Critical Risk Management Considerations for O&G Companies in a Depressed Pricing Environment

While the current environment of low insurance rates and improved coverage terms means greater opportunity to reduce cost, dynamic forces are currently reshaping the risk profile of Oil and Gas companies and creating new exposures for the industry.

For example, in the energy-producing states where USI Insurance Services works with many energy clients, the decline in oil and natural gas prices has led to a reduction in drilling activity and production, massive layoffs, revenue declines, and a dramatic rise in business restructuring activities.

At the same time, the need for companies to improve their competitive advantage by reducing risk exposures and cutting insurance costs has never been greater.

Premium rates across the commercial insurance market are declining due to the lack of a large loss event. As a result, some energy players are seeing up to 30% in property insurance rate reductions for a wide range of risks, including oil and gas exploration and production, onshore and offshore construction projects and petrochemical refineries. In the upstream London market premiums are reportedly down as much as 45%.

The Industry's Changing Risk Profile

To thrive in the current challenging environment, it is essential for O&G companies to have a thorough understanding of the evolving exposures, said Pascal Ray, USI senior vice president and marine and energy practice leader.

According to Ray, understanding how exposures are evolving and how they impact insurance programs is essential, especially for financially-challenged O&G companies seeking to cut cost and take advantage of savings opportunities.

The shift from conventional to unconventional oil and gas, which has changed how insurers evaluate the industry's exposures, is a perfect example. Specifically, the rise in hydraulic fractured well completions and decline in new well drilling means rig count is no longer a risk metric that can correctly quantify risk for insurers. The activity is now in well completions, re-completions, re-fracs, and other well stimulation and enhanced recovery methods to improve the performance of existing wells, said Ray.

The changing risk has other serious implications, including the following:

- Insurers view risks from wells completed using hydraulic fracturing as significantly different and higher than conventional wells
- A well drilled in one policy period, where coverage for the completed well was paid for, may not be completed via fracking until several years later, and possibly with a different carrier
- Fracking risks have evolved where creating separate insurance coverage for hydraulic fracking versus drilling exposures is being explored.

Blowout and Casualty Risks

Well blowouts remain a constant and growing risk to people and property in the United States.

As millions of wells across the country continue to age, some now over 150 years old, and casing and cementing on the older wells deteriorate, experts fear the risks of well failures continuing to increase.

Since blowouts can occur in any phase of a well's lifecycle, it is incumbent on companies to consider obtaining liability and control of well insurance for as long as they own the well.

The ongoing Porter Ranch Blowout in California underscores the importance of obtaining this coverage.

On January 7, California declared a state of emergency over the methane leak at Porter Ranch, which started in October 2015 and was brought under control on February 11, 2016. Since then 6,400

families have been evacuated, two schools closed, and a no-fly zone established over the area.

"This event is unique as it is developing into what may be one of the largest evacuations due to a well blowout in U.S. history. Some believe the total costs for this claim to insurers could be over one billion dollars but it will take years before anyone knows the true cost of this blowout." said Ray.

Going forward, Ray said O&G companies will need to seriously evaluate how much insurance coverage they purchase towards evacuation risks, environmental or air pollution risks, as well as litigation or defense costs.

Increased D&O Risks

Declining revenue and a rise in bankruptcy filings have raised litigation risks for directors and officers, according to Paul King, USI senior vice president of management professional services (MPS) and national cyber practice leader.

"The spate of restructuring activity, including bankruptcy filings, is also generating litigation for O&G companies, particularly shareholder claims. D&Os are exposed personally to tax liability in bankruptcy and may face claims simply because of the positions they held during the downturn," said King. "These claims must be defended against and can be costly."

Meanwhile, the Justice Department also are aggressively going after so-called "bad actors" in the industry.

For example, in December 2015, a jury found Don Blankenship, former chief executive of Massey Energy Co., guilty of a single misdemeanor charge for orchestrating a conspiracy to violate mine safety rules before the April 2010 deaths of 29 miners. The verdict marked the first time a CEO of a major company has been convicted of a workplace crime.

The worsening environment for energy sector D&Os underscores the need for companies to ensure their D&O programs are appropriately constructed to address bankruptcy and re-emergence risks.

In addition, since many D&O policies contain broad exclusionary language, such as insured-versus-insured and willful misconduct, D&Os can be left to absorb large uncovered expenses when they become the subject of litigation or investigation.

According to King, the right broker should have O&G sector knowledge, as well as re-structuring and post-bankruptcy expertise. The ability to draft and design manuscript policies and endorsement packages that provide broad grants of coverage and reduce exclusionary language is critical, he adds.

Cybersecurity Risks

As the O&G industry continues to digitize processes and job sites, cybersecurity has become a critically important risk to contemplate. Recently, the industry has been the target of a growing number of cyberattacks, a trend that underscores the need for companies to engage in frequent conversations around cybersecurity risks.

For instance, in late 2015, it was revealed that an oil pipeline explosion in Turkey was caused by a cyber-attack wherein a hacker infiltrated the pipeline's valve stations, shut down alarms and super-pressurized the crude oil in the pipeline, causing an explosion.

In 2012, a disgruntled employee who had access to the internal company network within Saudi Aramco released a virus that infected 30,000 computers and shut down operations.

These are not isolated incidents. According to PwC's report, "The Global State of Information Security Survey 2015," there were 5,493 detected security incidents directed against the oil and gas sector in 2014. The average cost of a successful attack was $4 million, according to the report.

Smart Risk Management

Whether its well blowouts, D&O risks, cyberattacks or the changing energy landscape, O&G companies need to be prepared for a future filled with varying risks and exposures. It is incumbent on O&G companies to do a better job of not only understanding their exposures but finding the right risk partner who can help them address their exposures accurately in order to maximize cost savings.

The consequences of not knowing, or not knowing enough, can be financially catastrophic.

To learn more about the solutions discussed here and the USI ONE Advantage contact a USI consultant.

The USI ONE Advantage®

To analyze our client's business issues and challenges, our property & casualty team leverages USI ONE™, a fundamentally different approach to risk management. USI ONE integrates proprietary business analytics with a network of local and national technical experts in a team based consultative planning process to evaluate the client's risk profile and identify targeted solutions. Clients then receive tailored recommendations for improving their total cost of risk. To learn more about USI ONE and the USI ONE Advantage, contact your local USI team today.