

# BEST'S REVIEW

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## The Trouble Within

by Al Slavin

The energy potential being unlocked from shale beds beneath North America continues to fuel new volumes of exposure and specialized coverage needs.

As advancements continue in the hydraulic fracturing method used to create and access man-made reservoirs of natural gas a mile underground, so do concerns about defending against pollution claims.

Anticipation is building over how the federal government will reach accord between natural gas interests and those clamoring about fracking's threat to groundwater quality.

Yet caught in the void is a coverage gap that leaves insureds without access to legal defense costs for gradual seepage-over-time claims—a growing source of costly litigation that has spurred a niche segment.

Jeffrey Hanneman, director of Aon Environmental Services Group, said customers were calling four or five times a week looking for this coverage. He said most markets were interested on an excess basis at a \$10 million or \$20 million limit in a tower, but only a handful would get involved on a primary basis.

There was no relying on operators' extra expense coverage because it did not address pollution liability, except

from a blowout; the casualty side of traditional programs would typically only cover sudden or accidental type issues.

Hanneman said that specialty insurer Ironshore helped fill a void by making an existing basic environmental policy more specific to the oil and gas industry. The SPILLS Oil & Gas form covers pollution risks from onshore production.

"It has more applicability than fracking, but that was certainly the driver for the product," Hanneman said.

Chartis and a few other insurers also offer this type of coverage through their Pollution Legal Liability form with manuscripted endorsements.

He said insurance markets for upstream energy have diminished in the past two years amid concern over the future course of pollution claims. In the world of fracking, groundwater contamination issues and the costs of merely defending allegations are significant variables.

*Best's Underwriting Guide* reports that inadequate cementing can allow gas from shallow rock to migrate into groundwater and contaminate water wells. BUG also states that the improper handling of the components of hydraulic fracture fluids or the fluid itself can contaminate near surface resources.

Pollution claims are driving up premium costs, especially in Marcellus Shale country.

### EPA Study Ongoing

As part of a study, the Environmental Protection Agency is currently assessing fracking's impact on groundwater quality. There is federal legislation afoot to make the natural gas industry subject to the Safe Drinking Water Act, which would require public disclosure of chemicals used in the fracking process. At the same time, Interior Secretary Ken Salazar has publicly indicated that new rules on fracking could be forthcoming.

A possible legal test regarding this federal act is playing out in the U.S. Court of Appeals for the Fifth Circuit in New Orleans. The EPA said that a Range Resources' fracking operation in Parker County, Texas, had contributed to natural gas contamination in the Trinity Aquifer within the Barnett Shale region. EPA ordered Range to take steps to protect area homeowners. Range Resources appealed EPA's administrative order. In an annual filing to investors, the company said it had not been allowed to provide a response to EPA's "factually baseless and legally deficient" order.

EPA said it took the action after conferring with the drilling industry's state regulator, the Texas Railroad Commission, and concluding that state and local authorities had not taken "sufficient action to address the endangerment." The case exemplifies the differences that must be navigated between regulatory schemes.

The fracking process, which uses a highly pressurized flow of water and sand to break apart shale and free pockets of trapped natural gas, dates

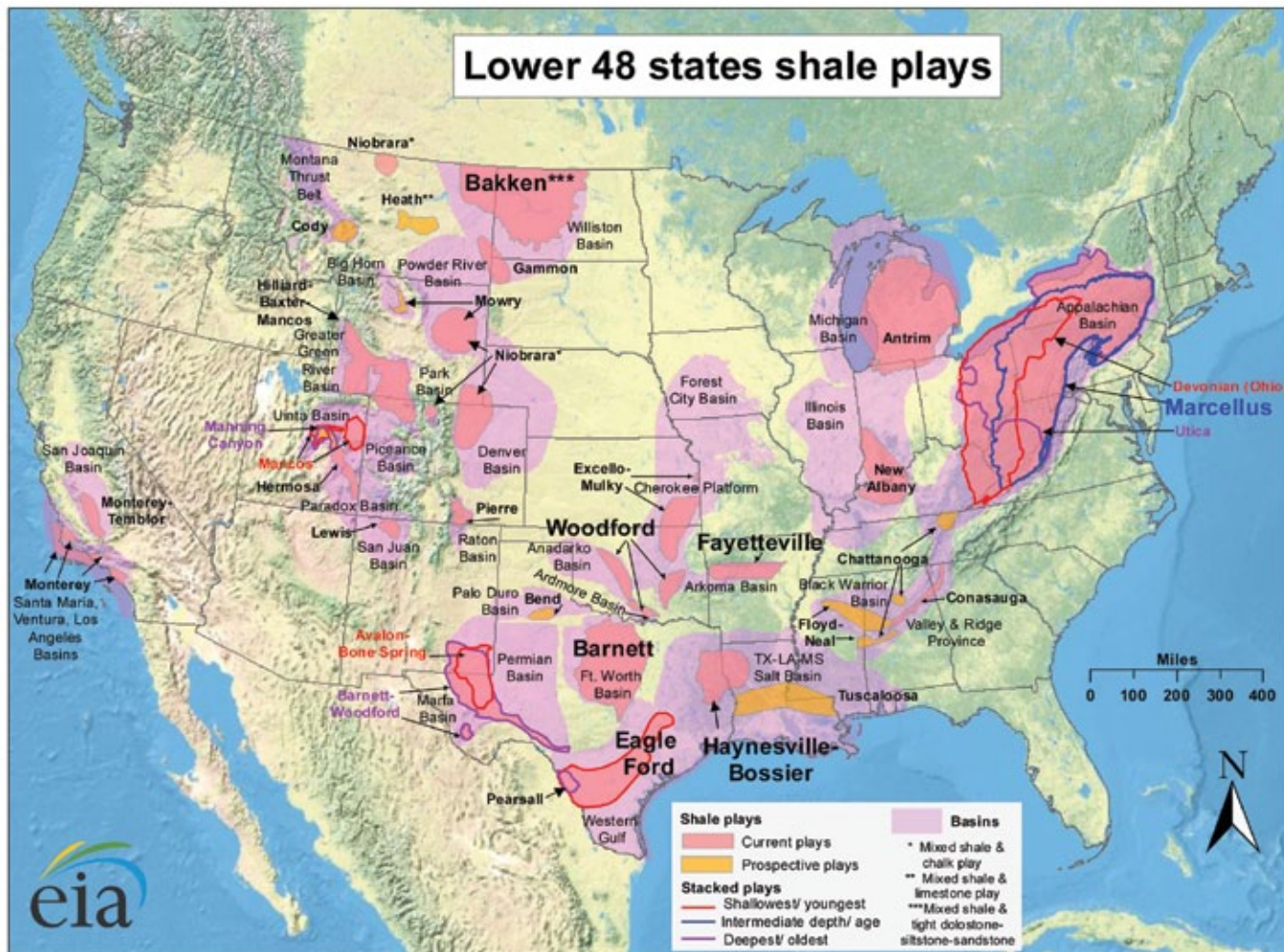


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—Jeffrey Hanneman,  
Aon Environmental Services Group

## Shale Fields

The U.S. Energy Information Administration expects the rapid expansion of shale gas production to continue with the resource generating 46% of U.S. domestic production by 2035.



Source: U.S. Energy Information Administration based on data from various published studies. Updated: May 9, 2011

back six decades. But the addition of chemicals to the formula is far more current and a growing source of fodder for litigation.

There is a well-established school of industry thought that fracking occurs far below the aquifers that feed drinking water supplies, and some residential drinking wells are naturally more susceptible to higher methane levels than others. Defendants also face difficulty trying to prove their way out of a claim without established baseline data.

Hanneman said premium rates on a per-well basis generally trend higher for coverage in the Marcellus Shale region, which includes Pennsylvania and New York, based on litigation that is playing out in that region.

### Pending Lawsuit

Last December, Cabot Oil and Gas Co. agreed to a \$4.1 million settlement negotiated by the Pennsylvania Department of Environmental Protection to compensate 19 households in Dimock Township, Pa., whose drinking water supply became contaminated. State regulators cited faulty cement work in the casings at Cabot's nearby natural gas well operations for the groundwater contamination.

Eleven households have appealed the settlement to the Pennsylvania Environmental Hearing Board. A separate federal lawsuit has been filed in the U.S. District Court for the Middle District of Pennsylvania.

Cabot is not alone in facing litigation issues in the Marcellus region. Chesapeake Energy has defended

cases in the same court venue. The company was fined more than \$1 million for contaminating private water supplies in Bradford County, Pa. Yet Hanneman said the pollution exposure issue is also weighing on others in the supply chain. He fielded a recent query about pollution insurance from someone leasing mineral rights to a fracking operation. He said the caller wouldn't own or operate wells, but wanted coverage in case they were named.

Interest is also coming from the ancillary players, including contractors, drillers and those hauling supplies to and from fracking operations. That hauling includes transporting water used in the fracking process to a site, then transporting the wastewater off-site.