

# Capital and finance: Spillage

As another oil company struggles with another, significantly smaller, leak - BRAVE Partners asks: who can take this risk?

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In the high jinks of student life, spillage (a spill from an alcoholic drink) is often penalised by some form of forfeit. In the serious business of oil exploration spillage of the oil is becoming heavily penalised as the world strives to both explore for oil in more inhospitable and inaccessible areas as well as protect the environment. Thick gooey oil slicks make good TV for news editors, but not for oil executives. Tony Hayward, the former CEO of BP, knows this only too well.

However, BP is now out of the spotlight. The Macondo well incident is vanishing into the rear view mirror of people's memories. It has been replaced by Shell's troubles in the North Sea.

## Bubble, bubble oil and trouble

The Gannet oil field sprang a leak in its sub-sea piping around August 12. Initially the leak was relatively serious, but the company quickly de-pressurised the line, which substantially reduced the leak. However, small amounts of oil continue to leak out and pictures of bubbling sub-sea lines and oil slicks on the surface of the North Sea in the TV news do not make for good PR. As President Obama demonstrated, with his "boot on the throat of British Petroleum" leaders who wish to gain popularity will talk tough on such issues. It does remain the largest leak of oil in the North Sea for over a decade.

## Covering the cost

The BP spill proved to be enormously expensive. Substantially more than the \$700 million provided for through the company's captive insurer, Jupiter. The Shell event is clearly substantially smaller. However, a theme is emerging. As oil exploration moves into more inhospitable and inaccessible areas the risk of spills is increasing. Furthermore, as the world becomes more environmentally aware and connected - TV images of oil bubbling uncontrolled to the surface are increasingly less tolerated. It is a long way from the early days when Rockefeller started Standard Oil from deposits that bubbled naturally to the surface in Pennsylvania, among other places. The world wants and needs oil, but it is intolerant to the risks associated with exploring for and extracting it.

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Oil leaks will become more frequent and less tolerated. BRAVE Partners believes that this is a risk that the industry will need to address.

## My friend will pay

As it is holiday season, most of us are struggling with a phrase book trying to impress the natives. Again in more irresponsible student days, a favourite phrase to try to learn was: "two beers please, my friend will pay". In the case of oil spills, the friend that pays is usually an insurer, or reinsurer for those that manage their risks through a captive. Whilst the oil majors generally do not use insurance or reinsurance, BRAVE Partners has commented that it is perhaps time that they reconsidered this option. The cost of large scale spills is now prohibitively large, even for the largest company in the world. ExxonMobil is currently trading places with Apple to be the largest company by market value.

## A Bolt from the blue

Just as demand for liability insurance looks set to rise, there appears to be downward pressure on supply. The Performance Management Director at The Society of Lloyd's, Tom Bolt, has recently expressed deep concerns over how offshore energy liability business has been written at Lloyd's. As the

excellent Insurance Insider reports, Bolt commented that he: "pretty intuitively wants to say 'no' to everybody [submitting a plan to write offshore energy liability]".

There appears to be a supply-demand imbalance brewing. This is the niche in which BRAVE Partners excels.

## BRAVE ideas

Since the BP leak in the Gulf of Mexico, BRAVE Partners has been developing ideas for creating a capital markets product that would protect against oil leaks. Some of these ideas have already featured in the firm's commentary, such as "[Avalon Pray](#)". However, the firm's thinking continues to develop.

BRAVE Partners' ideas centre on a structure that provides a clear objective loss trigger that investors can assess, analyse and, most

importantly, observe. As with all parametric trigger catastrophe bonds, the trick is making the structure respond closely enough to the actual loss exposure of the company. It is in this area that BRAVE Partners believes that the firm has made significant progress.

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## BRAVE Partners services

BRAVE Partners LLP is a boutique investment bank that focuses on the insurance and reinsurance sector. The partners of the firm have a track record in developing innovative structured transactions to solve issues for the sector. BRAVE Partners has been developing structures to transfer the liability risk associated with large oils spills to the capital markets since the Macondo oil spill. The firm has developed specialist expertise within this area.

BRAVE Partners can advise oil companies, insurers and reinsurers structures to transfer the third party liability risk associated with oil spill and other energy industry risks to the capital markets through a catastrophe bond, or other instrument.

### Interaction

If you enjoyed this commentary and would like to receive a weekly update by E-Mail, then please contact BRAVE Partners on [commentary@bravepartners.com](mailto:commentary@bravepartners.com)

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- Whilst a far smaller incident, the recent oil leak in the North Sea from a Shell platform suggests that this will be a persistent issue for the industry.
- The Macondo well leak demonstrates that the size of the losses from oil leaks can be vast – bigger than even a major oil company can readily absorb.
- BRAVE Partners has been working on catastrophe bond structures that the firm believes can successfully transfer the liability risk associated with oil spills to the capital markets.
- BRAVE Partners can:
  - Advise on the structure of a catastrophe bond to transfer certain offshore energy liability risks to the capital markets.
  - Arrange a capital markets transaction for an oil explorer, insurer or reinsurer.

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