clear that many insurers fell short of premium budgets for 2004. Many of the same insurers still have aggressive targets for 2005. This is contributing to competitive downward pressure in the market.

As yet there is little evidence of active cycle management. Few insurers seem prepared to lose business. The exception is the pharmaceutical sector where a number of insurers have cut capacity or withdrawn from some segments of this market. Paradoxically we could see this action increasing competitive pressure in other industry sectors including energy as the front line underwriters try to recoup lost income.

A factor with a potential pricing impact in the energy sector is the current crude oil price. Risks rated on turnover could see overall costs increased even where the rate is unchanged or even cut. It is important that underwriters are asked to focus on throughput which is a fairer representation of change in exposure than monetary sales.

We are beginning to see greater availability of longer term deals, although these are generally restricted to no longer than two years. In a falling market, and from a price-only perspective, these should be viewed with caution. There may on the other hand be

coverage benefits by locking in cover thus avoiding the application of new exclusions, particularly in relation to products.

Our comments so far reflect the onshore insurance market. The offshore (marine) liability market has hardened in the past few months. This is in reaction to the hurricane property losses which have affected underwriters who are writing both liability and property covers. Where the marine exposure is relatively small it may be possible to package the offshore and onshore cover in the onshore market with some price advantage.

### Coverage triggers

Losses occurring cover is still widely available where upstream exposures dominate. Depending on the risk losses occurring limits of between US\$500m and US\$900m can be placed. Downstream exposures involving chemicals and plastics products exposures continue to be underwritten on either a claims made or occurrence first reported basis. Higher limits in both cases move the trigger on upper layers to occurrence first reported Bermudian forms, as offered by OCIL and others.

### Pollution & Environmental

There has been a long term concern that insurers would seek to further restrict pollution cover. This has not generally happened, and becomes less likely as market conditions ease. There are territories where insurers focus on

## Third Party Liabilities<sup>continued</sup>

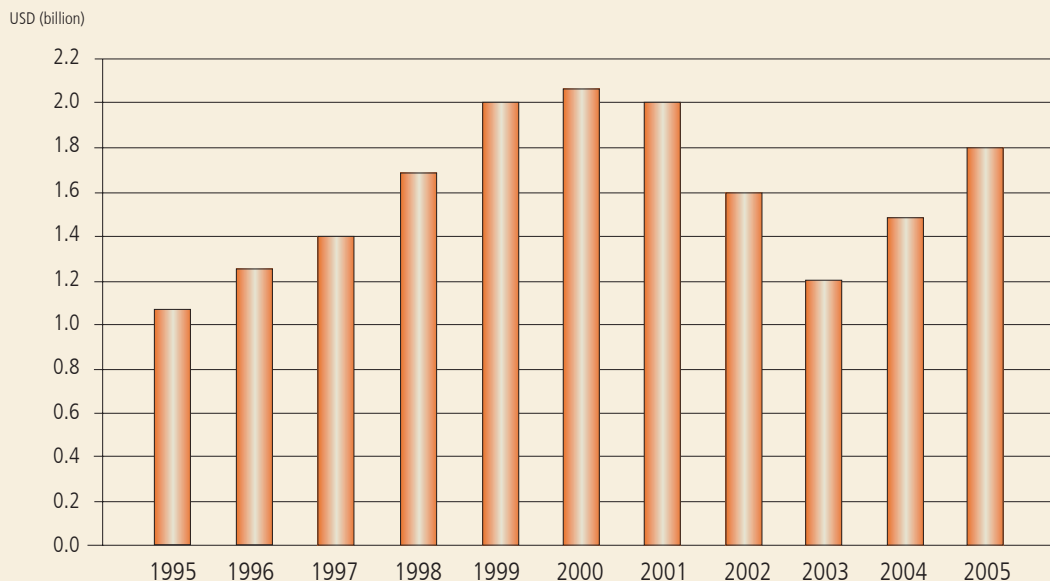
the issue and in specific cases may wish to impose more restrictive time element cover. Typically these will be less developed countries where there may be serious legacy issues.

In Europe there is an increasing focus on the potential impact of the EU Environmental Liability Directive. This aims to prevent and remedy "environmental damage", which is defined as damage to protected species and natural habitats. The directive has to be incorporated into the legislative regimes of Member States by 29 April 2007, but a decision on the well-publicised possibility of introducing a "system of harmonised mandatory financial security" (e.g. compulsory insurance) has been delayed until 2010.

Whilst not retroactive the legislation will introduce new exposures, the principal one being the liability to restore natural habitats damaged by accident or operations.

This legislation coupled with an increasing awareness of the limitations of existing cover in general liability programmes is increasing interest in the covers available from the specialist environmental market. A number of energy companies now buy policies covering both sudden and accidental and gradual pollution. The cover offered by the specialist markets will usually wrap around the sudden and accidental cover in the general liability programme. Insureds who are members of OIL must examine their options as the gradual pollution cover they have enjoyed is to be phased out at 1 January 2006.

### Global Liability Capacity



Source: Willis Research

## Third Party Liabilities<sup>continued</sup>

### Capacity

Overall liability capacity remains buoyant with limits available in excess of the needs of all but those insureds requiring the highest limits. A number of insurers have additional capacity in 2005. Gerling for example has increased to US\$75m from US\$50m, and Zurich Global Energy has a similar increase available.

QBE now has US\$30m in 2005 up from US\$25m, whilst Glacier Reinsurance based in Switzerland has commenced writing property and casualty in 2005 with a clean and unencumbered balance sheet. They will write energy risks and have capacity of US\$25m.

Our latest market capacity chart shows a theoretical maximum of US\$1.8bn. and illustrates the development of the market cycle. Whilst it is very unlikely that all the capacity shown here would be available on a single energy risk it is clear that competitive pressures continue to build for insurers that want to retain or build market share.

### Terrorism

Terrorism exclusions continue to be applied by insurers despite the lack of successful liability claims to date. Attacks on the energy industry have so far been rare outside conflict zones. However the exposure in the event of a poorly managed response to a threat or incident remains potentially catastrophic. For more details see the Terrorism update section of this Review.

### Asbestos

Asbestos exclusions are now almost taken for granted. However, many insureds are becoming increasingly concerned about the cover gap as regulations tighten worldwide. This is a particular problem for the asbestos remediation industry which is reliant on a small number of insurers who are prepared to provide cover. However, the focus is switching to a much wider range of companies, particularly property owners. Legal requirements to identify asbestos in buildings and ensure its proper management have highlighted the exposures faced in relation to occupants. As yet, the insurance industry has offered few solutions to this problem beyond trying to exclude the cover absolutely. However, the asbestos problem has much wider implications. This legacy issue represents one of the most significant uncertainties when trying to predict the future of the liability cycle. Costs associated with compensation will continue to rise and reserves continue to increase. This could yet lead to further fall-out from the market, or adversely turn capital provider sentiment.

### Emerging exclusions

**Silica** - Industrial processes such as sand blasting that use silica have produced a significant number of personal injury claims in the US. It is becoming increasingly common to see silica exclusions being introduced.

## Third Party Liabilities<sup>continued</sup>

**Welding Fumes** - Actions are underway in the US and elsewhere alleging ill health as a result of breathing fumes emitted in the course of welding. A principal focus has been Parkinson's disease following exposure to Manganese metal fumes released from consumable welding rods. Some insurers are starting to introduce exclusions. The wording of these exclusions can be quite wide and may apply to all liability flowing from fumes generated during the process, rather than being restricted to the welding rods themselves.

**MTBE** - Methyl-Tertiary Butyl Ether is increasingly a problem. We examined the issue in more depth in the October 2004 Review and insurers remain concerned about the environmental and human health impact of this substance. We have been successful in maintaining a degree of cover in some recent renewals but the market is becoming more difficult by the week. In the US, any Insured with a perceived exposure to the production, storage, or sale of MTBE will attract as strong an exclusion as possible, yet there are still nuances in some insurers' exclusions which may provide some cover. The customary pollution exclusion and buyback found in many occurrence first reported policies providing cover for products pollution are being re-underwritten to exclude the products pollution liability for MTBE.

### Conclusion

In summary, the international liability market is generally showing more flexibility on pricing, although the position in the energy sector remains generally less favourable than for other industrial sectors. However this statement hides some big variations, with some risks actually seeing rate increases (particularly where there is a poor claims record) whilst others are achieving rate cuts despite substantial increases in throughput.

More than ever, professional preparation and risk presentation pays substantial dividends in what is still a volatile insurance market for the energy industry. The energy liability marketplace in 2005 is noted for its lack of strong competition in the primary and umbrella areas. The attention to underwriting information which we highlighted in the last edition of the Review will continue, and risk differentiation will remain extremely important.

### Directors and Officers liability

Following the wave of global corporate scandals within the last couple of years the subject of the duties and responsibilities of directors has come under heightened scrutiny. Never in corporate history has the role of the director received such wide media coverage. Corporate governance has continued to broaden globally at a significant pace with new measures, guidelines and practices

## Third Party Liabilities<sup>continued</sup>

regularly introduced. In addition, parts of company law are under review to reflect the changing corporate climate. Transparency in the boardroom is now critical as investors and regulators push for additional disclosure of corporate information, thereby applying additional pressure.

Until recently premiums for D&O coverage rocketed as insurers received an increasing number of claims from directors being sued. However, within the last twelve months premiums have begun to reduce as some insurers have repaired their books, new capacity unburdened by legacy exposures has entered the market, and insurers compete to meet aggressive budgets.

From an energy standpoint the market appears to be stabilising. After Enron and some "near misses" pushed premiums sky-high, rates are now reducing and coming more into line with other industrial sectors.

Recent common sources of D&O litigation have been accounting allegations, reinstating financials, insolvency, employment disputes, breaches of banking covenants, breaches of contract and breaches of intellectual property rights. Shareholder suits in the US increase in frequency and severity and remain the largest source of D&O litigation. Certain European countries are currently reviewing their securities laws with the aim of improving

shareholder protection. In the UK there have been recent amendments to the Companies Act that broaden a company's ability to indemnify its directors. The impact of this on D&O insurance is yet to be seen, but one possibility is an increase in Company Reimbursement deductibles. On the regulatory side, bodies such as the SEC and FSA are not shy in investigating directors, and in some cases this has led to litigation.

The global D&O market is still very sensitive and it would only take a few substantial new claims to see an increase in premium rates. Companies that can demonstrate good corporate governance, maintain healthy relationships with their shareholders and regulators and have open dialogue with D&O insurers will be in a strong position to secure the best available terms and premiums.

## Market Updates **Terrorism**

The market is progressively softening. We have seen an improvement in rates, an increase in market capacity, broadened policy wordings and the availability of new products and new solutions to meet clients' needs.

Premium rates are continuing to improve where capacity is not an issue. Underwriters are currently offering reductions in the region of 15% to 20% on renewal business, and in the absence of a major insured event this trend should continue.

Deductibles can be more competitive than in the onshore energy property market. For instance, where US\$1 million PD deductibles may be required for a larger risk / the terrorism market can offer as low as US\$250,000 for the same risk. Likewise, where 45 or 60 days waiting periods for BI are required by the onshore market it is not uncommon to obtain 14 or even 7 days waiting periods from terrorism underwriters.

Market capacity has recently increased from US\$650 million to US\$850 million for any one risk. This increase is due mainly to increased line sizes from existing insurers and Lloyds Syndicate CRO1036 entering into the market with modest capacity.

The breadth of cover available is gradually improving. For example, small limits for chemical and biological coverage (hitherto absolutely excluded) have been offered, albeit very selectively, and dependent on location and aggregation of risk. The market is also now able to write long term policies of up to 48 months, although only on a net line basis with consequent reduction in available capacity.

Global demand for terrorism insurance continues to remain strong while the threat of terrorism remains high in many territories around the world.

As premium rates improve for property terrorism we are seeing clients using the savings to obtain terrorism protection in other areas of their business, for example:

- Third party liability Insurance, providing legal liability protection against actions bought by third parties for property damage or bodily injury/death. The insurance is designed to cover defence costs and damages set by the courts.
- Employer's liability insurance, providing legal liability protection against actions bought by employees for bodily injury and/or death or personal property damage. The insurance is designed to cover defence costs and damages set by the courts.

## Terrorismcontinued

- Personal accident, providing benefits for bodily injury and/or death following an act of terrorism. This coverage is particularly attractive to clients who have employees either travelling to or working in higher risk territories.
- “Non-cancellable policies”, giving the insured the extra comfort of knowing that the insurer cannot walk away - no matter what happens to TRIA, nor if terrorism activity escalates.

### USA - Securing terrorism cover for programs expiring after 31 December 2005

With the expiry and expected non-renewal of TRIA (Terrorism Risk Insurance Act) at the end of this year new approaches to post-TRIA terrorism insurance issues are evolving. Clients are looking to secure capacity early, in the reasonable expectation that as the expiry of TRIA draws nearer capacity will become scarce, and therefore more expensive, particularly in those major metropolitan areas with the highest aggregations, such as New York, Chicago and San Francisco.

It is now possible to arrange:

- “Non-certified terrorism” cover wrapped around an existing TRIA program, which will expand to provide full terrorism cover if TRIA is not renewed.
- The advantage is that the insured obtains “non-certified” cover now, establishes a relationship with the market, and secures capacity for full terrorism in the future.

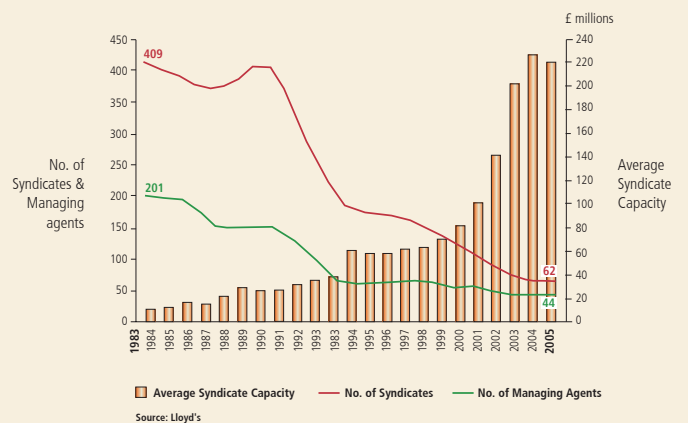
# Lloyd's

Lloyd's recorded a profit in 2004 of £1,357 million (£1,892 million in 2003) on an annually accounted basis. This is the third year in a row that strong profits have been posted, and despite 2004 being the worst-ever year for natural catastrophe losses Lloyd's managed to achieve a healthy combined ratio of 96.9%.

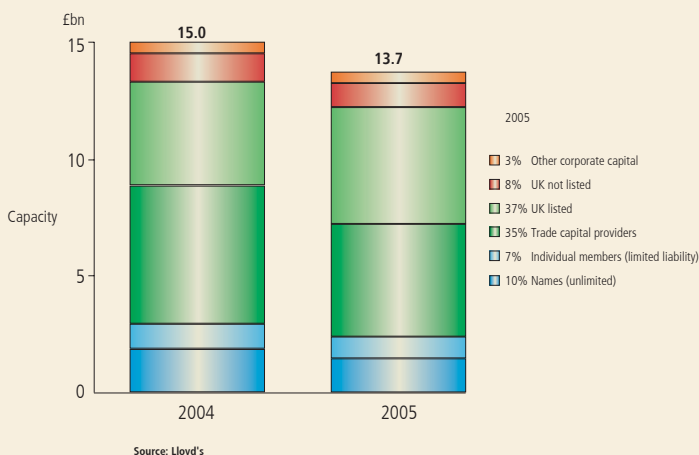
The Franchise Board is having a significant effect on improving underwriting discipline, and this has been underlined by a reduction in opening premium income capacity from £15 billion in 2004 to £13.7 billion this year to reflect softer market conditions.

Whilst average syndicate capacity has fallen somewhat the reduction in the actual number of syndicates would appear to have bottomed out, after reducing by 85% from its peak of over 400 15 years ago.

Lloyd's syndicates



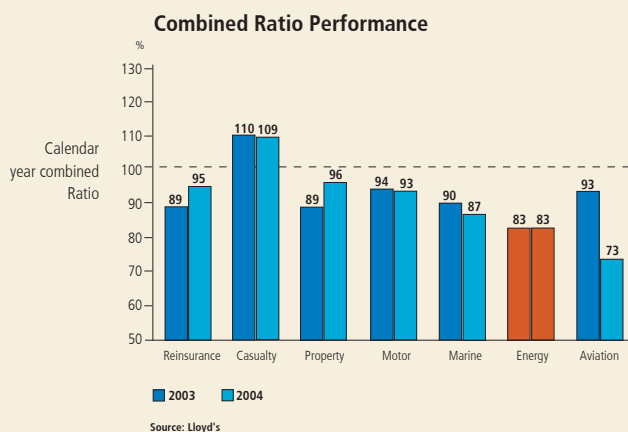
Source of Capital



A further positive development since the year end has been the settlement agreement that Lloyd's reached in March 2005 with the six reinsurers involved in the long running arbitration proceedings relating to an insurance policy supporting its New Central Fund. The settlement amount is £152 million, which includes amounts previously paid. In the words of Lloyd's General Counsel this agreement "demonstrates a desire on all sides to draw a line and resolve the uncertainties of this dispute".

### The Lloyd's energy sector

Once again the energy sector produced some of the best results in the market by repeating its outstanding 2003 performance and returning a virtually unchanged calendar year combined ratio of 82.5%



Given the prominence of Lloyd's in the global energy market and its major exposure to Hurricane Ivan losses in the Gulf of Mexico this would seem to be an extraordinary achievement. However, as Lloyd's 2004 annual report points out, "the results achieved in Lloyd's Energy account reflect the underlying strong profitability of the business and underwriters' ability not to unbalance their accounts through over-exposure to a single event such as Hurricane Ivan".

The annually accounted result, though, does not take into account post year-end loss

development, and since the beginning of 2005 the 2004 loss picture has rapidly deteriorated. As has been described in the upstream section of this Review, there is considerable concern amongst energy underwriters as global competition for energy business remains keen. For onshore underwriters who have not had the same exposure to Ivan, downwards pressure on pricing is particularly intense.

Speaking to the Norwegian insurance industry in March Lord Levene, the Chairman of Lloyd's, baldly described the problem. Commenting on Swiss Re's statement in its annual report that "insured losses have taken on a new dimension", he went on to say that with regard to the energy sector, "last year may prove to be the worst year on record, with losses of around US\$4.5 billion fuelled by Hurricane Ivan's destruction in the Gulf of Mexico". Yet despite this, and the recent Canadian tar sands loss in January, "amongst the business lines we underwrite, energy is (the) one area where we have seen the most pressure on pricing".

The establishment of the Franchise Board has given Lloyd's good grounds to hope that, in marked contrast to the past, underwriters will not underwrite unprofitable business or chase market share. This may indeed be the case, but the future remains uncertain, and restraint will not necessarily make Lloyd's energy underwriters' lives or relationship with their capital providers any easier.

# OIL and sEnergy Update

## OIL

Much has already been written on the subject of the withdrawal by OIL of Broad Form Pollution (BFP) coverage and we have no wish to prolong the debate. However, we would be remiss in our reporting if we did not mention that, since our last review published in October, OIL have formally announced they will discontinue BFP coverage at 1st January 2006.

From this date coverage will be provided on a sudden & accidental basis (40 day discovery / 120 day reporting) but claims for BFP from occurrences commencing prior to 1 January 2006 may still be submitted.

Policyholders can elect to give up their right to the BFP 'tail' at any time (up to and beyond 1st January 2006) and will receive a 10% rating discount for so doing. To achieve this discount OIL will reduce the policyholder's gross assets by 10%, although in the short term OIL will claw back some of the saving by assessing an additional charge by application of the avoided premium surcharge. It is important to remember however, that policyholders electing to forego the BFP "tail" will still be pooling pollution losses with those retaining this option.

Aside from the issue of gradual pollution coverage, there were several other distractions for OIL during the last quarter of 2004 and early part of 2005. Principal amongst these were:

- Losses - Hurricane Ivan and 2004 in general
- Withdrawal Premiums - Shareholder accounting for potential withdrawal premiums

### Losses

There has been much debate about the impact of Hurricane Ivan on OIL, with wide ranging speculation as to the severity of losses. OIL have now come out very strongly, with 'firm' predictive numbers, in an attempt to put an end to the countless rumours. As of the date of writing OIL have received claims from 8 members producing an expected net loss of US\$ 397 million (gross loss US\$658 million for 100% interest and before retentions). This is a little over two and one half times the size of the 1992 Hurricane Andrew net loss to OIL (in trended dollars) and comfortably within the per occurrence 'aggregation limit', although both OIL and the commercial market were fortunate that Ivan blew to the extreme eastern fringes of the Gulf of Mexico oil fields; had it followed the Andrew track the picture may have been very different.

As to 2004 overall losses this has been the worst year in OIL history. However, to put that statement into some perspective, the net underwriting loss of US\$777 million is only

## OIL and sEnergy Update continued

slightly worse than the loss for 2001 and in fact (when compared in 2004 dollars) is slightly better than 1988 which remains, on an adjusted dollar value basis, the worst year on record. OIL's rating model allowed it to recover its funding relatively quickly before, and it can fully expect to do so again. The OIL model actually anticipates a fair degree of volatility in its members loss activity and predicts an average loss expectancy in the region of US\$500 million per annum.

<b>Final 2004 underwriting results</b>	<b>US\$ M</b>
- Total Written Premiums:	<b>443*</b>
- Claims Incurred	<b>(782)</b>
- Prior years claims deterioration:	<b>(164)</b>
- IBNE (Incurred but not evolved) increase:	<b>(247)**</b>
- Other adjustments for IBNR:	<b>(27)</b>
- Producing a net underwriting loss of:	<b>(777)</b>

*\*this is the highest premium ever recorded, and reflects Pool A and B loss experience over the last 5 years*

*\*\*provision for potential exposure to MTBE*

From a financial perspective, the underwriting loss was offset by investment income of US\$238 million and after taking account of expenses, the actual net loss to OIL was US\$548 million.

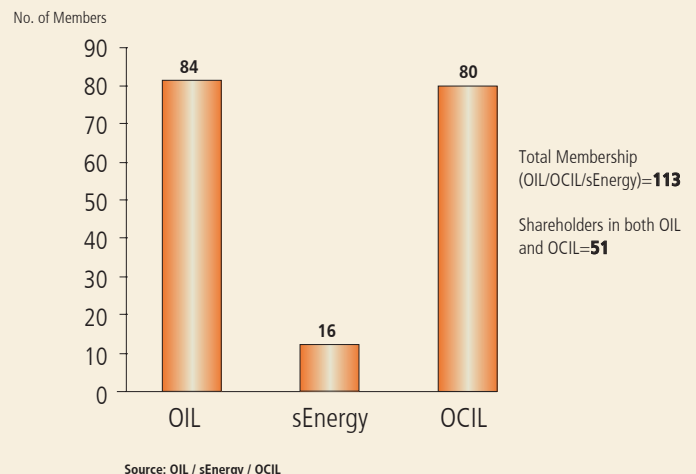
### **New accounting interpretation for the treatment of potential withdrawal premiums**

The 'Big 4' public US accounting firms have reassessed the way in which shareholders

should account for potential withdrawal premiums. They have developed a position whereby there is now a requirement for shareholders to account for a hypothetical withdrawal premium based on their theoretical (at any time potential) withdrawal from OIL. In short this has created an immediate balance sheet liability for OIL members accounting under US GAAP and resulted in much recent frantic activity to restate balance sheets in time for year end reporting. OIL are looking at ways to try to resolve the issue for their members, perhaps by changing the Rating & Premium Plan, but it remains an issue for the time being.

One interesting thought to come out of this apparent change in the basis of accounting is that where previously a member considering

**The Oil Group of Companies**



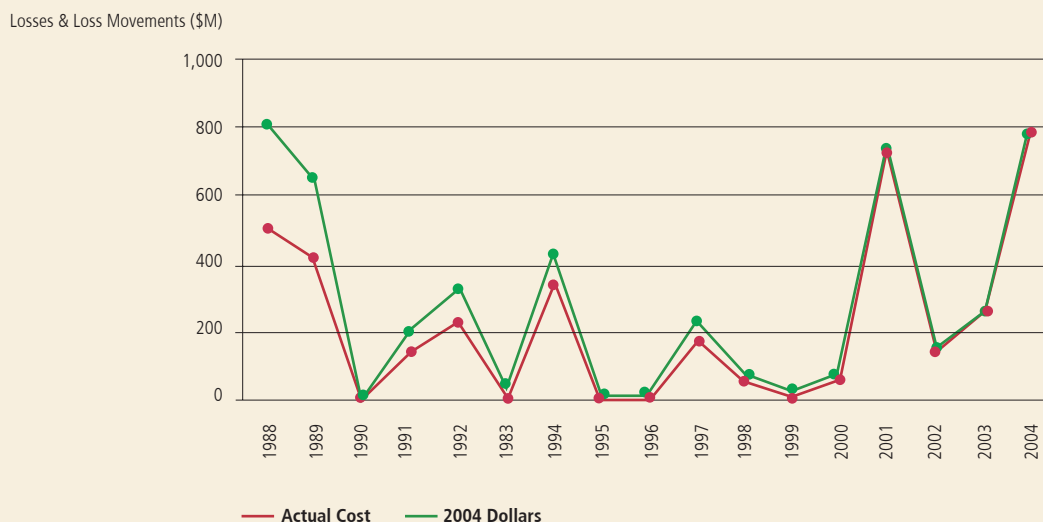
## OIL and sEnergy Update *continued*

withdrawal may have viewed the withdrawal premium as an insurmountable hurdle, that hurdle has now been 'surmounted', as the full amount of the liability will have already been taken onto the balance sheet. This accounting change therefore makes it potentially easier for members to leave OIL, with consequent concerns for the long-term stability of the mutual.

### Other matters in review

- OIL introduced a new rating sector for pharmaceutical companies. This is attracting the lowest rating of all OIL rating sectors as it is perceived as a benign manufacturing risk (although not by OCIL which will not cover pharmaceuticals). OIL estimate that a pharmaceutical company with US\$20 billion in assets will be charged at the minimum premium (US\$750,000 for 2005). The separate 'Chemical' rating sector has been eliminated with all chemical risks transferred to the 'Refining & Marketing/Petrochemical' sector now redesignated as 'Refining & Marketing/Chemicals'.
- One long standing member withdrew at the end of 2004: Crown Central, which had been a member for over 20 years, was no longer eligible following a divestment of qualifying assets.
- One new member, Pacific Gas & Electric Company, has recently joined and membership therefore stands at 84 with approximately US\$2 trillion of gross assets insured.

### OIL: Net Losses by Underwriting Year from 1988 to 2004



Source: OIL

## OIL and sEnergy Update<sup>continued</sup>

- Shareholder equity stood at US\$994 million at 31 December 2004.
- Total statutory capital was US\$1,794 million at 31 December 2004 (including US\$800 million raised in the capital markets) and both S&P and Moody's affirmed OIL's ratings at A+ and A1 respectively.
- On March 16 the OIL Board of Directors approved the following rates for 2005:
  - a) Standard (Pool A) **11.75 cents** (prior 0.3 modifier) - up from 9.22 cents in 1st quarter of 2005.
  - b) Flat (Pool B) **13.62 cents** (prior 0.2 modifier) - up from 9.07 cents in 1st quarter of 2005.These rates will be used for the 2nd and 3rd quarter billings and there may be some adjustment to rates used for 4th quarter billings (depending upon final loss outcome and insured assets)
- The near term outlook on losses does not appear to have improved much with several members having sustained losses, or potential losses, notably Suncor, early in 2005.

## sEnergy

The sEnergy picture in the latter part of 2004 and early part of 2005 is dominated by losses. It is widely expected (and accepted by sEnergy) that Suncor will produce a full limits loss of US\$200 million.

Additionally, the Snorre Field well incident in the North Sea and consequent loss of production has created a large (if not full limits) loss to sEnergy. There are several other as yet unquantifiable incidents, including the recent Syncrude loss, all of which means that we will get a better picture over the next few months of how the adjusting process actually works.

Apart from the above, the other matters in review are:

- sEnergy are discontinuing BFP cover at 1 July 2005 and will be offering only sudden & accidental cover on same basis that OIL will be offering from 1 January 2006 (though please remember that pollution is not a trigger for BI claims). For a short period, if a member purchases the Excess PD option, there will be a coverage gap between OIL and sEnergy.
- Membership remained at 16 as at 1 January 2005.

## OIL and sEnergy Update *continued*

- Currently sEnergy is carrying reserves of US\$ 260 million in respect of the SunCor and Statoil losses. In accordance with its "mission statement" to make claims payments within 120 days of loss sEnergy is in the process of making the first interim payments totalling US\$91 million to these two members.
- 2005 earned premiums amounted to US\$50 million.
- sEnergy statutory capital & surplus stood at US\$873 million at 31 December 2004 (sEnergy is rated A2 by Moody's).
- The Excess PD only option is still being (and will continue to be) extensively marketed by sEnergy. Presently there are no 'Excess PD only' members, but sEnergy feel this is a very attractive product and to some extent are blaming their lack of penetration on the timing of their sales drive last year. They believe that they started too late and missed the peak Energy renewal season. They addressed this in 2005 by making their sales pitch early for the July renewals. As part of this sales drive, sEnergy relaxed their new entrant financial obligations by significantly discounting the New Entrant Premium Supplement (NEPS) that has to be paid by all new members.
- The NEPS is normally levied (in addition to the Risk Premium) at up to US\$1,750,000 per year for 3 years (total US\$5,250,000), and if there are no claims a potential No Claims Bonus (NCB) of up to US\$400,000 is allowed. The NEPS can normally be discounted by as much as US\$1million per year for the 'perfect' risk. However, during the 'sale of the century' sEnergy offered to credit the NEPS in full if there were no losses, in effect suspending the normal NEPS discount system and increasing the potential NCB from the current US\$400,000 level to US\$1,750,000. This means that any member who joins sEnergy prior to 1st July 2005 (or commits to join by purchasing a US\$5,000 share), and who does not file any claims, will be refunded the US\$1,750,000 NEPS charge in full as an NCB in the 3rd, 4th and 5th years of membership.
- After 1 July 2005, the current system of charging a US\$1,750,000 NEPS and allowing a US\$400,000 NCB will be reinstated; it is a limited offer, like a seasonal sale.
- Limits remain unchanged; according to sEnergy there is no near term prospect (3 to 5 years) of increasing the 'per occurrence' aggregate limit from its current level of US\$200 million.

*Note: the foregoing is our understanding of the current rules, procedures and developments concerning OIL and sEnergy, and is based on published material and our discussions with OIL and sEnergy staff.*

# Lillehammer Conference



## Lillehammer Energy Claims Conference 2005

The large, difficult and technically complicated risks insured within the upstream energy sector ensure that claims are never out of the spotlight for long. The Lillehammer Conference provides a forum for discussing major issues amongst a wide range of energy insurance professionals.

The 10th Lillehammer Energy Claims Conference was held on 9-11 February in Hafjell just north of Lillehammer in Norway. Lillehammer was the venue for the 1994 Winter Olympic Games.

The conference is the leading international gathering of clients, underwriters, brokers, claims adjusters and other service providers involved in claims arising from upstream energy risks. The subject for this year's conference was 'Claims issues through the lifetime of an Offshore Oil and Gas Development project' and attendance was at a record level of nearly 200 delegates from around the world.

The purpose of this year's conference was to bring together various aspects of the offshore industry that may have been touched upon

over previous years and present a cradle to grave view of an offshore project and the insurance issues arising from it.

Of particular interest to many in the claims community were the activities and considerations leading up to the sanctioning of an oil or gas development project and the focus on obtaining the largest positive Net Present Value (NPV) possible. The correlation between speed, profit and risk was examined through the phases of licence, exploration, appraisal, feasibility, design and development and, through this examination, the search for the optimum NPV. What was apparent is that there is no single solution available. Some of the headline points arising from this presentation were:

- The differing requirements of oil companies during licensing
- Only drilling will tell you if hydrocarbons exist, despite increasingly sophisticated seismic analysis
- Pricing the costs of extraction and the costs of exporting/transporting the hydrocarbons together with the methods available for each are key factors
- Balancing production rates against capital expenditure to maximise NPV may entail a feasibility study before the project can proceed

## Lillehammer Conference continued

- Negotiation of Unit Operating Agreements, Joint Operating Agreements etc.
- Assessment of risks arising from the options for production and transportation arising out of the feasibility study

Also of interest were the post-sanction, pre-start-up phases of the project including:

- Scoping of the main contracts and sub-contracts and deciding on the remuneration basis (e.g. lump sum, reimbursable etc.)
- Insurances required, many of which would be outside the normal involvement of those attending the conference
- Negotiation of contract clauses particularly with regard to the indemnities, liabilities and responsibilities for insurance that contractors must provide
- Engineering contractor selection process
- Fabrication and commissioning phases

Much of the rest of the conference was focused on claims issues and related processes arising during the different stages of the project with panels and open discussion addressing these.

*Full details of this annual event can be found at '[www.energyclaims.net/](http://www.energyclaims.net/)'.*

## People & Places

Whilst many of the headlines have been about broker movements, there were over the last few months some important moves in the underwriting market which we detail as follows:

- **Roger Earnshaw** (formerly Axa) has joined Ascot, Lloyd's Syndicate 1414 as Property Class Underwriter, with responsibility for Power Utilities
- **Tim Kania** has transferred from AIG in New York to London with responsibility for Power, Construction, Boiler & Machinery and Energy Terrorism
- **Peter Cranston** has joined XL Insurance from Allianz as Senior Underwriter, Property Energy Department, Europe & Asia Pacific
- **Dirk Turley** has joined Glacier Re to write onshore property and liability business. He will shortly be joined by **Franco Masciovecchio** who is leaving Swiss Re
- **John Lambert** is leaving Partner Re in Paris to join Zurich Global Energy in London
- **Peter Jakszentis** is moving from Munich-American RiskPartners to join the Middle East Treaty Department of Munich Re
- **Doug Dowling** has left Allianz in Houston
- **Simon Mason** has joined Aspen Re from BRM to write offshore energy
- **Nick Abbott** has left Generali for XL to support **Ray Miller**
- **Chris Knowles** formerly of Zurich has joined Aegis to work on the offshore energy account
- **Richard Mander** has left Millennium to join Brit, writing the liability account
- **David Hipkin** formerly of Atrium has joined Arch to write the liability account
- **John Spencely** has joined Arch from Liberty International to write marine liability
- **Bob Hall** is moving from Arch to Watkins Syndicate to write the war account
- **David Fazan** and **Darren Tasker** have joined MARP to further strengthen the liability account
- **John Thomson** has left OCIL and **Graham Kirk** continues as the main point of contact for liability
- **Gerald Kitiyakara** has moved from Zurich Corporate to Zurich Global Energy to enhance liability underwriting capability

## Summary

Despite all odds and persistent statements to the contrary by many underwriters the energy market as a whole made money in 2004.

Premiums may be continuing to reduce in most sectors but deductibles are holding up and are still close to historic high levels.

Regardless of the widely held view that following the Ivan losses, and the more recent Canadian Tar Sands incident, the next big loss would be certain to change the market, we continue to expect increased competition for the volatile (but for the last three years profitable) energy business. We are, however, concerned that further loss deterioration coupled with a capacity crunch in the upstream sector may have the potential to change the whole energy market.

The pause for breath taken by the onshore energy market after the series of losses in January 2004 was not repeated in 2005, despite significant losses at the beginning of the year.

As underwriters and their management review their first six months results in a few weeks' time, we anticipate that they will be pleased with their technical results but disappointed at the lack of premium growth.

The acceleration of the pace of reduction witnessed in the third and fourth quarters of 2004 could then very well be repeated in the second half of 2005.

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