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March 2014

Deepwater Horizon Disaster (Macondo)

Implications and Lessons Learned

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Introduction

- Review the background to Deepwater Horizon
- Analyse the prevailing contractual framework for the Operator and non-Operators
- Consider consequences for the market and lessons to be learned

Background to Macondo

- In March 2008, BP leased the Mississippi Canyon Block 252, offshore Louisiana in the Gulf of Mexico – the Macondo Prospect

- In October 2009, BP farmed out interests to and entered into a joint operating agreement with:
  - Anadarko Petroleum Corporation (25%) and
  - MOEX Offshore 2007, a subsidiary of Mitsui (10%)

- BP remained the Operator and majority owner (65%)

Background to Macondo

- Drilling began 6 October 2009
- Transocean Marianas rig damaged by Hurricane Ida
- Drilling on the well suspended November 2009
- Transocean Deepwater Horizon rig replaces Marianas and drilling resumes in January 2010
- The semi-submersible Deepwater Horizon mobile offshore drilling unit was built in 1998 and by 2010 was overdue for a service

The events of April 2010

- An explosion on 20 April 2010 caused the rig to catch fire. 11 people died; 17 people were injured, and the rig sank to the seabed

- The explosion and leak was caused by:
  - a well integrity failure
  - a failure to control the flow from the well causing release and explosion of hydrocarbons
  - BOP emergency functions failed to seal the well

- Total (net) oil spilled estimated at 2.4 - 4.2 million barrels, at its highest point releasing 62,000 barrels per day

Summary of current status (1)

- April 2011: BP issued $40bn worth of lawsuits against rig owner Transocean, cementer Halliburton and blowout preventer manufacturer Cameron.
- May 2011: Settled with MOEX who agreed to pay $1bn in settlement of all claims.
- October 2011: BP bought Anadarko's 25% interest as part of settlement worth $4bn.
- August 2012: BP entered into settlement agreements with plaintiffs (representing settlement classes) to resolve private claims.
- October 2012: BP reached agreement to sell TNK-BP interest to Rosneft.
- January 2013: Civil trial brought by the US Government to begin to apportion blame for the disaster (on-going).

Summary of current status (2)

- January 2013: The US Justice Department announced that Transocean Deepwater Inc. agreed to plead guilty to violating the Clean Water Act and would pay a total of $1.4 billion in civil and criminal fines and penalties.

- July 2013: Halliburton plead guilty to destruction of critical evidence after the oil spill and said it would pay the maximum allowable fine of $200,000 and will be subject to three years of probation.

- Various criminal prosecutions including conviction of the technology director for Halliburton followed.

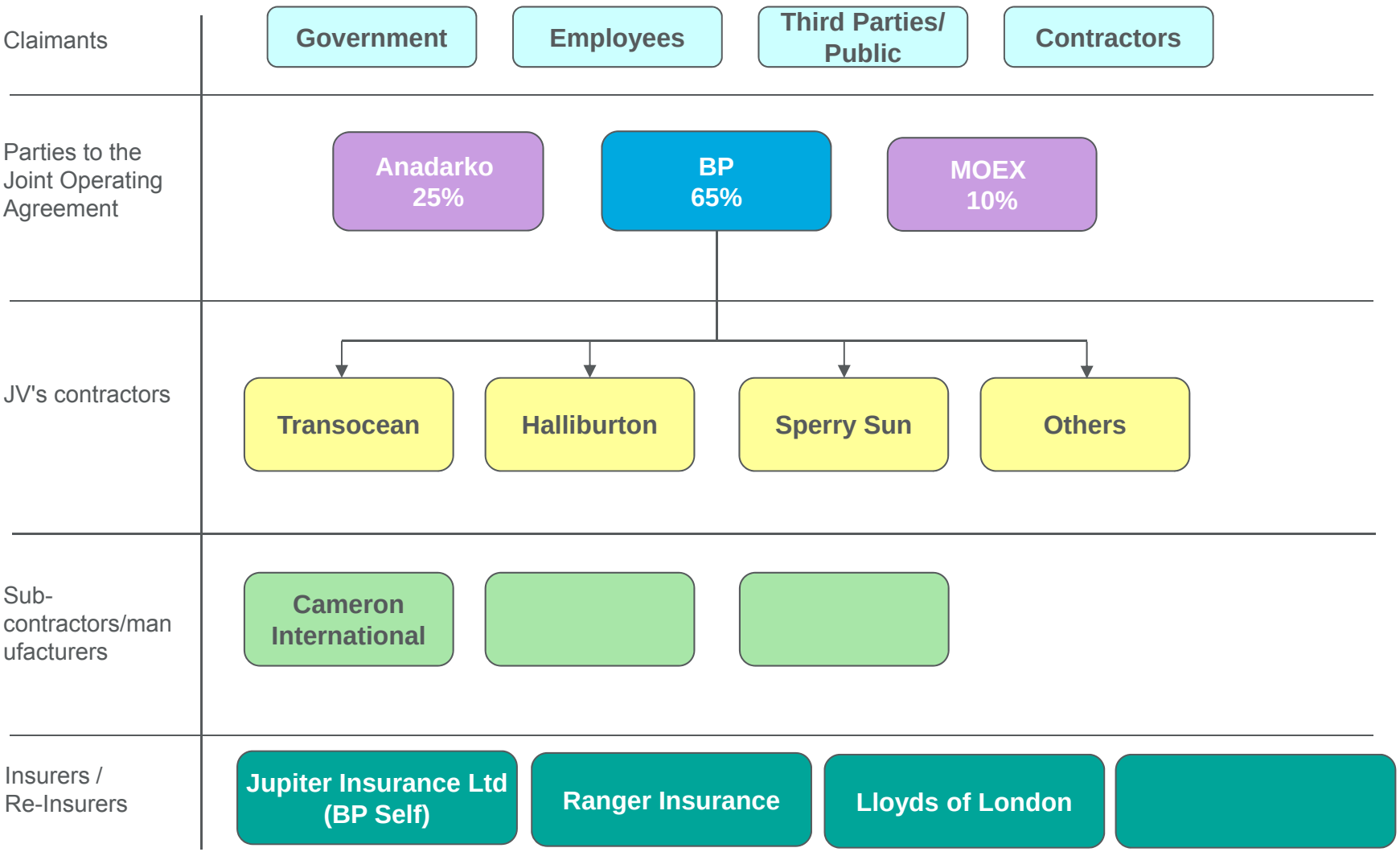
- Irrespective of the private claims the Operator/non-Operators and contractors remain liable for fines/exposure to Government claims.

- Exxon Mobil settled litigation on Exxon Valdez in 2009: 20 years after disaster.

Contractual framework

- Unincorporated joint venture
- Constitutional arrangements ad-hoc contractual: Joint Operating Agreement
- Various standard forms UKOG/AIPN/AAPL
- Focus on latest AIPN: 2012 Model

Principal participants



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Scope of Operator's role

- "Operator has all of the rights, functions and duties of Operator under the Contract, and shall have exclusive charge of the Joint Operations and shall conduct all Joint Operations." (Article 4.2.A)
- "Operator may employ independent contractors and agents, including Affiliates of Operator …, in such Joint Operations." (Article 4.2.A)
- "**Joint Operations** means the operations and activities within the scope of this Agreement … conducted by Operator on behalf of all Parties …" (Article 1.1)
- Operator shall:
  - "Perform Joint Operations in accordance with the Contract, the Laws, and this Agreement, and … the decisions of the Operating Committee not in conflict with this Agreement." (Article 4.2.B.1)
  - "Conduct Joint Operations in a diligent, safe and efficient manner in accordance with good and prudent petroleum industry practices …" (Article 4.2.B.2)
  - "… neither gain a profit nor suffer a loss as a result of being the Operator." (Article 4.2.B.5)

Limitation of Liability of Operator (1)

- "**Except as set out in Article 4.6.D** if applicable, and Article 20.1.C, neither Operator nor any other **Operator Indemnitee** shall bear (except as a Party to the extent of its Participating Interest share) any damage, loss, cost, or liability resulting from performing (or failing to perform) the duties and functions of Operator, and the **Operator Indemnitees are hereby released** from liability to Non-Operators for any and all damages, losses, costs, and liabilities arising out of, incident to, or resulting from such performance or failure to perform, even though caused in whole or in part by a pre-existing defect, or the **negligence** (whether sole, joint or concurrent), **gross negligence**, **willful misconduct**, **strict liability** or other legal fault of Operator (or any other Operator Indemnitee)." (Article 4.6.A)

Limitation of Liability of Operator (2)

Indemnity

- "Except as set out in Article 4.6.D, if applicable, and Article 20.1.C, the Parties shall (in proportion to their Participating Interests) defend and **indemnify Operator Indemnities** from any damages, losses, costs (including reasonable legal costs and attorneys' fees), and liabilities incident to claims, demands, or causes of action brought by or for any person or entity, which claims, demands or causes of action arise out of, are incident to or result from Joint Operations, even though caused in whole or in part by a pre-existing defect, or the **negligence** (whether sole, joint or concurrent), **gross negligence**, **willful misconduct**, **strict liability** or other legal fault of Operator (or any other Operator Indemnitee)." (Article 4.6.B)
- Ensure not only "not liable" but must be "indemnified"
- Clear words required to exclude negligence – contrast Buncefield (*Colour Quest Limited v Total Downstream UK PLC)*)

Limitation of Liability of Operator (3)

Exceptions in Article 4.6.D

- The Operator is liable where Operator or its Affiliates engage in Gross Negligence and Wilful Misconduct [of Senior Supervisory Personnel of Operator or Affiliates]
- Where Operator is liable, various options are offered:
  - Operator bears all liability
  - only damage, loss, to and liability to repair/replace Joint Property, and/or
  - a financial cap
- Gross Negligence: no settled meaning in UK law: *Porter v Magill*
- Senior Supervisory Personnel:
  - AIPN - directors/officers and wide-ranging option to include personnel from onsite manager of operations upwards
  - UKOG – directors/officers and senior management (i.e. members of/or reporting to management committees/individuals with direct responsibility of Joint Operations)

Limitation of Liability of Operator (4)

- In any event exclusion of:
  - **Consequential Loss**: "any losses, damages, costs or liabilities caused directly or indirectly by any of the following arising out of, relating to, or connected with this Agreement or the operations and/or activities carried out under this Agreement: (i) reservoir or formation damage; (ii) inability to produce, use or dispose of Hydrocarbons; (iii) loss or deferment of income; (iv) punitive damages; or (v) indirect damages or losses whether or not similar to the foregoing." (Article 1.1)
  - **Environmental Loss**: "any losses, damages, costs, or liabilities (other than Consequential Loss) caused by a discharge of Hydrocarbons, pollutants, or other contaminants into or onto any medium…relating to the Agreement or the operations and activities carried out under the Agreement, including: … (iv) fines, penalties, or other assessments." (Article 1.1)
  - Note inclusion of fines

Limitation of Liability of Operator (5)

Recoverability of fines

- If guilty of "gross negligence"/"wilful misconduct" cannot recover: "ex turpi causa non oritur action (meaning: from a dishonourable cause an action does not arise)

- Ex turpi causa principle: "the punishment inflicted by a criminal court is personal to the offender and the civil courts will not entertain a claim by him to recover an indemnity against it" (Denning J, *Askey v Golden Wine*)

Limitation of Liability of Operator (6)

- Flaux J in *Safeway Stores v Twigger* recently reconsidered the application of the principle:
  - before ex turpi causa principle can apply "there must be an element of moral turpitude or moral reprehensibility involved in the relevant conduct."
  - "something more than negligence would have to be shown before recovery of a fine was precluded on the grounds of public policy."
  - "[there is] a requirement for the claimant to be personally at fault."
- Clean Water Act
  - $1,100 for every barrel spilled
  - $4,300 per barrel if gross negligence
- US Government are pushing for gross negligence v BP and Transocean
- BP could therefore face over $17bn in fines!
- Whether an ex turpi causa principle applies will vary from State to State and country to country

Operator's role in relation to contracting

- Operator will contract with independent contractors as part of conducting the Joint Operations
- Often a requirement to include provisions in contracts with independent contractors protecting Non-Operators but preserving their rights, including:
  - Establishing that contractors can only enforce their rights against Operator
  - Permitting Operator to enforce the contract on behalf of all parties (i.e. including Non-Operators) and to recover any losses suffered by all the JOA parties
  - Requiring contractors to maintain insurance (Article 4.2.B.18)
- AIPN includes no express reference to Agency/UKOG: express provision Operator acts as agent in dealings with contractors
- If acting as Agent for a disclosed or undisclosed Principal – Agent should not normally be liable

Summary of Operator's Liability

Failure	Damages			Other Remedies
	Direct Loss	Consequential Loss	Environmental Loss	Removal of Operator
Failure not excused by Force Majeure	X	X	X	✓
Negligence	X	X	X	✓
Gross Negligence/Wilful Misconduct (other than of Senior Supervisory Personnel)	X	X	X	✓
Gross Negligence/Wilful Misconduct of Senior Supervisory Personnel	✓	X	X	✓

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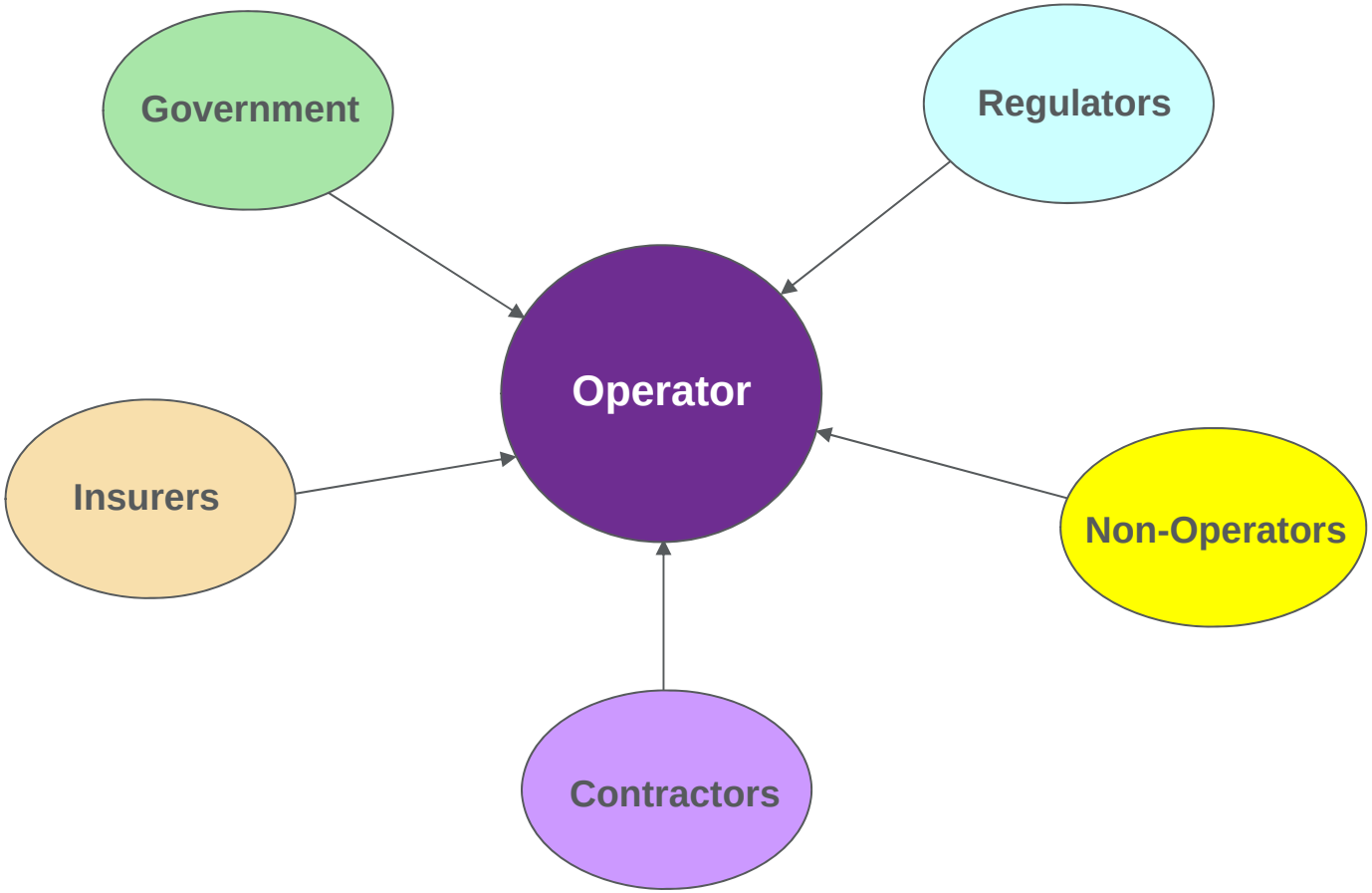
Liability Pressures



Consequence of Macondo (1)

Regulation/Government

- Increasingly 'political'
  - High profile/Government interference
  - NGOs more active
- Regulators/regulation : greater security
  - Separation of powers
  - EU amendments to the Environmental Liability Directive
  - Renewal of cap under US Oil Pollution Act 1990
  - Increase in OPOL liability : $120m - $250m
  - UK HSE inspector numbers increased / inspections doubled
- Regulators pursuing contractors not just Operators for non-compliance of safety rules / damage to environment etc
- Flight to quality
- Additional Cost

Consequence of Macondo (2)

Contractors

- Generally risk allocation had worked well
  - Knock for knock : people and property
  - Well and pollution originating below surface - Operator
- Operator best placed
  - Enjoys largest rewards
  - Controls operations
  - Strongest balance sheet (usually)
- Now being re-examined
  - Contractors looking to expand protection
  - Operator looking to carve out gross negligence / wilful misconduct
  - Contractors gross negligence indemnity / punitive damages
- Flight to quality
- Additional cost

Consequences of Macondo (3)

Insurance

- Pollution risk attracting more attention
  - Last pollution from blowout Jan 1989 - Norwegian N.Sea $225m
  - Previously bundled risks masked problem
- Consideration of imposing duty to insure
  - Capacity constraints in market
- Policy wording under greater scrutiny
- Premiums rising - costs of operation increase

Lessons Learned (1)

JOA Operator Liability - if you are acting for the Operator!

- Limit to Gross Negligence and Wilful Misconduct of Senior Supervisory Personnel
- Define Senior Supervisory Personnel narrowly and clearly
- Exclude liability "Environmental Loss" and "Consequential Loss"
- Seek to limit exposure to
  - damage to Joint Property
  - a financial cap (annual/ life of field)
- Ensure not only "not liable" but "indemnified"
- UKOG: failure to insure: exclude
- Increase overhead fee if possible/fines

Lessons Learned (2)

JOA Operator Liability

- Ensure clear references to indemnity covering (a) negligence and (b) fines but recognise:
  - Fines are increasing
  - Indemnity may be ineffective

- Provide for pay now: dispute later (2012 AIPN: failure to indemnify under JOA can be a default) (Article 8.1.A)

Lessons Learned (3)

Ultimately prevention is better than cure:

- Choose your partners well
- Decide whether you want to be Operator
- Consider level of oversight for non-operators

- Scale is such that no insurance / no indemnity / no contractual note allocation can protect you
- Reputation - and perhaps more are on the line.

Thank you

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