OIL & GAS: A WELLSPRING OF OPPORTUNITY

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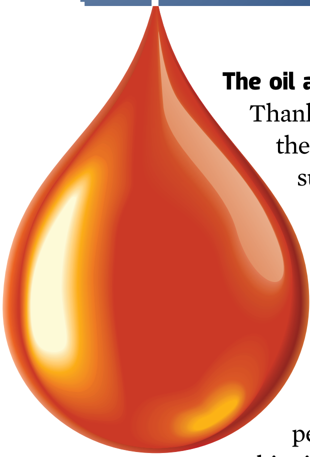
A WELLSPRING OF OPPORTUNITY

Oil and gas is currently the fastest growing industry in the US, but the market remains remarkably untapped in terms of potential for independent agents



The oil and gas industry has never been hotter. Thanks to advancements in new technology, the United States is currently poised to surpass Russia as the world's leading producer of oil and gas.

And the jobs are endless. According to a Bureau of Labor Statistics report, oil and gas experienced a 40% increase in jobs from 2007 to 2012, and a PricewaterhouseCoopers report reveals the industry employs 2.6 million people as of 2011. In fact, the boom is so big, its job growth far outpaces total private sector employment.

There is a downside to that development, however. The sector is growing so rapidly, organizations in newly expanding regions may not have access to skilled agents who are able to connect them with specialized insurance markets or help them manage risk—leaving the operations and the people who run them one event away from potential financial disaster.

It also leaves enterprising agents at the forefront of immense possibility.

TRACING THE ORIGINS OF THE OIL AND GAS BOOM

The energy boom has dominated media headlines, but U.S. involvement in oil and gas production is not new—and neither is its leading technology.

Hydraulic fracturing, known to most Americans as "fracking," is the process of injecting fluid at high pressure to release natural gas after drilling down into deep layers of shale. What may be surprising is that fracking was first practiced nearly 70 years ago in 1947 and patented just two years later.

So why the sudden explosion in popularity?

According to Richard Kern, manager of the energy and environmental divisions of Richmond, Va.-based James River Insurance Company, new technology has made it both easier and more economically viable to locate shale gas.

"The technology and practice of fracking got to the point where it was easier to find and retrieve shale gas, and so we've seen this boom in the last 10 years or so," says Kern, an oil and gas sector veteran of more than 40 years. "The price of oil has also stayed up at around $100 to $120 a barrel, which makes fracking more economical. When it was at $20 a barrel, it wasn't quite so competitive."

Now, active fracking operations number 1.1 million, with wells in more than half of U.S. states.

DEMYSTIFYING OIL AND GAS

Despite the significant growth, oil and gas represents a relatively untapped sector in terms of independent agent permeation—particularly in states where the industry is just beginning to make headway, like North Dakota, Wyoming and Utah.

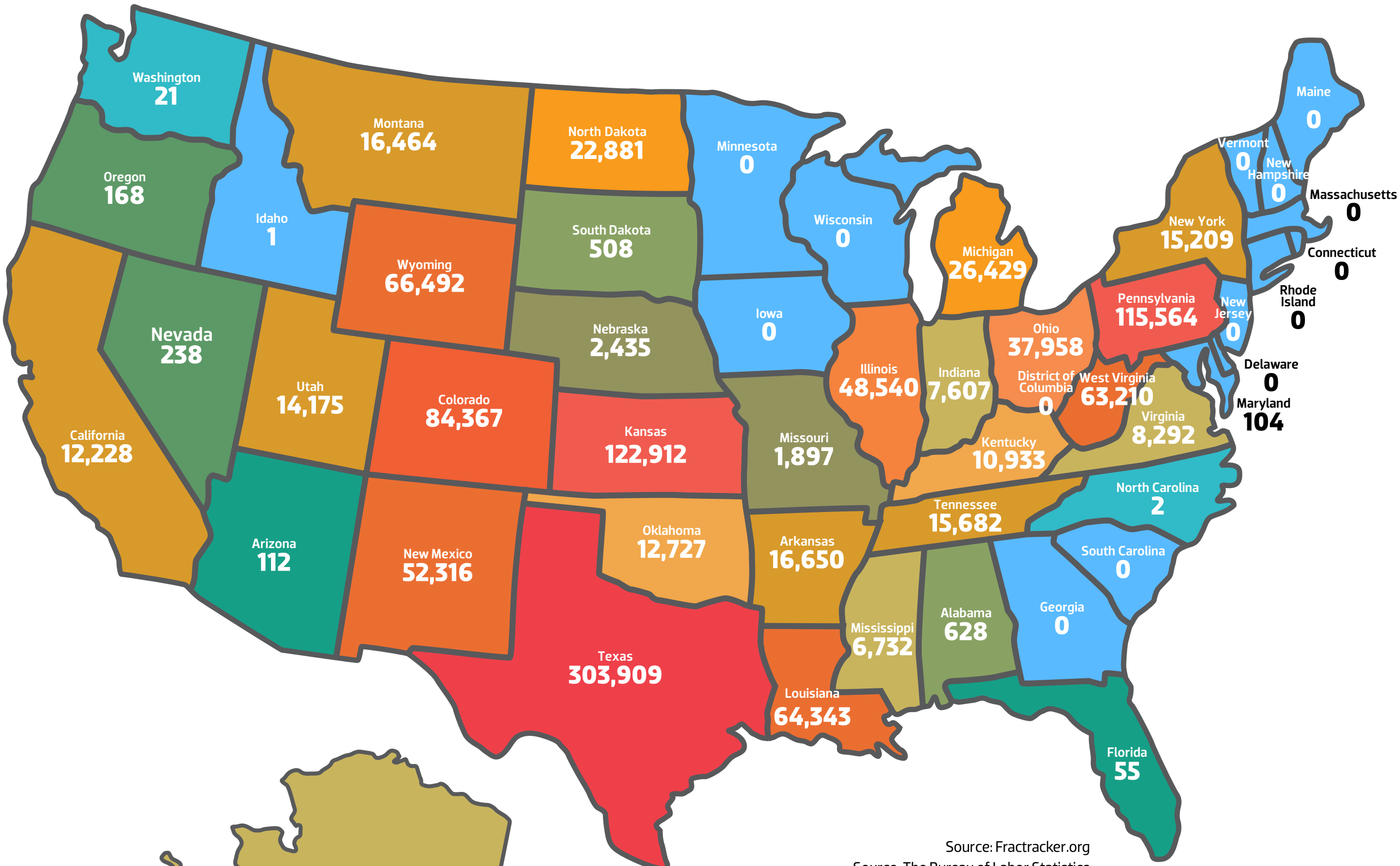
The convergence of that level of expansion with the value of local advisors means demand is coming agents' way.

"While most of the knowledgeable brokers in the past have been located in Texas, oil and gas companies in some of these newer regions will want to go to a neighbor or someone they see at soccer games," says Kern. "Insurance buyers want to deal with someone they know."

Several myths relating to the oil and gas industry keep independents at bay, however. One of the most

Oil and gas hotspots in the US

As of February 2014, there were roughly 1.1 million active oil and gas wells in the United States.



Source: Fractracker.org
Source: The Bureau of Labor Statistics

> "Oil and gas companies in some of these newer regions will want to go to a neighbor or someone they see at soccer games"
> **Richard Kern,** James River

pervasive is that the energy boom will eventually go bust.

Kern disputes this.

"I've been doing oil and gas since before 1980 and I've been hearing that same story all these years," he says. "The industry's not going to go away because of the economics. The country will still continue to burn fossil fuels because no one wants nuclear and we can't move solar along fast enough.

"Oil and gas is going to be there for the long haul."

The other, perhaps more prevalent, fear is that working in oil and gas insurance requires a high degree of industry-specific knowledge. That's true—but only to a point.

As senior underwriter for James River's energy division, Nataliya Marshall works primarily with wholesalers whose retail agent partners can start off with limited industry know-how. It is the specialized knowledge of the wholesaler, she says, that allows many agents to successfully write oil and gas business.

"We often run into situations where retail agents aren't experienced [in oil and gas], but they have enough common sense to find someone on the wholesale side of the business to hold their hand. It works," Marshall says. "If they start asking questions and have a desire to learn, they can be successful."

Cade Felker, vice president of Swett & Crawford's energy practice group, says he understands the difficulty agents may have in "giving up control" of some aspects of the account, but maintains the agent-underwriter relationship is key in the oil and gas sector.

"There's no way for retail agents to be an expert on all things," Felker says. "It's important for them to listen, understand and concentrate—then we can help them take advantage of all the resources underwriters can provide to meet the needs of the account."

CRACKING THE INDUSTRY

Given the capacity in the market and the specialization of insurance wholesalers, it isn't necessary for retail agents to be experts or even to aim for specialization in oil and gas. What is necessary is knowing which accounts to target first.

All areas of the oil and gas industry have grown, but some operations are benefiting from the boom more than others. Extraction—the production work performed before the shipment of oil—employed an impressive 193,000 people in 2012, but support activities are where the industry is seeing real progress.

These activities, which include excavation, well surveying, casing work and well construction, employed 286,000 people by the end of 2012—a 180% increase since 2007.

Some of those operations are an ideal entry point for independent agents with a more general background, says Maureen Dunn, an underwriter with James River's energy division.

"I see installation, service and repairs being a good, transitional class for agents, especially those with a background in construction or service classes," Dunn says. "[Those agents] are used to dealing with contracting risks, so a class like pipeline contractors would be a great transition for someone who has written groups like plumbers in the past."

Other prospective classes include geoscientists, petroleum engineers, chemical engineers, service unit operators and those contracted to build oil derricks and rotary drills. Oil and gas consultancies typically employ many of these services, and continue to grow in number.

Meanwhile, agents with more industry experience, or those who work in competitive states like Texas, would do well to chase higher risks like drilling consultancies or safety operations.

"As a retail agent, I would look at some of the more forbidden classes," says Felker. "These tougher and emerging businesses—drilling, gas monitoring, safety—those are the classes many standard retail agents just don't want to go after. That's where you can find an equalizer."

When it comes to prospecting for these clients, patience is paramount. Felker notes that it can take up to two or three years to build a respectable book of business, and sometimes agents just can't beat the deal a company is currently getting.

Working in a controversial niche

Fracking is the source of some of the most divisive environmental and safety conversations in the U.S. And while science has been a bit hazy on the exact effects of fracking, public sentiment definitely has an influence on insurance professionals servicing these accounts.

According to Richard Kern, manager of James River Insurance Company's Energy and Environmental divisions, nuisance claims from population centers near well sites are one source of potential risk.

"We've had some claims where someone buys land next door to a fracking site and complains about a nuisance," Kern says. "They represent third-party exposures."

The risk is especially present during geologic or seismic studies near urban areas. Kern recalls one incident in which a subcontractor used a "thumper truck"—which creates sound waves deep in the earth to locate and measure oil and gas deposits—near a neighborhood in south Texas.

"Because of a poorly worded contract, we ended up with 300 claims due to cracks in the walls and ceilings of homes," he says.

The theory that fracking operations may be responsible for increased seismic activity is also an area of interest to insurance professionals.

While Kern stresses that there is no evidence that fracking causes earthquakes, there is some uncertainty surrounding the practice of shooting waste fluid down injection wells using extreme pressure—a practice some believe is responsible for minor earthquakes.

Given that the general liability policy is silent on earthquakes, many turn to the CGL for financial risk management. However, insurers may limit coverage in the event of manmade seismic activity or even exclude it altogether.

"As a retail agent, I would look at some of the more forbidden classes"

Cade Felker, Swett & Crawford

Asking to analyze a company's insurance portfolio never hurts, though. It's a favorite technique of Ryan Smith, a leading producer with Houston-based Wortham Insurance, and one to which he attributes much of his success with oil and gas clients.

"When I call on people, typically I know there's an exposure that hasn't been addressed or has never been brought up by the current broker," he says. "I show them their current situation, how to resolve those problems and, nine times out of 10, they move their business to us."

TACKLING THE POLLUTION FACTOR

Working in oil and gas insurance means juggling industry prejudice, a sometimes unhappy local populace, numerous site contractors, and multi-phase operations that present major exposures at every turn. It's no wonder that in such an industry, financial losses stretch to six and sometimes seven figures.

Not only does that risk profile require that agents possess nerves of steel, it also necessitates carefully thought-out coverage and routine inspection for any gaps.

Perhaps the most visible gap is the pollution exclusion in the commercial general liability policy. For an industry so mired in environmental controversy, pollution exposures can become problematic very quickly.

Despite some insurance industry debate over what constitutes a pollutant, the definition generally accepted is anything "not naturally occurring." Personally, Kern interprets that as "virtually everything when dealing with oil and gas."

Regarding fracking, some risks are especially worrisome. Blowouts, or the uncontrolled release of oil or gas from a well, and the transportation of oil, salt water and other fluids are good examples.

"I would say our heaviest pollution issues have been with pipelines," says Kern. "When you drill, salt water comes up the well. Or, if you're manufacturing pipes and the pipe fails, fluids can get everywhere."

Fortunately, there are numerous insurance solutions tailored to the industry. In addition to standard pollution liability policies, time-element pollution endorsements provide coverage for bodily injury or property damage arising from accidental, short-duration releases of pollutants if discovered and reported in a timely manner—ideal for blowout incidents.

Contractors pollution liability—which protects contractors and their customers—is another option. Products pollution liability is considered essential for manufacturers of pipes and other equipment in the event of a malfunction and subsequent pollution release.

Of course, it isn't just those obvious incidents contractors have to worry about. So-called gradual pollution exposure can be just as financially disastrous.

Particularly concerning for onshore operations, gradual pollution occurs when a leak or other incident introduces pollutants to the environment that are not immediately discovered and neutralized. Underground pipes or storage tanks may leak and contaminate groundwater, for example, and some policies may not cover such events.

As such, agents need to read pollution policies carefully and ensure they obtain maximum pollution coverage protection available so that in the case of a pollution event, there are no major coverage gaps.

COVERING CONTRACTORS

One oil and gas operation may include as many as five different contractors working onsite at a time. Add in the complicating factor of jurisdictional biases, and the industry is much like construction—in the event of a loss, liability hangs on how different contractors are treated in policies.

One big mistake Kern sees many agents make is relying on ISO forms and endorsement titles like the Oil and Gas Industries Endorsement to resolve these issues, believing the forms broaden coverage. Instead, the forms restrict or exclude coverage, Kern says, while other forms leave "a lot of holes" where contractual liability is concerned.

"The forms limit contractual liability to things like maintenance inside a building, but retail agents often don't pay attention to what the terms in an endorsement actually mean," Kern says. "They just check titles."

Such a haphazard approach to contractual liability can lead to sticky situations where a contract holder can shift a great amount of liability to subcontractors, even for things like sole negligence. Throw different jurisdictions into the mix, with their individual anti-indemnity laws, and both contractual liability and agents' own E&O exposure goes through the roof.

For that reason, some of the first language agents should look at relates to contractual requirements.

"You really have to look at the indemnity section of the contract and the insurance requirements there," says Smith. "A lot of times—whether from a wording or limits standpoint—there are aspects that need to be redlined or highlighted in contracts."

Kern recommends insureds and their contractors indemnify each other through what's known as knock-for-knock indemnity. Under this form of indemnity, injuries and damages can occur only to the employees and property of both parties.

For agents less well-versed in contractual liability, exposure can be mitigated by the right approach to placing business.

"You can easily get into a real semantics game that requires a very specific understanding of contracts in all different regions," Felker says, "which is why retail agents need wholesale partners with that specific set of expertise.

DON'T OVERLOOK PROFESSIONAL LIABILITY

Contractors also run into issues regarding professional liability. While E&O concerns affect all players, the array of consultants now working on drill sites may be at special risk. Potentially unbeknownst to them, consultants take on liability for everything from updating safety manuals to providing oversight on the field.

"Through contracts, consultants are picking up professional liability exposures that need coverage," Dunn says. "Even a safety advisor who tells workers to wear hard hats could become responsible for all lives onsite. If someone dies, it could potentially fall to his E&O insurance."

Depending on a professional's risk profile, excess or umbrella coverage may be needed. However, limits dictated in contracts could also be too large for the exposure, in which case agents may be able to facilitate a discussion on more affordable limit requirements.

WHEN LOSSES OCCUR

Even operations with the best safety procedures experience losses.

Underwriters in the oil and gas industry understand this, but they still run into agents who mistakenly believe it's best to exclude such events from insurance applications.

Dunn and Marshall urge agents not to fall prey to this temptation.

"We're not looking at just one claim," Dunn says. "If you can present us with a work comp mod under a 1 and a treatment of workers that's favorable, one fluke incident that looks scary on a loss run to you is not scary to us."

Marshall adds that skilled underwriters know to ask questions illustrating how a client has addressed such losses and the safety measures they have taken to prevent future occurrences, which can help reduce potential rate increases.

MAKING IT IN OIL AND GAS INSURANCE

The U.S. oil and gas industry is big and poised to grow even bigger. According to a Pricewaterhouse Coopers report, the industry contributed more than $1.1 trillion toward U.S. GDP in 2011 and another 1 million jobs are projected to be added by 2035.

Despite the challenges and the risks inherent in working with the industry, it is clearly a major play for agents, whether they specialize or stick to writing local accounts. Those with the patience to stick it out and learn from experienced professionals have a lot to gain.

Agents who have already capitalized on the opportunity, like Smith, don't regret it.

"It's a great industry to be in," Smith says. "It's here for the long haul and it's an exciting time." IB

Top energy occupations

Geoscientists
11,140

Petroleum engineers
26,600

Derrick operators
22,400

Rotary drill operators
26,190

Service unit operators
57,390

Source: The Bureau of Labor Statistics, 2013

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