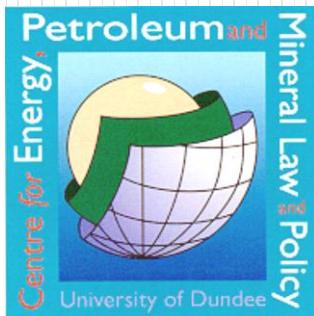


The International Legal Implications of the Gulf of Mexico Oil Spill: Liability, Regulation and Public Perceptions

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Summary

- The Macondo Oil Spill is a Game Changer – Why?
- Traditional Industry Approach to Liability
- How it is Challenged
- Regulatory Response and Risk
- Shift in Public Perceptions
- Options Ahead

The Macondo Accident: the Drilling Rig



Leaking at around 40,000 barrels a day



Oil arrives on the Beach



Cleaning Up



The Facts

- Blowout occurred on 20 April 2010
- The first major test of the national spill containment and response apparatus in the US (Oil Pollution Act 1990)
- The largest accidental oil spill in the world
- Eleven crew members died
- Impacted upon thousands of fishermen, marine life and damaged beaches

Facts Continued

- Well was 'capped' on 15 July 2010
- Hundreds of lawsuits were filed
- Hearings by government bodies in US but investigations carried out by official bodies in many other countries
- About 185 million gallons (4.4 million barrels) of oil were discharged

Questions Arising

- Who was in charge?
- Were the emergency response efforts delayed?
- Was federal oversight lax?
- Were the oil companies to blame (BP, Transocean, Halliburton, for example)?
- Should deepwater drilling be stopped? (e.g. by imposing a moratorium)

The Special Characteristics of this Incident

- Quantum: the size of spill was unique
- Extent was also unique, affecting a wide range of parties
- Operator was one of world's largest oil companies: it was able to pay for damage but most companies could not afford these amounts
- Incident occurred in deepwater area; as more exploration is moving into such waters, suggests that existing technology needs to be improved to mitigate risks
- Litigation extensive and ongoing, bringing in service contractors
- This occurred within the waters of a single state, unlike the Montara spill in 2009, which was 'trans-boundary'

The US Context

- OPA 90 introduced after 15 years of effort following Exxon Valdez tanker spill in Alaska
- Established federal management and control of oil spills and federal control over containment, cleanup and damages sustained as a result of the spill
- Creates a single fund – the Oil Spill Liability Trust Fund to pay for cleanup and removal costs of up to US\$1 billion
- Generally, strengthens the enforcement authorities, penalties and spill prevention counter-measures

Who is in Charge?

- Section 4201 states that the federal govt. takes control immediately to ensure that response is timely (offshore – the Coast Guard)
- BP was the responsible party and liable for all economic loss
- But a slow response: it took 10 days to elevate the spill to ‘national significance’: why?
- Reason: serious understating of the size of the spill
- BP: 1,000 barrels a day changed to 5,000 and then 40,000-60,000
- Delay resulted in response!

Why was it difficult to stop?

- No capability in place to stop the leakage
- There WERE contingency plans but they were wholly inadequate
- How were they designed?
- All of the major oil companies in the area had used boilerplate text copied for Arctic plans, including references to walrus as potentially affected species!

BP's Response Plan

- Requirement to identify a worst case oil spill from each rig and list equipment and personnel for containment of the spill;
- Its plan was regional and not specific to any particular rig or incident
- BP's Plan claims BP had the ability to respond to a blowout of 250,000 barrels a day but nowhere describes how it would handle such a very large spill
- Main problem: did not address which technology required to address a deepwater blowout – it was 'unlikely' to happen!

BP Quotes

- CEO Tony Hayward:
BP “did not have the tools you would want in your tool-kit”
- “it was entirely fair criticism to say BP dropped the ball when it came to planning for a major oil leak”

Presidential Commission

- “other companies had no effective containment preparations and laughable response plans that promised to look out for any polar bears or walruses that happened on the scene. The poor state of containment and response plans and capability in the Gulf of Mexico is indisputable evidence of a widespread lack of serious preparation, of planning, of management”

Provisional conclusion

- The problem was not so much the legislation but rather the lack of implementation and enforcement of its requirements, e.g. very poor contingency response plans

Liability: How the Risk was allocated

- BP used a model contract which included standard industry language for services
- The 2 parties agreed to indemnify each other “without limit and without regard to the cause or causes” of the incident
- This included negligence “whether such negligence be sole, joint or concurrent, active, passive or gross”
- Personal injury claims by the contractor’s employees had to be defended and indemnified by the contractor

Continued

- In the event of environmental pollution, BP undertook to indemnify Transocean for any and all pollution obligations including “loss, damage, expense, claim, fine, penalty, demand or liability”
- But parties are not exonerated from some financial consequences of a catastrophe: contractor has to pay for injury or death of its employees etc.

Industry Risk Management

- Key players are operator and service company
- Standard contracts exist for these services
- *Knock-for-knock* or *mutually hold harmless*
- The operator takes responsibility for loss or damage to itself/property of its other contractors, personal injury to operator & loss or damage suffered by third parties etc but to hold the contractor harmless from and against any claim arising from pollution or contamination from the reservoir. Contractor reciprocates.

Catastrophe Clause

- The Operator shall save, indemnify, defend and hold harmless the contractor against all claims, losses, damages, liabilities that result from loss or damage to any well or hole, blowout, fire, explosion etc, from these sources regardless of cause.
- Why? The risk-reward relationship has structured the liability relationship and related insurance

The Traditional Regime

- Brings reduced costs of litigation and insurance to the parties involved
- Relies upon the creditworthiness of the parties
- A catastrophic incident raises the possibility of a breakdown in this respect
- Strengthens the parties' interest in ensuring each others' creditworthiness and raises issue of whether collateral support should be provided
- Public interest element in ensuring this is foreseen and provided for (especially safety)

Risk-reward

- The operator negotiates with the regulators;
- Operator commits to a certain well design and well programme and other safety & environmental conditions
- Operator acts as the authority for the selection and approval of contractors
- Operator controls the operations of the contractors on the well site
- But they have an important financial upside

The US Litigation

- BP was **self insured** but tried to gain access to insurance cover of its partners/contractors
- Self-insurance allows well-funded companies to satisfy national requirements by showing they have sufficient financial strength
- BP challenged the established regime by arguing that its contractual indemnities did not stand and that some of the liability should be shared with the drilling company, Transocean, and with the cementing and mud logging company, Halliburton
- And the outcome?

Judge Barbier

- January 2012: BP has to indemnify Transocean for some of the compensatory damage claims over the oil spill.
Transocean was not responsible for compensatory damage claims raised by third parties for oil spilled below the surface even if attributable to negligence, gross negligence or strict liability
- But the indemnity did not extend to punitive damages for which T may be liable

Two aspects are notable

- The traditional allocation of liability was upheld: the reciprocal application and scope of the indemnities in the contract as a whole. The equal bargaining strength of the parties and the fact that the indemnity did not operate to lean an injured party without recourse all cited as reasons for supporting the view that the indemnity extended to T's gross negligence.

BP's Role

- BP is a large company; experienced in such operations all over the world and with good legal advice available, knowing existing case law so it could have argued for the exclusion of gross negligence from any indemnity provisions if had wished to. It did not.

Fines and penalties

- Previously it had been assumed that regulators would go after the operator in seeking damages not a service company
- This came as a surprise to the service companies
- Subsequently, in Brazil the regulators also came after the service companies following a spill

Impact of Environmental laws on Industry Exposure

- Both Halliburton and Transocean were deemed to be in breach of US environmental laws which cannot be indemnified by BP as operator.
- This raises an ominous prospect for service companies since in many countries the environmental laws allow for the imposition of penalties on a ‘polluter’

International aspects

- No international legal framework is in place to deal with the question of liability from pollution arising from a well blowout.
- Regional laws exist – OPOL
- National laws tend not to be consistent
- This matters since the Macondo incident has impacted upon industry's expectations of litigation and risk

Impact on Insurance Markets

1. Premiums went up quickly and radically
2. But not clear how long lasting this trend is
3. Other issues:
4. Extracting energy liability risks from package policies will be difficult
5. In the EU context attempts to cover environmental damage by extending the existing ELD rules to marine waters – insurers argue that there is no established means of restoring the marine environment after a spill so damages are unquantifiable – how to offer insurance then?

Looking Beyond the US Context

- The international law has been designed for tanker spills rather than for well-related pollution
- Much of it is national, e.g. US OPA
- Relationship between operator and contractor is one in which operator accepts liability
- Prevention focus: much depends on industry practice such as spill response plans approved by government regulators
- After the fact response: punitive damages, criminal penalties are possible but occur too late to stop damage

Continued

Further oil spills can be expected – Ghana, Nigeria, offshore Australia and note recent large gas leak in N Sea; this is something that has to be anticipated

- BUT
- Industry is already looking closely at technological innovations and is likely to move quickly on this, so there is hope of mitigation there

Regulation

- Many oil and gas jurisdictions are now reviewing contractual exclusion clauses, liabilities and indemnities, definitions of 'gross negligence' and wilful misconduct, but also other terms relating to insurance, choice of law and jurisdiction
- Several oil industry contractors involved in litigation with BP over Macondo liability – so the incident remains in the media spotlight!

Brazil Oil Spill: example of over-reaction

1. Leakage from Chevron operated Frade field offshore of less than 3,000 barrels of oil a day
2. Spill one thousandth of the size of the Macondo spill
3. Very limited character of damage (no oil reaching coastline; no evidence of environmental damage)
4. Heavy fines imposed upon the company by the regulatory agency and a criminal lawsuit filed against Chevron and rig operator Transocean
5. Civil lawsuits filed amounting to US\$10.6 billion and \$10.9 billion
6. Reaction out of proportion – is this the future of regulation?

Contrasts with Other Regions

- Pivotal role of PB in Macondo: well-established and large IOC can distract from important facts of life:
- Many medium to small oil companies, NOCs and 'new entrant' companies, including service companies
- They will not usually have access to the capital to pay the large claims that BP faced following the Macondo spill
- Even if the operator does NOT fail, contractors will face large regulatory fines

Looking outside of OECD Area

- 1. Existence of NOCs and use of PSC and service contract models have implications for the allocation of liability
- Would NOCs accept the kind of liability that BP took on even if the spill were small?
- Their accountability has not been tested
- In some countries (China) service contractors are part of vertically integrated NOCs: how would such a model be affected by new trends?

Again, outside the OECD

- 2. Local law requirements
- Exclusions of liability are unlikely to be upheld in certain jurisdictions: in Brazil and Indonesia local law will not allow the enforcement of indemnity provisions such as those currently used.
- Contractors will be liable under local law in the event of negligence
- Russia and Argentina similar

Finally, outside the OECD

- 3. Lack of capacity in ministries responsible for oil prevention and response
- Ghana has a National Oil Spill Contingency Plan (and has already had a spill offshore) but the legal regime does not clearly define the roles and responsibilities of stakeholders; vague in funding requirements for equipment to combat an oil spill; general plans for training personnel

Government Activism

- In US and UK governments have engaged with industry associations in various fora
- US National Commission made recommendations on liabilities and compensation costs
- Review of Oil Pollution Act
- UK: Oil Spill Prevention and Response Advisory Group (OSPRAG) and Parliamentary Committee

Regional Dimensions

- In EU a legal instrument has been proposed focused mainly on oil and gas safety issues
- Recent call for tender: “The objective of this study is to provide the Commission with expert advice on civil liability provisions and identify financial security mechanisms able to cover civil liability damages following an offshore oil and gas accident...The study will assist the Commission to develop policy options... (for) a comprehensive liability regime not only for environmental damage but also for traditional damage...”

Comment

- Fitch, a ratings agency (2012):
- The unpredictability of the EU regulatory response to offshore oil and gas production activity is more likely to impact upon corporate credit ratings than “a more remote risk of another catastrophic multi-billion dollar offshore accident”

Internationally...

- International Regulators' Forum has examined national experiences with respect to offshore safety
- Declared (2011): the Macondo and Montara disasters “have caused a paradigm shift in attitudes and requirements relating to safety and environmental protection in offshore petroleum activities”

G20

- A working group established called Global Marine Environment Protection (GMEP)
- Involves IOCs and NOCs as well as industry associations, governments, NGOs and international organisations
- Aims to share best practices in regulation and deal with the consequences of accidents

Asia Pacific Region

- Following Montara spill:
- Actions of Indonesia to mobilise International Maritime Organisation (IMO)
- Various proposals made and under review
- Unlikely to go away

Civil Society

- Increase in interest by NGOs in the environmental effects of offshore deepwater drilling
- Greenpeace tried to block drilling from ships and its demand that Cairn Energy publish a spill prevention plan for offshore Greenland attracted support from 100,000
- Used courts in England to try to block drilling

Choices to be Made

- Landscape of liability for catastrophic spills likely to be changed – perhaps this is what governments want? It would also reflect the growing body of public opinion on the issue of risk in offshore operations
- Trend is toward increased regulation
- So present allocation of liability likely to remain under pressure

Note: Government Roles in Oil & Gas Development

- As policy-makers with respect to how much development they want to see happen, and where and what risks are acceptable
- As regulators, authorising well programme and safety
- As enforcers, in going after offenders who violate licence conditions
- As economic stakeholders together with the operators

The Question for Government

- So, given this mix of roles – the issue is what risks should governments shoulder in the event of a catastrophic accident?

Five Options

- Status quo
- New legislation
- Treaty
- Voluntary action
- Regional response

Which Options might work?

- On 1, there is a changed set of facts. Operators are already reviewing the traditional model of risk allocation and not clear how courts would act now, and some operators might well default (cf. decommissioning defaults in UK)
- On 2, lobby government for new legislation: possible but process would be key – involve insurance industry as well as other players but all in the context of a heightened perception of risk among the public
- Option 3, rewrite the current regime in an international treaty; would take years leading to a long period of uncertainty – but regional agreements possible AND governments are indeed fostering cooperation – a good practice code?

Options 4 and 5

- Introduce a new initiative by means of voluntary actions from the industry alone. A fund to cover liability? Practical solutions would need to involve the insurance industry
- Option 5, a synthesis – build a regional response and let governments be the driver especially where they have already shown a willingness to act together in their common interest. However, any apportionment of liability would need to take into account who is best able to pay for the risk – are there examples from other industries?

THANK YOU!

From Scotland to Singapore