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Old King Coal finds new status in US

ALEX POWELL looks at coal mining from an underwriter's perspective

There's something quintessentially British about the coal mining industry – at least that seems to be what people living in Britain think. According to us, it is a sector that remains associated heavily with northern accents, trade union leader Arthur Scargill and the industrial picket lines of the 1980s.

This Brit-centric school of thought also says it is a sector in terminal decline. But take a slightly wider view of mining for a moment, and the fallacy behind this negative perception quickly becomes apparent.

Coal-mining: global activity

What we myopic Brits often fail to grasp is that coal mining is a global activity and is, in many parts of the world, in much ruder health than in the UK. In the US, where London market property underwriters are heavily involved in the industry, coal-mining is on something of an upward curve. Coal on that side of the Atlantic is in the ascendancy and provides a contrasting insurance market to its rather sickly British counterpart.

The new buoyancy in US coal is due to a number of factors – the Federal government's desire to reduce the country's dependence on oil; the development of new technologies that make coal use less environmentally harmful; and the global rise in demand for energy prompted by the rapid development of new economic powerhouses such as India and China.

But coal is not new to the US. The industry goes back hundreds of years in its three main production areas – the Appalachians, the Interior region incorporating the Illinois Basin and the western states centred on Colorado, Montana, Wyoming and Utah.

But recent experience is leading many US coal companies to issue optimistic statements about the future of their industry, in sharp contrast to what has happened in the UK. Coal reserves in the US remain plentiful and high energy prices are making them increasingly attractive.

From an insurance perspective, coal mining can be split neatly between surface open-cast mining, and underground mining – the latter posing the greater risk to the property underwriter. In the US, the industry is split roughly two-thirds above ground, one-third below ground.

Open-cast mining is essentially about 'dirt removal' using draglines (cranes with scoops/buckets) to expose the seam and then shovels and trucks to extract and remove the coal. Below ground, working in an often lengthy network of tunnels and faces, the coal is removed by either a continuous miner or longwall mining.

Continuous and longwall

The chief difference between the two (from the underwriter's perspective) is that the continuous miner process requires the roof to be shored up as it mines; longwall mining supports the roof as it progresses.

From the property underwriter's perspective, this all points towards a very attractive market – it is mature, it is well regulated and the industry is dominated by relatively few large players; and insurer-policyholder relationships are often very long standing. Although extremely specialised in its underwriting demands, the high premium volumes involved do make US coal mining a good proposition.

But all is not quite as rosy as it could be.

While the London market has a long and positive association with the industry, many underwriters have seen other markets' nerves tested over the past three or four years by

a number of sizeable losses – most notably underground collapses and fires. An explosion at the Sago mine in West Virginia cost the lives of 12 miners in January 2006; shortly afterwards two men died in a fire in another West Virginia mine, Aracoma Alama.

Earlier this year miners and rescuers were killed after a collapse in Utah's Crandall Canyon mine. While many syndicates and companies shy away from writing the underground side of the business, those that do have to ask themselves some very hard questions following these high-profile disasters.

Above-ground mining, in contrast to underground mining, is relatively a more straightforward class to underwrite, even though it has the same volatility in its potential for substantial losses. As most open-cast mines in the US are not situated in regions of seismic activity, are fairly immune to fire and rarely affected by flooding, the main risk is the threat of collapse of a dragline and the resultant business interruption (BI) exposure.

Mammoth equipment

Draglines range from \$5 million to in excess of \$100 million in cost and replacements have an exceedingly long lead time. Mining companies do not keep spares of these mammoth pieces of equipment just lying around.

But it is in the tunnels and faces deep underground that the most potentially expensive risks for property underwriters lie. Striking an underground source of water can flood a mine rapidly, resulting in damage or loss of equipment and the triggering of BI cover. Fires caused by a methane explosion or something as simple as a conveyor belt overheating can close a mine and prove extremely difficult to extinguish. Three years ago in Norway, a kilometre length of tunnel blazed underground for months until a local glacier was diverted down the shaft to extinguish it.

The third big risk is collapse. These are most often caused by minor seismic activity or the build-up of pressure in the rock strata above the mine tunnel. These can have a devastating impact and can easily destroy vital equipment like the longwall miner, with a replacement value starting at \$30 million and increasing.

Because of these recent significant claims – and also because of the recognition that this remains a tough class to write – premium rates are holding. While there has been some increase in capacity in London, Bermuda and the US, there are still a finite number of carriers willing to take the risks associated with mining, particularly underground. 2006 was a landmark year in terms of addressing rates and deductibles as the losses of the previous years filtered through and rates hardened sharply, but now there is some pressure to give a little premium relief – perhaps of the order of 5-10% – in order to reward long-standing customers as we come off this high.

Not an easy business

In terms of the future, the coal sector in the US will continue to grow but this will be primarily due to the expansion of existing players rather than new entrants; coal mining is not an easy business in which to be a start-up. The same is true of underwriters; even though mining can appear attractive, there are some nasty rocks on which the unwary can run aground.

But the key from the underwriter's perspective is that this is a healthy, well-regulated industry with most of its indicators pointing in the right direction. Those factors now making US coal an attractive source of energy will not disappear over night. Indeed, some of them may intensify; coal is now being talked about as an alternative to oil due to the development of a liquefaction process that can transform solid coal into a diesel-like fuel. This is an innovation that may put the industry on better terms with its environmentally-minded critics and help clean up its reputation as a “dirty” industry.

Coal is set for a boom period with the UK industry being the exception rather than the rule. A supportive US government, increasing energy demand and cleaner technology are all conspiring to make this an incredibly healthy market for property underwriters.

But unless we see the same leap forward in the technologies that ensure the safety of people and machinery underground, it will remain a hazardous class not for the faint hearted.

Alex Powell is class underwriter for non-marine property at AEGIS.