LOSS OF PRODUCTION INSURANCE

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SEVEN POINTS TO REMEMBER

NO. 1
LOPI is not an indemnity insurance

"Loss of Production Insurance (LOPI) is not designed to put the Insured in the same position they were before the loss event but instead it's a financial insurance product to protect their cashflow and balance sheet." **Ariana Dean**

"The Insured is not necessarily receiving the barrel price that they would have received if they were selling the product on the open market but instead protection up to the scheduled unit price agreed at inception of the policy."
Adrian McAndrew

The Insured may have a 10 year licence to extract oil or gas and will have made cashflow and other financial assumptions based on a forecasted production schedule.

If production suffers an unexpected interruption due to an insured event, then LOPI pays the fixed Unit price per barrel at the agreed volumes for the insured period, but subject of course to a Waiting Period (time deductible, sometimes with a financial threshold) which is typically 60 or 90 days in length.

This raises an interesting dilemma and one that might appear to subvert the principle of insurance. If the spot market price at the time of a loss is less than the unit price, per the policy, then it could be argued the Insured benefits from the outage as they recover a higher price per barrel from their Insurers than they might on the spot market. In the reverse situation, the Insureds absorb the delta between the spot market price and the unit price per the policy.

NO. 2
The Material Damage Proviso must be triggered for a claim to be admissible

"Loss Adjusters have to carry out detailed investigations to establish whether the material damage loss proviso in the policy has been triggered."
Sam Foster

As with property damage claims, a covered physical damage trigger needs to be established for a LOPI claim to be paid. This can bring with it all the usual challenges and controversies of determining what constitutes a trigger for cover. Detailed investigations are often required, sometimes delaying confirmation on policy liability. At this time, it is important that Insurers communicate their position with the Insured as it can otherwise create tension between them.

(Angela Flaherty's article 'Show me the damage' on page 16 explains the position in English law on this point)

NO. 3
Adjusting a partial shutdown is complex, compared to that of a full shutdown.

"When the Insured can produce some oil or gas the aim is to try to calculate the 'but for the loss' number."
Arianna Dean

Sometimes this can be challenging, especially when the indemnity periods stretch over two, three or more years. In year one, things may be quite clear as the Insured has a much better idea of how the reservoir is likely to perform, but in later years it becomes more complicated with many more variables affecting the Insured's production forecasts. Whilst they may have forecast a certain volume, new wells may not produce as expected. This requires the Loss Adjuster and (Re)Insurers to understand and interpret the forecasted production data and determine a loss figure that all parties can agree.

It is important to note that if the oilfield is in its infancy all parties may have difficulty understanding the performance of the reservoir and, therefore, quantifying the impact on production.

NO. 4
When the Insured is a minority JV partner they can be at the mercy of the Operator

"Insurers are often asked to accept that a joint venture partner has no direct control over the scope and management of the repair project or the flow of information."
Adrian McAndrew

When a LOPI claim is triggered, Loss Adjusters will closely monitor the repair project to ensure timely management and return to production. Where the Insured is a non-operating Joint Venture (JV) partner, they really are at the mercy of the expediency of the Operator. The Operator may or may not have purchased LOPI cover for their own interest and could therefore have diverging priorities from their JV partners. A limited flow of information makes it more difficult for Insurers to verify the extent to which the loss has been successfully mitigated.

NO. 5
Mitigation costs incurred in the Waiting Period

Costs incurred, by the Insured, during the Waiting Period can benefit the (Re)Insurers but may not be recoverable from the policy" **Sam Foster**

The Insured has an underlying duty to act as a prudent uninsured in the operation of their asset and particularly so in the aftermath of an incident. At the time of a LOPI claim, an Insured might incur costs within the first 60/90 days of the incident happening (the Waiting Period) that mitigate the insured loss. When analysing costs incurred within the Waiting Period, there is an argument that they are not recoverable, as the Insured carries the financial responsibility in this period; although it is not uncommon for the Insured to submit their costs to their Insurers' for consideration.

NO. 6
Make sure asset registers are up to date

"Incorrect or outdated asset registers within an Insured's policy schedule, that don't recognise key dependency premises, could affect the level of indemnity recoverable from the policy"
Sam Foster

Insureds are typically dependant on key assets in the field to get their hydrocarbons from the 'well to market'. LOPI typically provides full indemnity (subject to the normal adjustments) when the loss is due to damage resulting from a 'Scheduled Dependency Premise'. However, the same policy will typically provide a much lower limit of indemnity for losses emanating from damage to an 'Unscheduled Dependency Premise'. This can dramatically affect the level of indemnity that is recoverable under the insurance policy, which is why it is important for the Insured to keep their asset registers and policy schedules accurate, clearly articulating which premises they are dependent upon to get their oil to market.

NO. 7
Transparency and communication prevent claims settlement delay

"If an Insured has not previously suffered a LOPI loss, they may not fully appreciate the intent of questions that are asked by the Loss Adjuster so it is important that (Re)Insurers are transparent with the Insured in explaining what they are trying to achieve, with the requests for information made by the Loss Adjuster." **Adrian McAndrew**

It is vital the Insured provides the information requested by the Loss Adjuster as this helps determine coverage at the earliest opportunity and subsequently make expeditious payments. A payment schedule can also be considered by (Re)Insurers in line with the Loss Adjuster's recommendations following their analysis of the Insured's claim.