

Insurance/Bonding As A Regulatory Response To Risks From Fracking

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Reasons To Focus On Liability/Ex Post Financial Responsibility

- Difficult To Assess Risks Ex Ante
 - - new technology
 - - new siting (closer to population centers)
 - - greater intensity of development
- Difficult For Regulatory Agencies To Regulate Even With Good Information
 - - state political dynamics/ “capture”
 - - barriers to sharing of regulatory insights among jurisdictions
 - - reasons for skepticism about “best practices” regulation and regulatory compliance defense

Liability

- Liability regimes require possibility of successful ex post litigation
- That requires that lawyers, landowners, localities believe realistic possibility of recovery
- Broad pools of insurance very useful to that end
- Causation a major issue for tort litigation in this context although one could imagine a range of causation rules running from traditional tort to the CERCLA causation rule

Bonding/Insurance Key To Ex Post Approach

- Addresses key problem of insolvency/judgment-proof or defunct corporate actors
- Ensures there will be some money for remediation, which otherwise might not become available even with great public need
- Also helps address problem of ex ante regulation by enlisting a third-party (insurer) that is financially motivated to demand information, assess risk, and reward safer conduct

Bonding

- Like a Pigouvian tax
- In theory, very useful, but overall history in oil, gas, and mining, suggests implementation kept problem: too low bonds, too little assessment of amounts needed for different kinds of activities, too easy conditions for release, too many ways to avoid formal closure – all reflecting same political economy problems that lead to weak ex ante command and control regulation

Examples

- **North Dakota** \$50,000 per well
- **Ohio** \$5,000 per well
- **New Mexico** \$5,000 or \$10,000 per well + \$1/ft.
- **Farmington, NM** \$20,000 minimum bond
- **Arlington, TX** \$50,000 per well

Bonding

- Advantages: avoids causation/proof issues largely, more contractual than tort-like, bonds require a commitment to close and (sometimes) clean up, even if no showing specific contamination due to specific well
- Question is: is there a way to structure implementation so that it will be more effective?

Insurance

Some evidence of voluntary insuring in fracking context, so far limited mandated insuring:

Requirements for environmental liability insurance: Only Maryland (\$1 million per loss), Illinois (\$5 million per loss) and several municipalities— Arlington, TX; Fort Worth, TX; Farmington, NM, for example (\$5 million per loss).

Lots of Value

- Ex post – source of funds
- Ex ante – insurers can perform a number of useful functions:
 - - by requiring information disclosure as a prerequisite to insuring, they may increase our understanding of fracking risks
 - - by formulation and pushing for best procedures on a national basis

Insurance

- - by incentivizing better, safer conduct via insurability and premium setting
- Consider:
- While a dozen or more large insurers will write EIL coverage for energy companies generally, only five or six will write primary EIL for well owners or contractors with significant fracking operations, said Jeff Hanneman, managing director with the environmental services group of Aon Risk Solutions in Houston. . . . Insurers are selective about the risks they write, and rates depend partly on geography, he said. Underwriters are concerned about companies with operations in the Marcellus shale, where well sites often are near populated areas . . .
- Douglas McLeod, Insurance coverage options for fracking risks . . .
<http://www.businessinsurance.com/article/20130224/NEWS07/30224999>
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Will Insurance Be Available

- Issue has been raised especially re long-tail contamination risks
- However, some companies are engaged in fracking-related insurance now and seem open to a range of product offerings
- Moreover, regulatory requirements would drive demand, make a market more viable by making investments in risk rating and knowledge acquisition and monitoring cost-effective

Operationalizing Bonds

- Need for statutory language that covers more than formal closure/plugging of well
- Need for way to prevent companies from avoiding formal closure even after no or minimal production
- Need for discretion or rules that allow for higher bonds for particularly risky activities or by actors with poor track records
- Need for better planning for insolvency and for more realistic amounts

Operationalizing Insurance

- Need for different amounts for different settings w different risk profiles
- Need rules for when self-insurance does and does meet statutory mandate (good reasons to restrict self-insurance option)
- Local versus state versus federal role: questions of state preemption

Some evidence of interest in risk ratings for bonding and insurance

- Jory Caulkins, Independent Energy Standards, Jan. 12, 2015: “One of the areas we are working on is using our ratings system to help insurance underwriters better assess and price risk of different oil & gas operations. We are in the early stages of working with a few different carriers right now, with others in the queue. We are also having dialogues with regulators around bonding and insurance mechanisms, and have a standing capacity commitment from a major bonding underwriter for \$100M+ for some of these potential programs.”