

# The BP Disaster: The Flood of Oil has Stopped, Insurance Claims have Just Begun

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## I. INTRODUCTION

The BP disaster (also referred to as the *Deepwater Horizon* disaster or the Macondo blowout) in the Gulf of Mexico is now considered to be the largest accidental oil spill in history.<sup>1</sup> On April 20, 2010, an explosion and resulting fire at the *Deepwater Horizon* semi-submersible oil drilling platform, the cause of which is still uncertain as investigations continue, killed 11 platform workers and injured 17 others out of the 126 crew members on board the platform at the time. On July 15, 2010, 85 days after the explosion and many subsequent failed attempts to plug the leak, the flooding of oil was finally stopped by capping the gushing wellhead.<sup>2</sup> It has been estimated that during this period approximately 4.9 million barrels (a barrel of oil is 42 gallons) of crude oil were released, at a peak spill rate of 35,000 to 60,000 barrels per day.<sup>3</sup> By comparison, the entire 1989 *Exxon Valdez* disaster is estimated to have spilled 257,000 barrels of oil into Prince William Sound in Alaska.<sup>4</sup>

The BP disaster is causing extensive damage to marine and wildlife habitats, as well as the Gulf of Mexico's fishing and tourism industries. Scientists have reported immense underwater plumes of dissolved oil, which are nearly impossible to track, and even harder to remove or remediate.<sup>5</sup> Crews continue to work to protect hundreds of miles of private property, beaches, wetlands and estuaries along the northern Gulf Coast using skimmer ships,

floating containment booms, anchored barriers, and sand-filled barricades along the coasts, as well as surfactants (dispersants) and surface burning techniques throughout the Gulf's waters.

The BP disaster has already begun, and will undoubtedly continue, to give rise to insurance claims under first-party property policies by individuals and businesses seeking coverage for property damage and business interruption losses stemming from the BP disaster. For example, for individuals and businesses operating on the Gulf Coast a majority of the first-party claims will likely involve 'time-element losses' arising out of the prevention and/or disruption to fishing, tourism, and shipping channels because of the oil spill and on-going remediation efforts.

The BP disaster has also led to a variety of liability claims against BP and other related entities. In response, BP has announced the creation of a \$20 billion fund to pay claims in return for a complete release.<sup>6</sup> This BP fund will not only be utilized by injured claimants, but will also likely be used by subrogees, i.e., insurers who have paid claims to injured claimants and are now pursuing responsible third-parties (e.g., BP) to recoup their costs. The parties, for which nearly all claims and related suits have been asserted to date include: BP plc, owner of the leaking well in conjunction with minority operators in the joint venture, Anadarko Petroleum Corporation and Mitsui & Company Ltd;

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Transocean, Ltd., owner and operator of the *Deepwater Horizon* oil platform; Halliburton, Inc. contractor for Transocean on the *Deepwater Horizon*; and Cameron International Corporation, manufacturer of the 'blowout preventer' which was alleged to have failed causing and/or contributing to the BP disaster. The claims that have been asserted so far generally fall into three categories: (1) claims for death and bodily injury to workers stationed on the *Deepwater Horizon*, as well as responders performing removal and remediation work for the oil spill; (2) claims for economic loss by private individuals and businesses (e.g., local maritime industry consisting of fisherman, shrimpers, and charter boat captains, restaurants, hotels/resorts, beach clubs and waterfront property owners); and (3) claims for governmental disaster response, remediation, and clean-up costs.

To analyze all of the claims and coverage issues that might arise as a result of the BP disaster would extend well beyond the scope of this article. Instead, we provide a general overview of the types of claims and corresponding insurance issues which we have already seen and are likely to see arise from the BP disaster. Presently, there are at least five Gulf Coast jurisdictions – Alabama, Florida, Louisiana, Mississippi and Texas – whose body of law will probably come into play regarding these claims and suits, and it is safe to postulate that many more jurisdictions will become involved as the claims and litigation continue to mount throughout the country.

## II. FIRST-PARTY PROPERTY COVERAGE

### A. Property Damage Losses

First-party property policies generally protect an insured's place of operations and inventory, and provide coverage for lost or damaged property. Many first-party property policies are sold on an 'all risk' basis, meaning that they cover losses to real property caused by any peril not expressly excluded.

Since the BP disaster, certain properties located on or near the Gulf Coast have reported adverse

effects from oil from the BP disaster. These claimants *may* have experienced 'direct physical loss or damage' to their property which *may* constitute 'covered' property damage under a first-party property policy. Normally, at a minimum, ample quantities of oil need to come into contact with an insured's property to cause loss or damage.

Several other considerations would also likely come in to play for potential claimants. First, the insured would need to establish that the property at issue constitutes 'covered property' as property policies generally cover the insured's interest in structures, personal property, and improvements and betterments on the insured premises. As many commercial first-party property policies, however, exclude land and water as covered property, portions of loss or damage from oil contamination to wetlands, waterfront property and beaches may not be covered.

Moreover, the 'pollution exclusion' contained in most first-party property policies will pose a significant hurdle to recovery for loss or damage. The specific language of such an exclusion varies. For example, pollution exclusions generally bar coverage for losses "resulting from, contributed to or made worse by actual, alleged or threatened release, discharge, escape or dispersal of contaminants or pollutants," "all whether direct or indirect, proximate or remote or in whole or in part caused by, contributed to or aggravated by any physical damage insured by this policy." Most jurisdictions recognize crude oil to be a 'contaminant' or 'pollutant'.<sup>17</sup>

The application of the pollution exclusion will most likely have effects beyond claims for property damage coverage. Indeed, most business interruption coverage requires the losses sustained by the insured to result from property damage as result of a 'covered peril.' As such, should a claimant's business interruption claim stem from damage related to or arising out of oil contamination, the pollution exclusion may also bar any business interruption claim.

### B. Business Interruption Losses

In addition to claims involving direct physical loss or damage to covered property, claims for business interruption losses resulting from the BP disaster appear to be a significant portion of the total claims presently being asserted. Similar to other 'large loss events,' Hurricanes Katrina and Rita for example, the BP disaster has already significantly impacted local and national businesses in their carrying out of day-to-day operations. Unlike hurricanes and other natural disasters which often result in a direct physical loss to covered property, the crude oil which has spread throughout the Gulf of Mexico may have little contact with an insured's land-based 'covered' property.

In simple terms, business interruption insurance is intended to return to the insured's business the amount of profit it would have earned had there been no interruption of the business or suspension of its operations as a result of a covered loss. In order to generally recover lost income under a policy's business interruption provision, therefore, the insured must show that: (1) direct physical loss to covered property was caused by a covered peril; (2) interruption of business was caused by or resulted from the physical loss to covered property; and (3) monetary loss is a direct result of the covered interruption of business.

Most jurisdictions have held that physical loss or damage to covered property by an insured peril is generally a prerequisite for recovery under a policy's business interruption provision.<sup>8</sup> Moreover, an insured's inability to access property without any accompanying physical damage generally will not be covered under a standard business interruption provision.<sup>9</sup> A few courts have, however, extended the direct physical loss concept to situations where premises have become unsafe or unusable, even though there was no visible, tangible damage to the property.<sup>10</sup>

Even when there is physical loss or damage to covered property, there must be a causal connection between the physical loss or damage and the interruption of the insured's business. Hence, businesses along the Gulf Coast that have endured physical damage or loss to covered

property as a result of the crude oil from the BP disaster, will most likely need to show that the loss of business income was the direct result of or caused by physical loss or damage to some covered property.

### ***C. Contingent Business Interruption Losses***

Contingent business interruption (CBI) insurance generally provides coverage to an insured when a supplier or a key customer suffers a direct physical loss that interrupts the insured's own business (i.e., revenue stream).<sup>11</sup> While business interruption insurance protects against the loss of prospective income because of the interruption of the insured's business caused by a covered peril on the insured's covered property, CBI insurance protects against the loss of prospective income because of the interruption of the insured's business caused by an insured peril to property that the insured does not own, operate, or control.<sup>12</sup> Generally, CBI coverage requires the insured to establish that: (1) the contingent or dependent property suffered direct physical loss or damage by a covered peril; (2) the physical loss or damage prevented the contingent or dependent property from receiving and/or supplying goods or services; and (3) the physical loss or damage to the contingent or dependent property caused an interruption or suspension of the insured's business.

In sum, CBI coverage protects an insured against economic losses caused by the inability of the insured to receive a supplier's goods or services or the insured's inability to supply goods or services to customers. Such coverage may be implicated, for example here, when operations of a seafood restaurant in New York City are interrupted because the restaurant cannot get its daily supply of fresh seafood from a Gulf Coast supplier whose operations have ceased as a result of a covered peril.

### ***D. Civil Authority and Ingress/Egress Losses***

#### ***i. Civil Authority Losses***

Generally speaking, civil authority coverage insures losses caused by the inability of the insured to access its premises when a civil authority denies it such access because of a covered peril to, or destruction of, property belonging to third-parties. Some civil authority coverages require physical damage to the insured's own covered premises; others do not.

After the BP disaster, many beaches and waterways were closed by the federal or local government as the initial response and remediation efforts commenced. As an example, some insureds affected by these governmental restrictions may submit claims under a policy's civil authority provision.

Generally, in order for an insured to be covered for 'civil authority losses,' the insured needs to be able to show: (1) an 'action' or 'order' of civil authority; (2) the action or order of civil authority either prohibited, prevented, or impaired access to the insured's premises; and (3) the order or action of civil authority that prohibits, prevents, impairs, or inhibits access to the insured's property was the result of covered direct physical loss or damage to property other than the insured's property.<sup>13</sup> One should be mindful that under certain civil authority coverages, access to the premises must be 'prohibited' or 'prevented,' as opposed to merely impaired, in order to obtain this type of coverage.<sup>14</sup>

#### **ii. Ingress/Egress Losses**

Similar to civil authority coverage, ingress/egress insurance covers an insured against lost business income and extra expense when the insured's covered property is inaccessible for reasons other than an order of civil authority. This type of coverage typically requires that the property damage be located within a specified radius of the insured's covered property. Such coverage may be implicated if, for example, access to a business' covered property is prohibited due to a covered peril located in the business property's immediate area.

### **E. Other Types of First-Party Losses**

#### **i. Extra Expense Losses**

Extra expense coverage normally indemnifies an insured for the reasonable and necessary increased costs of conducting its business operations due to property damage caused by a covered peril. One example of such expense would be the increased costs in maritime shipping and transportation in the Gulf as a result of the crude oil spill.

#### **ii. Gross Earnings Losses**

Gross earnings coverage is another type of business interruption insurance which generally provides coverage for profits (gross earnings) a business would have earned, *but for* a covered business interruption. Often included in this gross earnings loss coverage are profits, continuing expenses, management payroll, and ordinary payroll.

#### **iii. Sue and Labor Losses**

Generally, sue and labor coverage functions to "reimburse [an] insured for those expenditures that are made primarily for the benefit of the insurer to reduce or eliminate an [imminent] covered loss."<sup>15</sup> Thus, in order to establish a claim for sue and labor, an insured will need to show: (1) that the expenses were incurred to avoid an imminent loss; and (2) that the sue and labor efforts performed and costs incurred were for the insurer's benefit, i.e., to avoid or minimize a loss that otherwise would be covered under the policy in question. Here, efforts made and costs incurred by an insured to protect covered property from being damaged by oil may be covered under sue and labor provisions.

### **III. THIRD-PARTY LIABILITY COVERAGE**

BP, Anadarko, Mitsui, Transocean, Halliburton, Cameron International, and likely others, now face potential liability by plaintiffs allegedly injured as a result of the BP disaster. To date, over 300 lawsuits have been filed against these companies and the list of defendants named in these actions likely will grow to include any company that ever assisted in the construction or manufactured any of the many

parts which made up the structure of the *Deepwater Horizon*.<sup>16</sup> For example, on August 10, 2010, the United States Judicial Panel on Multidistrict Litigation (MDL) issued an order transferring 77 lawsuits – with the potential of more than 200 additional "tag-along" cases – dealing with third-party liability issues concerning the cause (or causes) of the *Deepwater Horizon* explosion and fire, and the role, if any, that each of the above referenced entities played in the disaster.<sup>17</sup> Furthermore, BP's officers and directors have been named as defendants in a shareholder derivative lawsuit related to the oil spill, demonstrating how officers and directors may face personal exposure for third-party losses. To give some context, the following chart demonstrates a portion of the total reported amount of insurance coverage at play between the main possible defendants:

**Available Third-Party Liability Coverage for Main Companies in the BP Disaster**<sup>18</sup>

<b>Company</b>	<b>Available Insurance Coverage (in \$U.S.)</b>
BP plc	\$0
Anadarko Petroleum Corp	\$177.5 million
Mitsui & Co. Ltd	\$45 million
Halliburton, Inc	\$700 + \$900 million (general liability)
Transocean, LTD	\$600 million
Cameron International Corporation	\$500 million
<b>TOTAL</b>	<b>\$3 BILLION</b>

Beyond this basic information, the totality of the potentially relevant insurance coverage can be difficult to estimate given the nature in which these companies usually place insurance coverage. Energy companies, and those that own and manufacture oil platforms, normally do not purchase 'boilerplate' general liability policies. They typically have highly complex insurance programs in place which provide coverage for certain types of pollution losses.

**A. Comprehensive General Liability/Commercial General Liability Losses**

Comprehensive General Liability/Commercial General Liability (CGL) policies generally provide liability coverage for bodily injury or property damage to a third-party. CGL policies normally insure against all liability exposures of a business, unless specifically excluded. CGL policies usually also include coverage for losses associated with products, completed operations, premises and operations, and independent contractors.

**i. Product Liability Losses**

CGL products liability coverage often insures a liability suit brought against the manufacturer and/or distributor of a product because of someone incurring bodily injury or property damage through use of the product. For example, there have been allegations that the 'blowout preventer' to the BP well may have failed which caused and/or contributed to the disaster. Cameron International, as the manufacturer of the "blowout preventer," may look to this type of CGL insurance to cover associated losses brought by third-parties.

**ii. Completed Operations Losses**

CGL completed operation liability coverage generally insures bodily injury or property damage incurred because of a defect in a completed project of the insured. For example, it has been reported that work on the blowout preventer was performed several weeks prior to the BP disaster.<sup>19</sup> If this is accurate, and the blowout preventer is determined to have failed due to faulty workmanship, liability for this type of loss may be covered under this type of provision. Completed operations liability coverage, however, is not a warranty, meaning it would not cover the blowout preventer; just the property damage or personal injury caused by its "failure."

**iii. Premises and Operations Losses**

CGL premises and operations liability coverage insures bodily injury incurred by third-parties on the premises of the insured, and/or as the result of the insured's day-to-day operations necessary to conduct its business. It should be noted, however, this type of coverage almost never extends to the business or its employees.

#### **iv. Independent Contractors Losses**

CGL independent contractors liability coverage insures bodily injury incurred as the result of negligent acts and omissions of an independent contractor employed by the insured. For example, BP contracted Halliburton to perform services on the subject well and therefore, may be liable under this type of coverage for losses which may be associated with Halliburton's work, should it be deemed to have been performed in a negligent manner.

#### ***B. Environmental/Pollution Losses***

Environmental/pollution liability coverage generally insures bodily injury, property damage, and remediation costs resulting from a 'pollution' incident at a 'covered' site. Third-party environmental/pollution coverage is designed to defend and/or indemnify – depending on the specific type of policy – the insured from allegations that a release of a pollutant from the insured's facility adversely affected a claimant. For example, if the crude oil that has spread throughout the Gulf of Mexico contaminated the water supply of a coastal municipality, prohibiting its residents from drinking the water, this type of coverage *may* cover the resulting losses and pay damages from resulting lawsuits.

#### ***C. Directors' and Officers' (D&O) Losses***

D&O liability coverage usually, when applied to 'public companies,' (those having securities trading under national securities exchanges) contains three insuring clauses: (1) Insuring Clause 1 (Side-A) provides coverage to individual directors and officers when not indemnified by the corporation; (2) Insuring Clause 2 (Side-B) provides coverage for

the corporation when it indemnifies the directors and officers (corporate reimbursement); and (3) Insuring Clause 3 (Side-C) provides coverage to the corporation itself for securities claims brought against it. Simply put, for the purposes of this article, D&O liability insurance provides financial protection for the directors and officers of a company who are sued in conjunction with the performance of their duties as they relate to the company.

As mentioned, a derivative action has already been filed in court against the directors and officers of companies involved in the BP disaster, with dozens more likely to follow. BP, who has confirmed to have procured commercial D&O insurance, will be looking to this type of coverage to provide a defense and indemnity for directors and officers facing such claims relating to BP's alleged errors and omissions.

#### ***D. Commercial Workers Compensation/Employers' Liability Losses***

Commercial Workers Compensation liability coverage provides coverage for losses due to injury or death of the insureds' employees. Generally, this type of insurance covers medical and rehabilitation costs and lost wages for employees injured at work. Here, all employees of the main companies referenced above, who were injured or killed as a result of the BP disaster, would most likely be entitled to be insured for these losses under this type of coverage.

#### ***E. Offshore Physical Damage Losses***

Offshore physical damage liability coverage insures physical damage or loss to offshore property and equipment. Generally, it covers 'all risks' physical loss or damage to fixed offshore drilling, production, and accommodation facilities as well as mobile drilling rigs such as jack-ups, semi-submersibles (*Deepwater Horizon*) and drill ships. Typical insureds include integrated oil companies, oil and gas lease operators, independent oil companies, and drilling contractors.

#### ***F. Operators' Extra Expense (Control of Well) Losses***

Operators' Extra Expense (Control of Well) liability coverage often provides insurance for costs incurred when regaining control of an offshore or onshore well 'blowout,' including re-drilling expenses and seepage, pollution emanating from the blowout, as well as liability coverage, and damage to and loss of third-party property. Indeed, it is unclear at this point if Cameron International is placed with this type of coverage, but in light of the facts alleged to date, they would seem to benefit from this particular type of insurance.

#### **IV. CONCLUSION**

While the claims landscape is presently in flux, as various types of claims continue to blossom, one thing is clear, labors will made to consign as much of the costs for the losses as possible under the various types of insurance coverage discussed above. Insurers are equipped to handle these types of claims, but given their volume, certain uniqueness and variety, along with the significant amounts of money at play, it seems inevitable that not all parties will be in agreement as to which losses are covered and which are not under a particular type of insurance coverage. The BP disaster appears to be a key opportunity for both the insureds and insurers to further define their ever evolving relationships.

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<sup>1</sup> See Katarzyna Klimansinska, *BP Oil Spill Leaves a 22-Mile Plume Migrating in Gulf of Mexico*, Bloomberg News (Aug. 19, 2010).

<sup>2</sup> See Jim Polson, *BP Halts Gulf of Mexico Leak, Starts Pressure Test*, Bloomberg News (July 15, 2010).

<sup>3</sup> See Jim Polson, *BP Well Gushing as Much as 60,000 Barrels Oil a Day, U.S. Says*, Bloomberg News (June 16, 2010).

<sup>4</sup> See Mark Chediak, *BP's Well Gushed 4.1 Million Barrels Into Gulf Waters*, Bloomberg News (Aug. 2, 2010).

<sup>5</sup> See Kim Chipman, *Scientists Say as Much as 79% of Oil Remains in Gulf*, Bloomberg News (Aug. 17, 2010).

<sup>6</sup> See *BP Establishes \$20 Billion Claims Fund for Deepwater Horizon Spill and Outlines Dividend Decisions* at <http://www.bp.com/genericarticle.do?categoryId=2012968&contentId=7062966>

<sup>7</sup> See Couch on Insurance 3d § 155:90.

<sup>8</sup> See, e.g., *United Airlines, Inc. v. Insurance Co. of the State of Pennsylvania*, 439 F.3d 128, 131 (2d Cir. 2006) ("The purpose of business interruption insurance is to indemnify the insured against losses arising from an inability to continue normal business operations and functions due to damage sustained as a result of the hazard insured against"); *Philadelphia Parking Authority v. Federal Insurance Co.*, 385 F. Supp. 2d 280, 288 (S.D.N.Y. 2005) ("Interruption in business must be caused by some physical problem with the covered property which must be caused by a covered cause of loss"); *Roundabout Theatre Co., Inc. v. Continental Casualty Co.*, 302 A.D.2d 1 (N.Y. App. Div. 2002) (policy clearly and unambiguously provides coverage only where insured's property suffers direct physical damage); *Dictiomatic, Inc. v. U.S. Fidelity & Guaranty Co.*, 958 F. Supp. 594 (S.D. Fla. 1997).

<sup>9</sup> See *Harry's Cadillac-Pontiac-GMC Truck Co. v. Motors Insurance Corp.*, 486 S.E.2d 249 (N.C. 1997) (Access to an insured's auto dealership was hindered for one week as a result of a snowstorm. The insured was covered under a CGL policy that provided, in part, protection against loss of income resulting from the suspension of business due to property repairs).

<sup>10</sup> See *Farmer's Insurance Co. of Oregon v. Trutanich*, 858 P.2d 1332 (Or. Ct. App. 1992) (odors from methamphetamine cooking were held to constitute "direct physical loss" to covered property under a homeowner's policy because the odor damaged the house); *Western Fire Insurance Co. v. First Presbyterian Church*, 437 P.2d 52 (Colo. 1968) (all-risk policy covered the cost of remedying the infiltration and contamination of the church from gasoline and gasoline vapors in the soil under and surrounding the building); *Matzner v. Seaco Insurance Co.*, No. 96-0498-B (Mass. Super. Aug. 12, 1998) (carbon monoxide levels in apartment buildings sufficient to render building uninhabitable constituted a direct physical loss); *Sentinel Management Co. v. New Hampshire Insurance Co.*, 563 N.W.2d 296 (Minn. Ct. App. 1997), *aff'd in part, rev'd in part*, 615 N.W.2d 819 (Minn. 2000) (although asbestos contamination does not result in tangible injury to the physical structure of a building, a building's function may be seriously impaired or destroyed and the property rendered useless by the presence of contaminants).

<sup>11</sup> Bruce R. Kaliner, *The Expanding Role of Contingent Business Interruption Insurance*, § 17 Mealey's Business Interruption Ins. (Volume 3, 1st ed. 2003).

<sup>12</sup> See *CII Carbon, L.L.C. v. National Union Fire Insurance Co. of Louisiana, Inc.*, 918 So. 2d 1060, 1061 n.1 (La. Ct. App. 2005).

<sup>13</sup> See, e.g., *Zurich Am. Ins. Co. v. ABM Indus.*, 397 F.3d 158 (2d Cir. 2005).

<sup>14</sup> *Southern Hospitality v. Zurich American Insurance Co.*, 393 F.3d 1137 (10th Cir. 2004); see e.g., *Travelers Indemnity Co. v. Pollard Friendly Ford Co.*, 512 S.W.2d 375 (Tex. Ct. App. 1974); *Altru Health System v. American Protection Insurance Co.*, 238 F.3d 961 (8th Cir. 2001); *Davidson Hotel Co. v. St. Paul Fire & Marine Insurance Co.*, 136 F. Supp. 2d 901, 912 n.6 (W.D. Tenn. 2001).

<sup>15</sup> *Tillery v. Hull & Co., Inc.*, 717 F. Supp. 1481, 1486 (M.D. Fla. 1988) (quoting *Blasser Brothers v. Northern Pan-American Line*, 628 F.2d 376, 386 (5th Cir. 1980)), *aff'd*, 876 F.2d 1517 (11th Cir. 1989); see also *Albany Insurance Co. v. Anh Thi Kieu*, 927 F.2d 882 (5th Cir. 1991); *Continental Food Products, Inc. v. Insurance Co. of North America*, 544 F.2d 834 (5th Cir. 1977).

<sup>16</sup> See *Analysis: BP's spill clean-up now shifts to the lawyers* at <http://www.reuters.com/article/idUSTRE6794OR20100810>.

<sup>17</sup> See *Transfer Order, In Re: Oil Spill by the Oil Rig "Deepwater Horizon" in The Gulf of Mexico*, on August 10, 2010, MDL No. 2179 at [http://litigationconferences.com/wp-content/uploads/2010/08/MDL-2179-Transfer\\_Order.pdf](http://litigationconferences.com/wp-content/uploads/2010/08/MDL-2179-Transfer_Order.pdf).

<sup>18</sup> See *The Macondo, Gulf of Mexico, Oil Spill Insurance Implications* at [http://www.rms.com/publications/2010\\_Macondo\\_Oil\\_Spill\\_Insurance\\_Implications.pdf](http://www.rms.com/publications/2010_Macondo_Oil_Spill_Insurance_Implications.pdf).

<sup>19</sup> See *BP Learned of Faulty Blowout Preventer Weeks Before Explosion* at <http://ecopolitology.org/2010/06/21/bp-learned-of-faulty-equipment-weeks-before-explosion/>.