

Mitigating Risk in Offshore Exploration and Development Activities *

prepared for:

66th Annual Oil & Gas Law Conference
February 19-20, 2015
Houston, Texas

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I. INTRODUCTION

The 2010 Macondo well incident (the “Macondo well incident”) changed the landscape for offshore oil and gas drilling in the United States. Although the practice of offshore drilling had existed for about 115 years at the time of the Macondo well incident, the last 20 years had witnessed a drastic growth in the technological developments, geological discoveries and legal frameworks that allowed oil and gas companies to drill more offshore wells farther from the shores and at deeper depths. Prior to the Macondo well incident, many believed that ultra-deep water drilling had limited risk because drilling units were located longer distances from the coast, which would, in theory, provide oil and gas companies with more time to control a potential spill before very extensive environmental and property damage was caused, and because all of the deepwater players were major oil and gas companies with extensive technical experience and greater resources, making them better prepared to respond in the event of a spill. But that false sense of security disappeared in the aftermath of the Macondo well incident when the industry was forced to examine the effects of deepwater pressure and currents and increased oil flow rates. This realization has resulted in a new risk regime for offshore drilling, including new federal regulations and new contractual framework.

The purpose of this paper is to (1) explore the history of offshore drilling in the United States, including the birth of offshore technology and the offshore legal framework, (2) summarize the Macondo well incident, the applicable law and the subsequent litigation and legislative and regulatory changes, and (3) analyze certain key risk allocation provisions in the various offshore drilling and operating contracts in light of the aftermath of the Macondo well incident.

II. HISTORY OF OFFSHORE DRILLING

A. *The Birth of Offshore Technology*

The origins of offshore drilling can be traced back to 1897 off the coast of Summerland, California where H.L. Williams built three wooden piers approximately 450 yards from the shoreline and erected derricks atop the piers.¹ Steel pipe casing was submerged down 35 feet of water and pounded through 455 feet of sea floor into the oil sands. Production from 20 derricks peaked in 1902 at about 75 barrels per day and declined rapidly after that.² The Summerland operations were quickly abandoned and vanished in 1942 when a tidal wave struck the southern coast of California.³ Over the next ten years, many other wildcatters tried their luck with the pier and derrick technique off the coasts of California, but it was not until 1932 that Indian Oil Company built a stand-alone platform in the shallow waters off the shore of Rincon, California.⁴

Halfway across the country, J. B. McCann, a scout for Gulf Oil Corporation in East Texas, developed wooden pile platforms to produce oil and gas from a formation found under Lake Caddo.⁵ Beginning in 1910 and over the next four decades, Gulf Oil Corporation drilled approximately 278 wells and produced 13 million barrels of oil from under Lake Caddo, marking the first commercially successful water-based operations and setting a blueprint for future water-based operations.⁶

Simultaneously with Gulf Coast Corporation's efforts, innovations to water-based drilling were occurring in other places in the world, in particular, Lake Maracaibo, Venezuela, where a merchant marine captain by the name of Louis Giliasso developed the idea of using a barge sunk

¹ WILLIAM L. LEFFLER ET AL., DEEPWATER PETROLEUM EXPLORATION & PRODUCTION: A NONTECHNICAL GUIDE 1 (2d ed. 2011).

² *Id.* at 1-2.

³ *Id.* at 2.

⁴ *Id.*

⁵ *Id.* at 2-3.

⁶ *Id.* at 3.

in place, as opposed to the platforms on driven wood pilings, as a drilling platform.⁷ The Texas Company (subsequently Texaco) found the technology through a Byzantine search in 1933 and undertook to implement and perfect it.⁸ By the 1930s, rotary drilling had replaced the pounding-casing method of drilling, and, combined with the Giliasso technology, the Texas Company's efforts yielded the first submersible platform, allowing companies to drill more efficiently by simply pulling the casing and refloating the barges after completion of a well to move on to drilling the next.⁹

Notwithstanding the early history of offshore drilling, the most significant milestones to present-day offshore operations were not reached until halfway through the twentieth century. Although several oil companies, including Pure Oil Company, Humble Oil and Magnolia Petroleum Corporation, engaged in early offshore drilling, it was Superior Oil Company's and Kerr-McGee Corporation's accomplishments that truly marked the beginning of the offshore drilling boom.¹⁰ In 1937, Pure Oil Company and Superior Oil Company partnered to build a 30,000 square foot platform atop timber pilings to drill a well at what was then a record one mile from the coast of the town of Creole, Louisiana.¹¹ That initial well, which was drilled in 14 feet of water to a depth of 9,400 feet, proved successful, resulting in the drilling of an addition ten directional wells and production of approximately four million barrels of oil from the Creole Field.¹²

In 1947, Superior Oil would make additional technical, economic and geographical advancements on its own as it departed from the pile supported platform it had used in its joint

⁷ *Id.* at 4.

⁸ *Id.* at 5.

⁹ *Id.*

¹⁰ *Id.* at 6.

¹¹ *Id.*

¹² *Id.*

efforts with Pure Oil Company and instead contracted the J. Ray McDermott Company to prefabricate a steel tubular structure onshore, which was then barged to the drilling site 18 miles away from the coast of Louisiana.¹³ With this innovation, Superior Oil Company “shortened installation time, improved structural integrity, reduced costs, improved safety conditions around installation, and, to the contractors’ delight, created a new industry sector, prefabrication.”¹⁴ However, Superior Oil Company’s success was overshadowed by Kerr-McGee Corporation because its first well was a dry hole, allowing Kerr-McGee Corporation to complete a productive well out of landsight just eight months prior to the completion of Superior Oil Company’s second well.¹⁵ Ironically, although the technology used by Kerr-McGee Corporation, a smaller platform set on steel and wood piles that predated Superior Oil Company’s steel tubular structure, was arguably superior, it was the combination of a smaller fixed platform with mobile drilling tenders that attracted many other companies. It allowed the bulk of the drilling investment (the tender and topsides) to be redeployed to a different drilling location in case of a dry hole.¹⁶

But it was the Breton Rig 20 and the Mr. Charlie – designed by John T. Hayward and A. J. Laborde – that were the first submersible mobile offshore drilling units most closely resembling the submersible platforms used today. In 1948, John T. Hayward designed a “totally submerged platform at a safe above water distance with manageable freeboard[,] no drift [and] [p]ontoons on either side of the barge [to provide] both stability and displacement control.”¹⁷ The following year, the Breton Rig 20 was used to drill six exploration wells in the Gulf of Mexico, moving approximately 10 to 15 miles between each well and drilling within one to two

¹³ *Id.* at 7.

¹⁴ *Id.*

¹⁵ *Id.* at 8.

¹⁶ *Id.* at 9.

¹⁷ *Id.* at 10.

days of leaving the prior drilling site. However, the design of the Breton Rig 20 still left it vulnerable to flipping.¹⁸ A. J. Laborde identified the risk and partnered with John T. Hayward to form a new company, Ocean Drilling and Exploration Co., which went on to build the Mr. Charlie, a submersible designed to withstand the stability challenges.¹⁹

Despite the significant advances of the Breton Rig and the Mr. Charlie, those rigs still operated in merely 20 to 40 feet of water.²⁰ Kerr-McGee Corporation became the leader in submersibles, building rigs capable of operating in almost 200 feet of water.²¹ The 30 submersibles built during this period were operated well into the 1990s.²² Almost concurrently with the development of submersibles, in the 1950s, a consortium of companies consisting of Continental Oil Company, Union Oil Company, Shell Oil Company and Superior Oil Company, came together to develop floating platforms to conduct operations in up to 400 feet of water off the coast of California.²³

Technological advances in offshore drilling continued through the end of the twentieth century and beyond, allowing modern-day rigs to operate in water depths of up to 12,000 feet of water and drill an additional 28,000 feet below the seabed.²⁴ The various types of offshore drilling units include jackup units, tender assist drilling, semisubmersible units, submersible units, fixed platform units, ship-shaped and barge-shaped units, each used in distinct offshore drilling environments.

B. The Birth of the Offshore Legal Framework

In the early days of offshore drilling, the states of California, Louisiana and Texas

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.* at 11.

²² *Id.*

²³ *Id.* at 14.

²⁴ NATIONAL COMMISSION ON THE BP DEEPWATER HORIZON OIL SPILL AND OFFSHORE DRILLING, A BRIEF HISTORY OF OFFSHORE OIL DRILLING (STAFF WORKING PAPER NO. 1 – DRAFT) 12 (August 23, 2010).

exclusively handled the provision and regulation of leases for subsea drilling, but in 1945, President Harry Truman declared that the federal government had exclusive jurisdiction over the entire continental shelf.²⁵ The United States Supreme Court upheld President Truman's claim in 1947 and again in 1950.²⁶ But because there was no existing federal law conferring authority to any federal governmental body to authorize and oversee offshore drilling and the Supreme Court's decision stripped the states of that power, offshore drilling came to a halt by the end of 1950.²⁷

The need to resolve the so-called "Tidelands dispute" took center stage in the 1952 presidential election, with then candidate General Dwight Eisenhower pledging to restore the leasing authority to the coastal states.²⁸ President Dwight Eisenhower's election resulted in the compromise legislation of the Submerged Lands Act of 1953 and the Outer Continental Shelf Lands Act of 1953 ("OCSLA").²⁹ The former gave coastal states the right to lease out up to three nautical miles from the coast or up to nine miles from the coast if "justified by the boundaries documented when states entered the union or by a subsequent action by Congress."³⁰ After lengthy legal battles, Florida and Texas obtained the right to the nine-mile limit.³¹ The latter gave the federal government, through the Department of the Interior, the authority to issue leases in all coastal areas outside of state jurisdiction, which became known as the Outer Continental Shelf ("OCS").³²

The Mineral Management Service ("MMS") was created in 1982 to improve systematic problems with the federal minerals management programs and undertake certain functions of the

²⁵ *Id.* at 2.

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.* at 3.

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

Conservation Division of the U.S. Geological Survey, the Bureau of Land Management, the Office of Earth Sciences Applications, and the Office of Policy and Analysis and any and all functions in support of the OCS Program.³³ MMS grew to include two operation subunits, Offshore Energy and Minerals Management (“OEMM”) and Minerals Revenue Management (“MRM”). The former regulated “OCS activities, including administering OCS leases, monitoring the safety of offshore facilities, and protecting our coastal and marine environments,” while the latter “collect[ed], account[ed] for, and disburs[ed] revenues from energy and mineral leases on the OCS and onshore Federal and American Indian lands.”³⁴

Environmental regulations affecting offshore drilling operations also took shape over time and as a result of critical environmental incidents. The first relevant federal legislation appears to have been the Clean Water Restoration Act of 1966 (the “Clean Water Act”), which among other things, prohibited individuals from discharging oil into the navigable waters of the United States.³⁵ But just two years later, on January 28, 1969, a blowout at a Union Oil Company well in the Santa Barbara Channel accelerated federal action.³⁶ The blowout lasted 11 days and ultimately released approximately 80,000 barrels of oil, creating a 800-square mile slick of oil that blackened an estimated 30 miles of Southern California beaches, making it the greatest offshore incident in American waters prior to the Macondo well incident.³⁷ Within ten days after the Santa Barbara incident, Secretary of the Interior Walter Hickel, backed by President Richard Nixon, issued a moratorium on all drilling and production on offshore rigs in

³³ HENRY B. HOGUE, CONGRESSIONAL RESEARCH SERVICE, REORGANIZATION OF THE MINERALS MANAGEMENT SERVICE IN THE AFTERMATH OF THE DEEPWATER HORIZON OIL SPILL 7 (November 10, 2010).

³⁴ *Id.*

³⁵ Digest of Federal Resource Laws of Interest to the U.S. Fish and Wildlife Service, Federal Water Pollution Control Act (Clean Water Act), accessed January 27, 2015.

³⁶ NATIONAL COMMISSION ON THE BP DEEPWATER HORIZON OIL SPILL AND OFFSHORE DRILLING, *supra* note 24, at 3.

³⁷ *Id.*

California waters.³⁸ President Nixon then formed an Environmental Quality Council charged with recommending measures to restore the areas affected by the Santa Barbara incident, determining the adequacy of existing regulations for all wells licensed in the prior two years and then in operation in American waters, and producing more stringent and effective regulations.³⁹ A preliminary assessment of the leases affected by the moratorium resulted in permission to resume operation for only five out of 72 leases.⁴⁰ By the end of the summer of 1969, the Environmental Quality Council's findings and reports also led the Department of the Interior to issue completely new regulations regarding OCS leasing and operations, which was the first update since the program's inception 15 years earlier.⁴¹ Presumably, also in light of the Santa Barbara incident, subsequent amendments to the Clean Water Act further defining liability with respect to discharges of oil were made in 1970. This incident also permanently curtailed production off the coast of California, which in turn solidified the Gulf of Mexico as the epicenter of United States offshore drilling operations.

Although offshore drilling operations declined, three more blowouts and a major rig fire occurred off American shores following the Santa Barbara incident, and in 1989 another catastrophic event provided a catalyst for more comprehensive oil pollution legislation. In the first minutes of March 24, 1989, the *Exxon Valdez*, a 987-foot tank vessel carrying 53,094,510 gallons of crude oil and bound for Long Beach, California, collided with the Bligh Reef in the Prince William Sound of the Gulf of Alaska as the *Exxon Valdez* attempted to navigate its way out of the Gulf.⁴² The collision caused eight of the 11 cargo tanks to be torn open, causing the

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² SAMUEL K. SKINNER & WILLIAM K. REILLY, NATIONAL RESPONSE TEAM, *THE EXXON VALDEZ OIL SPILL* 3 (May 1989) at p. 3.

spill of 10.1 million gallons of crude oil into the Gulf of Alaska.⁴³ President George H. W. Bush commissioned a report prepared by the National Response Team⁴⁴ to summarize the event and make recommendations to improve the ability to plan for and respond to oil spills.⁴⁵ The United States Congress transformed the findings and recommendations of the *Exxon Valdez* Oil Spill Report into the Oil Pollution Act of 1990 (the “Oil Pollution Act”).⁴⁶ While several other federal and state statutes and regulations governing offshore drilling were established over time, the Clean Water Act and the Oil Pollution Act are the primary applicable statutes.

III. THE MACONDO WELL INCIDENT

A. *Background to the Macondo well incident*

Transocean⁴⁷ and British Petroleum (“BP”)⁴⁸ entered into an agreement for the construction, use and operation of the ultra-deepwater floater Deepwater Horizon (the “Deepwater Horizon”) on December 9, 1998.⁴⁹ On March 19, 2008, BP acquired a federal lease of 5,760 acres on the OCS comprising Mississippi Canyon Block 252. Subsequently, Transocean was engaged by BP to drill the Macondo well on BP’s federal lease (the “Macondo well”).

On April 22, 2010, the Deepwater Horizon sank after a blowout of the Macondo well caused a fire and explosion on the rig. Eleven people died and others were injured as a result of

⁴³ *Id.* at 3.

⁴⁴ The U.S. National Response Team (NRT) is an organization of 15 federal departments and agencies responsible for coordinating emergency preparedness and response to oil and hazardous substance pollution incidents. U.S. NATIONAL RESPONSE TEAM, www.nrt.org (last visited Jan. 19, 2015).

⁴⁵ SKINNER & REILLY, *supra* note 42, at ES-1.

⁴⁶ United States Environmental Protection Agency, <http://www.epa.gov/oem/content/lawsregs/opaover.htm>, (last visited Jan. 19, 2015).

⁴⁷ While there were various Transocean entities involved in the various contracts covering the construction, ownership and operation of the Deepwater Horizon and the drilling of certain wells, including the Macondo well, all such entities will be referred to as simply: Transocean, for purposes of this paper.

⁴⁸ While there were various BP entities involved in the various contracts covering the construction, ownership and operation of the Deepwater Horizon and the drilling of certain wells, including the Macondo well, all such entities will be referred to as simply: BP, for purposes of this paper.

⁴⁹ *In re Oil Spill (Phase One Trial)* at 671.

the incident. At the time of the explosion, the Deepwater Horizon was located approximately 41 miles off the coast of Louisiana in Mississippi Canyon Block 252 and was contracted to BP.

The Macondo well incident became the largest oil spill in the history of offshore drilling in United States waters and would force the industry to assess the risk of offshore drilling in ways it had not before. In the aftermath, there was litigation and legislative and regulatory action.

B. The Applicable Law

Although there are numerous laws and regulations that were applicable to the Macondo well incident, the focus of the subsequent litigation was on the Clean Water Act and the Oil Pollution Act.

(1) The Clean Water Act

The Clean Water Act prohibits the “discharge of oil or hazardous substances (i) into or upon the navigable waters of the United States...in such quantities as may be harmful” and sets forth certain mandatory and discretionary civil and criminal penalties against any owner, operator, or person in charge of a vessel that experiences a prohibited discharge.⁵⁰ The criminal penalties include fines and sentencing guidelines. The civil penalties are in the form of a per-day or per-barrel fine without limitation.⁵¹

In order to assess the criminal and civil penalties in the event of a prohibited discharge, the U.S. Coast Guard or the Environmental Protection Agency may consider (1) “the seriousness of the violation;” (2) “the economic benefit to the violator, if any, resulting from the violation;” (3) “the degree of culpability involved;” (4) “any other penalty for the same incident;” (5) “any

⁵⁰ 33 U.S.C. § 1321(b)(3), (5), (7) (2006). “Such quantities as may be harmful” means discharges of oil that violate applicable water quality standards or cause a film or sheen upon, or discoloration of, the surface of the water. *See* § 1321(b)(3); *United States v. Boyd*, 491 F.2d 1163, 1165-66 (9th Cir. 1973).

⁵¹ *See* 33 U.S.C. § 1321(b)(5), (7).

history of prior violations;” (6) “the nature, extent, and degree of success of any efforts of the violator to minimize or mitigate the effects of the discharge;” (7) “the economic impact of the penalty on the violator;” and (8) “any other matters as justice may require.”⁵² The Oil Pollution Act amended the Clean Water Act to impose strict liability with a mandatory civil penalty on a violator in an amount up to \$37,500 per day of the violation, or an amount of up to \$1,100 per barrel of oil discharged.⁵³ Further, if the violation is the result of gross negligence or willful misconduct, the violator is subject to a civil penalty of not less than \$140,000, and not more than \$4,300 per barrel of oil discharged, resulting in effect, in treble damages for any fines and penalties incurred for the violation.⁵⁴

(2) **The Oil Pollution Act**

In contrast, the focus of the Oil Pollution Act is providing compensation to claimants from oil spills in U.S. navigable waters. The Oil Pollution Act imposes strict joint and several liability of up to a statutory limit on the “responsible party for a vessel or facility from which oil is discharged, or which poses a substantial threat of discharge, into or upon navigable waters or adjoining shorelines of the exclusive economic zone.”⁵⁵ The main categories of liability are removal costs and economic damages.⁵⁶ The former includes: “the costs to prevent, minimize, or mitigate oil pollution,” and the latter includes: injury to natural resources, injury to real or personal property (including economic losses resulting from that injury, and loss of subsistence

⁵² 33 U.S.C. § 1321(b)(8).

⁵³ 33 U.S.C. § 1321(b)(7)(A) (2006); 40 C.F.R. § 19.4 (2010).

⁵⁴ 33 U.S.C. § 1321(b)(7)(D) (2006); 40 C.F.R. § 19.4.

⁵⁵ 33 U.S.C. § 2702(a) (2006). “Responsible party” means any person owning, operating or demise chartering a vessel. § 2702(d)(2)(A) For an offshore facility, “responsible party” means the lessee or permittee of the area in which the facility is located or the holder of a right of use and easement granted under applicable state law or the OCSLA for the area in which the facility is located. 33 U.S.C. § 2701(32)(C) (2006). “Exclusive economic zone” means the zone established by Presidential Proclamation Numbered 5030, dated March 10, 1983, including the ocean waters of the areas referred to as “eastern special areas” in Article 3(1) of the Agreement between the United States of America and the Union of Soviet Socialist Republics on the Maritime Boundary, signed June 1, 1990. 33 U.S.C. § 2701(8)

⁵⁶ 33 U.S.C. § 2702(b) (2006).

use of natural resources), loss of revenues on the use of natural resources or real or personal property, loss of profits or impairment of earning capacity resulting from such pollution, and the costs of providing additional public services during or after removal activities.⁵⁷

A responsible party may avoid liability under the Oil Pollution Act if the responsible party can establish, by a preponderance of the evidence, that the oil spill was caused *solely* by “(1) an act of God, (2) an act of war, or (3) an act or omission of a third party” (other than an employee, agent, or contracting party of the responsible party).⁵⁸ In addition, a responsible party’s liability under the Oil Pollution Act is capped at certain amounts based on the source of the oil spill.⁵⁹ However, in order to avail itself of any such protection, a responsible party may not assert those defenses if it failed to report the incident, failed to provide all reasonable cooperation in response to the spill, or failed, without sufficient cause, to follow a governmental order.⁶⁰ Further, a responsible party may lose the protection of the limitations of liability under the Oil Pollution Act in the case of the responsible party’s gross negligence or willful misconduct or violation of applicable federal safety, construction or operating regulations of its own or its agents, employees or persons acting pursuant to a contractual relationship with the responsible party.⁶¹ Notwithstanding the liability limitations set forth in the Oil Pollution Act, state law may impose additional unlimited liability for oil discharge or removal activities.⁶²

In order to ensure that a potential responsible party has the financial wherewithal to fulfill its liability obligations in the event of an oil spill, the Oil Pollution Act requires vessels and

⁵⁷ 33 U.S.C. § 2701(31) (2006) (amended by Pub. L. No. 11, § 281, 124 Stat. 2905 (2010)); 33 U.S.C. § 271(b).

⁵⁸ 33 U.S.C. 2703(a) (2006).

⁵⁹ JONATHAN L. RAMSEUR, CONGRESSIONAL RESEARCH SERVICE, LIABILITY AND COMPENSATION ISSUES RAISED BY THE 2010 GULF OIL SPILL 5 (May 12, 2014).

⁶⁰ 33 U.S.C. §2703(c).

⁶¹ 33 U.S.C. § 2704(c)(1) (2006) (as amended by Pub. L. No. 11, § 281, 124 Stat. 2905 (2010)).

⁶² 33 U.S.C. § 2718(c) (2006).

offshore facilities to establish and maintain evidence of financial responsibility.⁶³ The financial responsibility requirement can be met with (1) evidence of insurance; (2) surety bond; (3) guarantee; (4) letter of credit; and/or (5) qualification as a self-insurer. The Oil Pollution Act also established the Oil Spill Liability Trust Fund to provide compensation to injured parties for any removal costs and damages resulting from an oil spill.⁶⁴

C. The Subsequent Litigation

Within weeks of the tragic events of April 20, 2010, approximately 3,000 cases with over 100,000 named claimants had been filed against BP, Transocean, Halliburton, MOEX Offshore 2007, LLC and others, in federal and state courts across the country.⁶⁵ The claims asserted in those suits ranged from “wrongful death and personal injury due to the explosion and fire,” “to post-incident personal injury resulting from exposure to oil and/or chemical dispersants used during the oil response,” to “damage to property or natural resources,” to “economic losses resulting from the oil spill.”⁶⁶ In order to manage the various claims effectively, the United States Judicial Panel on Multidistrict Litigation transferred most of the federal cases (except for shareholder derivative suits and other securities-related cases) into one Multidistrict Litigation no. 2179 (“MDL 2179”).⁶⁷ The court of MDL 2179 (the “Court”) pursued a phased trial proceeding focusing on two cases, *In re Triton Asset Leasing GmbH, et al.* (Civ. A. No. 10-2771) (“Phase One”) and *United States v. BP Exploration & Production Inc., et al.* (Civ. A. No. 10-4536) (“Phase Two”), both of which were proceedings under admiralty law.⁶⁸

⁶³ 33 U.S.C. § 2716(c) (2006) (as amended by Pub. L. No. 11, § 281, 124 Stat. 2905 (2010)).

⁶⁴ 26 U.S.C. § 9509 (2006). The Oil Spill Liability Trust Fund is funded primarily by an eight cents per barrel tax on petroleum produced in or imported to the United States and also by transfers from other pollution funds, fines, penalties, accrued interest and cost recoveries from responsible parties. Ramseur, *supra* note 59, at 8.

⁶⁵ *In re Oil Spill (Phase One Trial)* at 667.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.* at 668.

(1) **Phase One**

Phase One commenced on February 25, 2013.⁶⁹ The original action was a limitation action filed by Transocean under which it sought to limit its liability with respect to the Macondo well incident.⁷⁰ Transocean impleaded other parties it believed were partially or wholly liable for the Macondo well incident and those parties subsequently filed several counter claims and cross claims.⁷¹ The Court's goal in Phase One was to make "fault determinations relating to the loss of well control, the ensuing explosion and fire, the sinking of the Deepwater Horizon, and the initiation of the release of oil from the well."⁷² The Court also considered issues with respect to Transocean's limitation defense and the various cross, counter and third party claims among the several defendants.⁷³ Phase One concluded on April 17, 2013, and the Court issued its Findings of Fact and Conclusions of Law (the "Phase One Findings") on September 4, 2014 (revised and re-issued on September 9, 2014).⁷⁴ The Court denied BP's request to amend the Phase One Findings or for a new trial on November 13, 2014.⁷⁵

In the Phase One proceedings, the Court found that BP's actions leading up to the Macondo well incident constituted gross negligence and willful misconduct,⁷⁶ Transocean's actions constituted negligence and Halliburton's actions also constituted negligence.⁷⁷ The

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *In re Oil Spill (Phase Two Trial)* at 3-4.

⁷⁵ *Id.*

⁷⁶ BP and the United States government disagreed over the definition of "gross negligence." BP argued that "gross negligence" requires a "culpable mental state," requiring an actor to have "subjective awareness of the risk involved and nevertheless proceed with conscious indifference to the rights, safety, or welfare of others." On the other hand the government argued that "gross negligence" is a purely objective standard that "differs from ordinary negligence only in degree." Although Court agreed with the government, it conceded that precedent was not clear with respect to the definition of "gross negligence" and thus frames both the "gross negligence" and "willful misconduct" analyses in terms of "recklessness." Even so, the Court determined that BP's actions constituted gross negligence and willful misconduct. *In re Oil Spill (Phase One Trial)* at 731-37.

⁷⁷ *In re Oil Spill (Phase One Trial)* at 746-47.

Court apportioned fault 67% to BP, 30% to Transocean and 3% to Halliburton.⁷⁸ In determining that BP's conduct constituted gross negligence and willful misconduct, the Court conducted both a single act analysis and a multiple act analysis.⁷⁹ The Court found that BP's misinterpretation of the negative pressure test and failure to order a new one, was such an "extreme departure from the care required under the circumstances" that it, on its own, constituted "reckless" behavior, thereby meeting both BP's and the United States government's standard for "gross negligence" and "willful misconduct."⁸⁰

Similarly, the Court found that a series of BP's negligent acts could, as a whole, constitute "gross negligence" and "willful misconduct," including:

drilling the final 100 feet of the well with little or no margin, running the production casing with the float collar in unconverted mode and without a shoe filter, failing to verify whether the float collar converted by reverse circulating the well, not conducting a CBL,⁸¹ using LCM⁸² as a spacer for the displacement and negative pressure test, misinterpreting the negative pressure test, allowing simultaneous operations to occur during displacement, and failing to provide a displacement schedule to the Transocean drill crew.⁸³

Therefore, BP is liable for the heightened civil penalty of *up to* \$4,300 per barrel of oil discharged (such volume would be determined in Phase Two) under the Clean Water Act.

Although the Court found that BP's conduct also warranted punitive damages under general maritime law, it determined that BP could not be held liable for such damages under Fifth Circuit precedent establishing that "operational recklessness or willful disregard" is generally insufficient to impose punitive damages on an employer.⁸⁴ Instead, in order to merit

⁷⁸ *Id.* at 747.

⁷⁹ *Id.* at 737-43.

⁸⁰ *Id.* at 742.

⁸¹ "CBL" means cement bond log, which is a cement evaluation technique used after a cement job is pumped to evaluate whether zonal isolation has been achieved. *Id.* at 691.

⁸² "LCM" is left-over circulation material, which was used by BP as a spacer between the mud and seawater during the displacement and negative pressure test. *Id.* at 709.

⁸³ *Id.* at 742-43.

⁸⁴ *Id.* at p. 749.

punitive damages, “conduct must emanate from corporate policy or...a corporate official with policy-making authority [must have] participated in, approved of, or subsequently ratified the egregious conduct.”⁸⁵ However, the Court did find that Transocean’s and Halliburton’s contractual indemnities and releases against BP were validly enforceable.⁸⁶ The Court also found that the Oil Pollution Act’s limits of liability did not apply to BP because BP’s violation of C.F.R. § 250.420(a)(2), requiring the casing and cementing of wells to “prevent the direct or indirect release of fluids from any stratum through the wellbore into offshore waters,” proximately caused the Macondo well incident, making such limits inapplicable.⁸⁷

With respect to Transocean, the Court found that Transocean was not entitled to limited liability under the Limitation of Liability Act because (1) “the Limitation of Liability Act does not apply to oil spill claims arising under the Oil Pollution Act,” (2) “the drill crew’s failure to divert flow [of gas]⁸⁸ overboard constituted a proximate cause of the explosion, fire, and oil spill that was within Transocean’s privity and knowledge,” (3) “Transocean’s maintenance failures respecting the BOP⁸⁹ constituted negligence and/or created an unseaworthy condition within its privity and knowledge,” and (4) “the master’s failure to timely activate EDS⁹⁰ constituted negligence within the privity and knowledge of Transocean.”⁹¹ The Court also found that Transocean was liable for removal cost under the Oil Pollution Act because it was an “operator” of an “OCS facility.”⁹²

⁸⁵ *Id.*

⁸⁶ *Id.* at 752. A detailed analysis of the enforceability of Transocean’s and Halliburton’s indemnities and releases against BP is found in Part IV below.

⁸⁷ *Id.* at 754-55.

⁸⁸ *Id.* at 716.

⁸⁹ “BOP” means blowout preventer. *Id.* at 666.

⁹⁰ “EDS” means Emergency Disconnect Sequence. *Id.* at 725.

⁹¹ *Id.* at 753-54.

⁹² *Id.* at 755-56.

(2) **Phase Two**

Phase Two commenced on September 30, 2013.⁹³ The original action was brought by the United States seeking civil penalties under the Clean Water Act and a declaratory judgment of liability under the Oil Pollution Act.⁹⁴ Phase Two was sub-divided into two segments, one concerned “issues pertaining to the conduct or omissions relative to stopping the release of hydrocarbons,” or “source control,” and the other focused on “the amount of oil actually released into the Gulf of Mexico, which is an important factor in determining the amount of civil penalties under the Clean Water Act.” Phase Two concluded on October 18, 2013⁹⁵ and the Court issued its Findings of Fact and Conclusions of Law (the “Phase Two Findings”) in January 15, 2015.⁹⁶

In the Phase Two proceedings, the Court found that, considering the Phase One evidence and the Phase Two evidence, BP did not engage in such extreme, extra-negligent conduct with respect to source control planning to warrant punitive damages.⁹⁷ The most determinative factor was that BP’s source control plan complied with federal regulations and common industry practice.⁹⁸ Similarly, the Court found that BP’s conduct with respect to source control planning did not make it a superseding cause of the oil spill or warrant a reallocation of comparative fault amongst BP, Transocean and Halliburton.⁹⁹ As a result, the Court’s Phase Two Findings for the source control segment did not change the Court’s Phase One Findings.¹⁰⁰

With respect to the quantification segment of Phase Two, after weighing all of the evidence from various experts, the Court found that 4.0 million barrels of oil were released from

⁹³ *Id.* at 668.

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *See generally In re Oil Spill (Phase Two Trial)* .

⁹⁷ *In re Oil Spill (Phase Two Trial)* at 36.

⁹⁸ *Id.* at 37.

⁹⁹ *Id.*

¹⁰⁰ *Id.*

the reservoir.¹⁰¹ At the outset, the parties stipulated that 810,000 barrels of oil were collected without contacting any ambient sea water.¹⁰² Therefore, for purposes of calculating the maximum civil penalty under the Clean Water Act, the Court determined that 3.19 barrels of oil were discharged into the Gulf of Mexico.¹⁰³ The “Penalty Phase” to calculate the exact amount of Clean Water Act penalties to be imposed on BP and Anadarko Petroleum Corporation (as owners of the Macondo well) for the Macondo well incident got underway on January 20, 2015 and concluded on February 2, 2015, with a decision expected mid-2015.¹⁰⁴

D. DOJ Criminal and Civil Settlements

In addition to the actions described above, the Department of Justice (“DOJ”) reached certain criminal and civil settlements with the various parties involved in the Macondo well incident. On November 15, 2012, BP and DOJ announced a criminal penalty settlement for approximate \$4 billion.¹⁰⁵ In connection with that settlement, BP pled guilty to 11 felony counts of misconduct or neglect of ship officers for the deaths of the 11 Deepwater Horizon crew members, misdemeanor counts under the Clean Water Act and the Migratory Bird Treaty Act, and a felony count of obstruction of Congress.¹⁰⁶ BP and the Securities and Exchange Commission reached a civil settlement of \$525 million involving securities fraud charges arising from, among other things, statements concerning the estimated flow rate of the well.¹⁰⁷ The Securities and Exchange Commission stated it would use the amount to establish a fund “to

¹⁰¹ *Id.* at 43-44.

¹⁰² *Id.* at 39.

¹⁰³ *Id.*

¹⁰⁴ *Id.* at 3.

¹⁰⁵ JONATHAN L. RAMSEUR & CURRY L. HAGERTY, CONGRESSIONAL RESEARCH SERVICE, DEEPWATER HORIZON OIL SPILL: RECENT ACTIVITIES AND ONGOING DEVELOPMENTS (May 12, 2014) at p. 8. The \$4 billion is to be divided as follows: \$2.394 billion to the Nation Fish and Wildlife Foundation to support the restoration efforts in the Gulf states, \$1.5 billion to the Oil Spill Liability Trust Fund, \$350 million to the National Academy of Science for oil spill prevention and response research, \$100 million to the North American Wetlands Conservation Fund, and \$6 million to the General Treasury. *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

provide harmed investors with compensation for losses they sustained in the fraud,”¹⁰⁸

On January 3, 2013, Transocean and DOJ announced civil and criminal penalty settlements. Transocean agreed to pay a civil settlement of \$1 billion¹⁰⁹ and a criminal settlement of \$400 million.¹¹⁰ On February 17, 2012, MOEX Offshore 2007 LLC, which owned approximately 10% of the Macondo well, also reached a \$700 million¹¹¹ settlement with DOJ, with an additional \$20 million in supplemental environmental projects.¹¹²

E. Subsequent DOI Reforms and Congressional Activity

The impact of the Macondo well incident was so profound that it immediately prompted reforms by and within the Department of the Interior, the governmental body with regulatory authority over offshore drilling in the OCS (“DOI”), as well as congressional action.

(1) DOI Reforms

Prior to the Macondo well incident, DOI had already identified several “management shortcomings, ethical lapses among personnel, and conflicts of interest in the former [MMS],” but the events of April 20, 2010, accelerated the changes necessary to address these concerns.¹¹³ Most notably, on May 19, 2010, Secretary of the Interior Ken Salazar replaced MMS with the Bureau of Ocean Energy Management, Regulation and Enforcement (“BOEMRE”).¹¹⁴ Further, on October 1, 2011, DOI sub-divided BOEMRE into three separate entities, the Bureau of Ocean Energy Management, the Bureau of Safety and Environmental Enforcement (“BSEE”) and the

¹⁰⁸ *Id.*

¹⁰⁹ The \$1 billion is to be divided \$800 million to the Gulf Coast Restoration Trust Fund and \$20 million to the Oil Spill Liability Trust Fund. *Id.* at 9.

¹¹⁰ The \$400 million is to be divided as follows: \$150 million to the National Fish and Wildlife Foundation, \$150 million to the National Academy of Sciences and \$100 million to the Oil Spill Liability Trust Fund. *Id.*

¹¹¹ The \$70 million is to be divided as follows: \$45 million to the Oil Spill Liability Trust Fund and \$25 million to be distributed in various amounts among the five Gulf states. *Id.* at 9-10.

¹¹² *Id.* at 9.

¹¹³ *Id.* at 10.

¹¹⁴ *Id.*

office of Natural Resources Revenue.¹¹⁵

In addition, the various DOI agencies have issued a number of new regulatory and policy changes related to offshore activities intended to “reduce accident injuries, and spills during offshore drilling activities.”¹¹⁶ These include new requirements to the regulations for Safety and Environmental Management Systems (“SEMS”), including developing and implementing stop work authority and establishing guidelines for reporting unsafe working conditions, conducting job safety analyses for activities identified in an operator’s SEMS program, and auditing of SEMS programs by an accredited audit service provider.¹¹⁷ On February 24, 2014, DOI also increased the liability cap for offshore facilities like the Deepwater Horizon from \$75 million to \$133.65 million.¹¹⁸

On August 16, 2013, DOI’s BSEE and the Department of Transportation’s Bureau of Transportation Statistics entered into an interagency agreement to develop a system that would expand the ability of BSEE and industry to “collect certain information about accident precursors and potential hazards associated with OCS operations in particular locations.”¹¹⁹ Finally, on August 22, 2013, BSEE and the Department of Energy entered into a Memorandum of Collaboration in order to coordinate the ongoing efforts of the two agencies related to offshore research and technological improvements, with the objectives of “building safety through technological improvements, supporting research and development for offshore operations, and working together to support the implementation of recommendations arising from various investigations and studies related to the Deepwater Horizon oil spill.”¹²⁰

¹¹⁵ *Id.*

¹¹⁶ *Id.* at 11.

¹¹⁷ *Id.*

¹¹⁸ Federal Register, Vol. 79, No. 239, December 12, 2014 at p. 73832.

¹¹⁹ RAMSEUR & HAGERTY, *supra* note 105, at 12.

¹²⁰ *Id.*

(2) Congressional Action

The 111th Congress

Senate and House committees of the 111th Congress held more than 60 hearings on a variety of issues related to the Macondo well incident.¹²¹ Of the 150 proposals related to oil spill matters, only three became laws.¹²² Two of those were appropriations-related laws specific to the Macondo well incident, while the last was a broader appropriations law applicable to the U.S. Coast Guard.¹²³

The 112th Congress

Although interest in oil spill related action had arguably diminished with only 50 bills containing oil spill-related provisions, the 112th Congress was able to enact additional substantive legislation. The most notable were the Pipeline Safety, Regulatory Certainty and Job Creation Act of 2011 and the RESTORE Act.¹²⁴

The Pipeline Safety, Regulatory Certainty and Job Creation Act of 2011, enacted on January 3, 2012, (1) increased civil penalties for violating safety requirements and required automatic and remote-controlled shutoff valves on newly constructed transmission pipelines, (2) directed the Department of Transportation to analyze leak detection systems and, after reviewed by Congress, issue requirements based on that analysis, and (3) required the Pipeline Hazardous Material Safety Administration to review whether current regulations are sufficient to regulate pipelines transmitting “diluted bitumen,” and analyze whether such oil presents an increased risk of release.¹²⁵

The RESTORE Act became law on July 6, 2012 and established the Gulf Coast

¹²¹ *Id.*

¹²² *Id.*

¹²³ 124 STAT. 1278; 124 STAT. 2314; 124 STAT. 2905.

¹²⁴ RAMSEUR & HAGERTY, *supra* note 105, at 12-13

¹²⁵ *Id.*

Restoration Fund, which will make funds available for expenditure without further appropriation.¹²⁶ The RESTORE Act distributes these monies to various entities through multiple processes, as follows: “35% divided equally among the five Gulf of Mexico states to be applied toward one or more of 11 designated activities; 30% provided to a newly created Gulf Coast Ecosystem Restoration Council to finance ecosystem restoration activities in the Gulf Coast region; 30% disbursed by the Council to the five Gulf Coast states, based on specific criteria¹²⁷ ...; and 5% to support marine research and related purposes.”¹²⁸

The 113th Congress

Interest in oil-spill related legislation continued to subside, and by May 12, 2014, members of Congress had only proposed approximately 15 bills that include oil spill-related provisions.¹²⁹ One of those, the Offshore Energy and Jobs Act, was passed by the House on June 28, 2013 and sought to “accelerate domestic oil and gas production by providing for...a [further] reorganization of the current DOI subdivisions responsible for domestic oil and gas operations.”¹³⁰

IV. CONTRACTUAL ALLOCATION OF RISK IN OFFSHORE DRILLING ACTIVITIES

Development of oil and gas resources relies heavily on the equipment and expertise of multiple parties. Allocation of risk among the owners, operators and contractors for a particular prospect is key to any negotiation of offshore exploration and development agreements. In light of the aftermath of the Macondo well incident developments over the past several years, it is prudent for each company involved in offshore exploration and production activities to evaluate

¹²⁶ *Id.* at 4.

¹²⁷ The criteria include: shoreline impact, oiled shoreline distance from the Deepwater Horizon, and coastal population. Each state must submit a plan for approval, documenting how funding will support one or more of the 11 designated activities. *Id.*

¹²⁸ *Id.*

¹²⁹ *Id.* at 13.

¹³⁰ *Id.*

and reassess the risk allocation structures and provisions in their standard-form contracts. Typical risk-allocation provisions in these contracts include, but are not limited to, provisions relating to choice of law, indemnification, release of liability, insurance, responsibility for fines and penalties, as well as commercial provisions such as liquidated damages for delayed delivery or performance. This Part IV discusses several of these provisions in an effort to provide practical guidance toward understanding and drafting offshore activity agreements that are governed by U.S. maritime law in light of decisions arising out of the Macondo well incident.

A. Choice of Law

The first step in analyzing the risk allocation structure of any contract is to determine which law applies to the interpretation of the agreement. The second step is determining whether a particular provision, indemnification for example, is enforceable under the governing law of the contract. For example, there are key distinctions between U.S. maritime law, in particular the OCSLA, and state law regarding the enforceability of indemnity provisions. As a result, the enforceability of indemnity agreements is often in question.

(1) Application of Maritime Law

Maritime law (OCSLA) applies to activities in the OCS, which is defined as “all submerged lands lying seaward and outside of the area of lands beneath the navigable waters as defined in section 1301¹³¹ of [the OCSLA], and of which the subsoil and seabed appertain to the United States and are subject to its jurisdiction and control” and extending three geographical

¹³¹ “Lands beneath navigable waters “ means (1) all lands within the boundaries of each of the respective States which are covered by nontidal waters that were navigable under the laws of the United States at the time such State became a member of the Union, or acquired sovereignty over such lands and waters thereafter, up to the ordinary high water mark as heretofore or hereafter modified by accretion, erosion, and reliction; (2) all lands permanently or periodically covered by tidal waters up to but not above the line of mean high tide and seaward to a line three geographical miles distant from the coast line of each such State and to the boundary line of each such State where in any case such boundary as it existed at the time such State became a member of the Union, or as heretofore approved by Congress, extends seaward (or into the Gulf of Mexico) beyond three geographical miles, and (3) all filled in, made, or reclaimed lands which formerly were lands beneath navigable waters, as hereinabove defined.” 43 U.S.C. § 1331 – Definitions.

miles from the coast line of each state seaward (or into the Gulf of Mexico).¹³²

There are two key judicial decisions interpreting whether U.S. maritime law will apply to a contract, *Davis & Sons, Inc. v. Gulf Oil Corporation*,¹³³ and *Grand Isle Shipyard, Inc. v. Seacor Marine, LLC*.¹³⁴ The contract at issue in *Davis & Sons, Inc.* was a blanket agreement between two parties covering offshore and onshore facilities to which work-orders detailing specific work to be performed would be attached, with each work order incorporating the terms and conditions of the blanket agreement by reference.¹³⁵ The approach of signing a blanket (or master) agreement to which specific work orders is attached is common in the oil and gas industry. In this case, the Fifth Circuit established that for a blanket agreement with work orders attached, a contract may be both maritime in nature and non-maritime in nature, with the determination being made with respect to each work order in light of the work to be performed under that work order. The court based its determination on a six factors:

- 1) [W]hat does the specific word order in effect at the time of injury provide?
- 2) [W]hat word did the crew assigned under the word order actually do?
- 3) [W]as the crew assigned to work aboard a vessel in navigable waters;
- 4) [T]o what extent did the word being done relate to the mission of that vessel?
- 5) [W]hat was the principal work of the injured worker? and
- 6) [W]hat work was the injured worker actually doing at the time of the injury?¹³⁶

If, after working through the test and looking at historical treatment in jurisprudence, the contract has, in the words of the U.S. Supreme Court, a “genuinely salty flavor,”¹³⁷ U.S. maritime law will apply to the contract with respect to that particular work order.¹³⁸

The Fifth Circuit simplified the approach in *Davis & Sons, Inc.* in its 2009 decision in

¹³² *Id.*

¹³³ *Davis & Sons, Inc. v. Gulf Oil Corporation*, 919 F.2d 313 (5th Cir. 1990).

¹³⁴ *Grand Isle Shipyard, Inc. v. Seacor Marine, LLC*, 589 F.3d 778 (5th Cir. 2009) (en banc).

¹³⁵ *Id.* at 316.

¹³⁶ *Id.* at 316.

¹³⁷ *North Pacific S.S. Co. v. Hall Bros. Marine Ry. & Shipbuilding Co.*, 249 U.S. 119, 125 (1919).

¹³⁸ *Davis & Sons, Inc.*, 919 F.2d at 316, 317.

*Grand Isle Shipyard, Inc. v. Seacor Marine, LLC.*¹³⁹ In reaching a determination as to whether U.S. maritime law applied in this case, the Fifth Circuit applied a simplified test that assessed whether “a majority of the work called for by the contract is on stationary platforms or other enumerated OCSLA sites.”¹⁴⁰ The court reasoned that adopting a “focus-of-the-contract” test means that the parties would be aware of whether U.S. maritime or state law applies at the outset of the agreement, clarifying the indemnification and liability structure in the event of an accident.¹⁴¹

If U.S. maritime law does not apply, the laws of the state adjacent to the work site / incident will apply.¹⁴² As discussed below, while U.S. maritime law may uphold the enforceability of indemnification provisions with certain public policy exceptions, anti-indemnity statutes apply where state law governs an agreement.

(2) **Application of State Law**

State law will apply to offshore agreements that are not governed by maritime law. Where a contract is governed by the laws of the State of Texas, the Texas Oilfield Anti-Indemnity Act will apply and invalidate any indemnity clause that:

- (1) is caused by or results from the sole or concurrent negligence of the indemnitee, his agent or employee, or an individual contractor directly responsible to the indemnitee; and
- (2) arises from:
 - a. personal injury or death;
 - b. property injury; or

¹³⁹ *Grand Isle Shipyard*, 589 F.3d at 778 .

¹⁴⁰ *Grand Isle Shipyard*, 589 F.3d at 787-88. Note that other federal statutes may apply to offshore drilling activities as well. For example, the Longshore and Harbor Workers’ Compensation Act (LHWCA), which provides for compensation in respect of disability or death of an employee occurring on the navigable waters of the U.S. *See* 33 U.S.C. § 903.

¹⁴¹ *Grand Isle Shipyard*, 589 F.3d at 787.

¹⁴² OCSLA provides in pertinent part: “[t]o the extent that they are applicable and not inconsistent with [OCSLA] or with other Federal laws and regulations of the Secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent State now in effect or hereafter adopted, amended, or repealed are hereby declared to be the law of the United States for that portion of the subsoil and seabed of the OCS, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward to the outer margin of the OCS...” 43 U.S.C. Section 1333(a)(2)(A).

- c. any other loss, damage, or expense that arises from personal injury, death, or property injury.¹⁴³

The State of Louisiana likewise adopted an anti-indemnity statute holding that indemnification provisions that provide, or purport provide, for defense or indemnity for damages arising out of or resulting from death or bodily injury are contrary to public policy and unenforceable “where there is negligence or fault (strict liability) on the part of the indemnitee, or an agent or employee of the indemnitee, or an independent contractor who is directly responsible to the indemnitee.”¹⁴⁴

Thus, the threshold question of which substantive law applies to interpretation and enforcement of an offshore agreement is a critical determination to drafting appropriate and enforceable indemnification provisions. This article discusses indemnification, release and related provisions on the assumption that U.S. maritime law applies to the offshore agreement.

B. Indemnification and Release

Indemnification and releases of liability lie at the heart of every contractual risk allocation structure. Offshore contracts generally allocate liability among the parties for specific known risks, such as pollution below the surface of the water, pollution on or above the surface of the water, the unseaworthiness of any vessel, patent or latent defects in vessels or equipment, destruction or damage to downhole equipment, damage caused by drilling fluid, loss or damage to the hole, and actions of the operator. The offshore agreement may also contain “catch-all” release and indemnity provisions that address any loss or liability not specifically mentioned elsewhere in the agreement.

Offshore contract drafters, negotiators and litigators must navigate complex and unique statutory and public policy hurdles in crafting and enforcing indemnity and release provisions. It is common in offshore agreements for each party to bear the risk of damage and loss to its own

¹⁴³ *Id.*

¹⁴⁴ La. Rev. Stat. Ann. § 9:2780(A) (2005).

people and property, even where the loss is caused by the gross negligence of another party. This approach has the benefit of clarifying insurance coverage and reducing the cost of insurance and litigation for the parties to a contract; however the enforceable scope of both a release and indemnity will vary depending on the choice of law, and must be examined carefully in light of the governing law of the offshore agreement. At issue is a party's ability to (i) enforce the indemnity provision, (ii) release liability for its own intentional misconduct or gross negligence, and (iii) be indemnified for the consequences of its own intentional misconduct or gross negligence.

Many indemnification provisions contain elements of a release, as well as indemnification.¹⁴⁵ However, the enforceable scope of a release differs from that of an indemnity under U.S. maritime law, and it is important to understand the distinction between these two different (albeit related) concepts and draft these provisions carefully. Generally, a “release” or exculpatory clause entails a party relieving a counterparty to a contract from liability to the relieving party in the event the relieving party is damaged. In other words, a release, generally speaking, “surrenders legal rights or obligations between the parties to an agreement...”¹⁴⁶ In a release, the injured party remains uncompensated for its loss. Unlike a release, an indemnity determines which party to a contract will ultimately bear the risk of injury to a third party,¹⁴⁷ and under what circumstances and to what extent the indemnifying party will

¹⁴⁵ Indemnification provisions typically contain the language “... shall assume full responsibility for and shall protect, **release**, defend, **indemnify**, and hold harmless...” and thereby these provisions have been interpreted by the courts as having elements of both a release and an indemnity. See Order and Reasons [As to Transocean and BP's Cross-Motions for Partial Summary Judgment Regarding Indemnity] Rec.Doc. 5446, 841 F. Supp. 2d 988, 1001 (E.D. La. Jan. 26, 2012) [hereinafter *Order As To Indemnities*].

¹⁴⁶ See e.g., Dresser Indus., Inc. v. Page Petroleum, Inc., 853 S.W.2d 505, 507-08 (Tex. 1993) (citation omitted).

¹⁴⁷ While it is possible to include indemnification provision providing for indemnification of a party for losses caused by the breach of a contract by a counterparty, this article does not address counterparty indemnification provisions. Presumably the same analysis (and specificity of provisions) would apply to indemnification for losses caused by a counterparty's breach of the underlying contract.

bear the risk of injury.¹⁴⁸ The injured party is not foreclosed from a remedy for its loss by the existence and enforcement of an indemnification provision – rather the contract specifies which contractual party will reimburse the injured party.

It is against public policy for a party to *release* a counterparty to a contract from liability for intentional misconduct or gross negligence under U.S. maritime law.¹⁴⁹ However, *indemnification* for the consequences of a party's own gross negligence may be enforceable if (1) the intent to do so is clearly and expressly stated and (2) the parties had roughly equal bargaining power such that the freedom of contract principles of U.S. maritime law are not at issue.¹⁵⁰ Indemnification for the consequences of a party's own intentional misconduct has been construed as against public policy and, as with a release, is not enforceable under U.S. maritime law.¹⁵¹

Under U.S. maritime law,

A contract of indemnity should be construed to cover all losses, damages or liabilities which reasonably appear to have been within the contemplation of the parties, but it should not be read to impose liability for those losses or liabilities which are neither expressly within its terms nor of such a character that it can be reasonably inferred that the parties intended to include them within the indemnity coverage. Thus, for example, it is widely held that a contract of indemnity will not afford protection to an indemnitee against the consequences of his own negligent act unless the contract clearly expresses such an obligation in unequivocal terms.¹⁵²

Understanding that it is possible for a party to be indemnified for the consequences of its own gross negligence under U.S. maritime law, what then is the possible scope of this indemnity? Losses generally can be broadly categorized into one of three categories: (i)

¹⁴⁸ See *St. Paul Fire & Marine Ins. Co. v. Universal Builders Supply, Inc.*, 409 F.3d 73, 86 (2d Cir. 2005).

¹⁴⁹ See *Houston Exploration Co. v. Halliburton Energy Servs., Inc.*, 269 F.3d 528, 531 (5th Cir. 2001); *Energy XXI, GoM, LLC v. New Tech Eng'g*, 787 F. Supp. 2d 590, 611 (S.D. Tex. 2011).

¹⁵⁰ See e.g., *Order As To Indemnities* at 1001.

¹⁵¹ *Id.* at 1001.

¹⁵² See *Corbett v. Diamond M. Drilling Co.*, 654 F.2d 329, 333 (5th Cir. Unit A 1981) (citations omitted).

compensatory damages, (ii) punitive damages, and (iii) fines and penalties. As a result of the series of decisions in litigation arising out of the Macondo well incident, we understand the following:

(1) **Indemnification for a Party's Own Gross Negligence**

Gross negligence is generally understood to entail a disregard of an unjustifiable high risk of harm to another caused by a party's actions,¹⁵³ or a reckless disregard for the consequences of an action, and is a question of fact. In 2012, in light of the facts and circumstances in the case, Judge Barbier of the Eastern District of Louisiana that public policy *does not* bar indemnification for compensatory damages arising out of or related to a party's gross negligence.¹⁵⁴ In this decision, Judge Barbier held that indemnification for the consequences of gross negligence is a contractual matter and is not prohibited by public policy.¹⁵⁵

In reaching this decision, Judge Barbier concluded that an analysis of the enforceability of indemnification for the consequences of a party's own gross negligence rested on two concepts: (1) "freedom of contract, which weighs in favor of enforcing the indemnity," and (2) a "reluctance" to encourage grossly negligent behavior which "weighs against enforcing the indemnity."¹⁵⁶ Judge Barbier noted that the two parties in the case at issue, Transocean and BP, were both sophisticated entities with roughly equal bargaining power, neither of whom required the protection of the court.¹⁵⁷ It is not clear from this decision whether disparate bargaining power could foreclose the enforceability of an indemnity for the results of a party's own gross negligence.

Judge Barbier reiterated the courts' conclusions regarding the enforceability of

¹⁵³ *Reino de Espana v. Am. Bureau of Shipping, Inc.*, 691 F.3d 461, 468 (2d Cir. 2012).

¹⁵⁴ *See e.g., Order As To Indemnities* at 1002.

¹⁵⁵ *See e.g., Order As To Indemnities* at 1002.

¹⁵⁶ *See e.g., Order As To Indemnities* at 1000.

¹⁵⁷ *See e.g., Order As To Indemnities* at 1001.

Transocean's and Halliburton's indemnity provisions in their respective contracts with BP in the Phase One Findings.¹⁵⁸ The Eastern District of Louisiana has already denied BP's motion to modify the Phase One Findings or have a new trial. Thus, this type of indemnification should generally be enforceable.

In light of the above, in drafting offshore agreements, drafters and negotiators should ensure that the treatment of losses and liabilities for gross negligence are clearly articulated, and provide evidence of mutual bargaining power within the four corners of the offshore contract to the extent practicable. In addition, it may be prudent to craft a definition of "gross negligence" within the offshore agreement given that the definition of gross negligence varies depending on the circuit and appeals court and there is currently no consensus regarding the exact definition, as evidenced by the "gross negligence" analysis in the Phase One Findings.

(2) **Indemnification for Punitive Damages**

There is no reported U.S. maritime case addressing indemnification against punitive damages in the U.S. Supreme Court or the Fifth Circuit. However, in 2012, Judge Barbier also found that public policy *does* bar indemnification for punitive damages where a party is found to have been grossly negligent and will not support a contractual provision that shifts liability for punitive damages to an innocent party.¹⁵⁹ In reaching this decision, Judge Barbier cited and adopted the reasoning set forth in *Doughdrill v. Ocean Drilling & Exploration*, noting:

[t]he public policy purpose behind permitting [punitive] damages is to punish the defendant for egregious conduct, teaching him not to do it again, and to deter others from engaging in similar behavior...[I]n the case at bar we are confronted with contractual indemnification. No clearer example of a situation which would subvert the purposes of awarding punitive damages can be imagined than to permit such indemnification.¹⁶⁰

¹⁵⁸ *In re Oil Spill (Phase One Trial)* at 757.

¹⁵⁹ See e.g., *Order As To Indemnities* at 1003.

¹⁶⁰ See *Doughdrill v. Ocean Drilling & Exploration*, 665 F.Supp. 477, 481-82 (E.D. La. 1987).

(3) **Indemnification for Statutory Penalties**

In the offshore oil and gas industry, environmental protection laws are a significant source of potential civil penalties, and can be asserted under the Clean Water Act and the Oil Pollution Act.¹⁶¹ Courts vary in their treatment of indemnification for civil penalties. Extrapolating from Judge Barbier's ruling in the Macondo well incident litigation, according to the Eastern District of Louisiana, public policy would also *bar* indemnification for penalties imposed on a party by statute where the purpose of the penalties is to deter conduct in violation of the statute (as opposed to paying for cleanup or reimbursement of damages). As discussed in Part III.B, owners, operators, and persons in charge of any vessel, onshore facility or offshore facility have strict liability for pollution under the Clean Water Act, with gross negligence and willful misconduct increasing the amount of the penalty.¹⁶²

In assessing whether a violator may be indemnified by a contract party for liability for penalties under the Clean Water Act and Oil Pollution Act, Judge Barbier examined legislative history of the Clean Water Act, as well as the text of the statute, concluding that allowing a contractual indemnity for penalties under the Clean Water Act would subvert the purpose of the penalty provision to punish the violator and deter the violator and others from similar actions.¹⁶³

In light of these holdings, drafters of offshore agreements should carefully draft provisions to obtain indemnity for civil penalties, but remain cognizant that this type of indemnity is closely examined by the courts.

(4) **Costs and Expenses of Enforcing an Indemnity Provision**

The litigation arising out of the Macondo well incident also clarified important timing and reimbursement issues arising in connection with the enforcement of indemnification

¹⁶¹ See *Order As To Indemnities* at 1005-1006.

¹⁶² See 33 U.S.C. § 1321(b)(7)(D).

¹⁶³ See *Order As To Indemnities* at 1005-1006.

provisions and the defense of third party claims.

In Macondo well incident litigation, the District Court of the Eastern District of Louisiana held that contractually agreeing to reimburse an indemnified party for the cost of suit and attorney's fees may not entitle the indemnified party to reimbursement of attorney's fees, costs and expenses it incurs to establish its right to indemnification.¹⁶⁴ The drilling contract at issue in this case stated, in pertinent part:

[t]he phrase "shall protect, release, defend, indemnify and hold harmless" means that the indemnifying party shall protect, release, defend, indemnify, and hold harmless the indemnified party or parties from and against any and all claims, demands, causes of action, damages, costs, expenses (including reasonable attorney's fees), judgments and awards of any kind or character, without limit and without regard to the cause or causes thereof....¹⁶⁵

In reaching this determination, the Court relied heavily on the *Weathersby v. Conoco Oil Co.*, which held in part that "[u]nder a general indemnity agreement..., the indemnitee enjoys no right to recover its legal fees incurred in establishing its right to indemnification,"¹⁶⁶ as well as a Second Circuit case holding that the phrase "including but not limited to cost of suit and attorneys' fees" does not include the cost of establishing the right to indemnity, but is construed as referring to defense of the primary claim.¹⁶⁷

In light of these cases, any party desiring indemnification for the costs and expenses of enforcing a right to indemnity should provide for this right explicitly in the applicable contract.

(5) Timing of Assumption of Defense Costs

In litigation arising out of the Macondo well incident, the District Court of the Eastern District of Louisiana case also addressed the issue of whether an indemnifying party is obligated

¹⁶⁴ See *Order As To Indemnities* at 1008.

¹⁶⁵ See *Order As To Indemnities* at 1008.

¹⁶⁶ See *Weathersby v. Conoco Oil Co.*, 752 F.2d 953, 959 (5th Cir. 1984) (per curium) (citations and quotations omitted).

¹⁶⁷ See *Peter Fabrics, Inc. v. S.S. Hermes*, 765 F.2d 306, 316 (2d Cir. 1985).

to assume defense costs and expenses at the beginning of a case where issues for which a party may be entitled to indemnification are likely to be addressed. This was an issue of first impression under U.S. maritime law. The Court distinguished indemnity agreements from insurance contracts by concluding that a duty to defend requires the indemnifying party to reimburse the indemnified party for defense costs “after there has been judicial determination on the merits.”¹⁶⁸ The court focused on the distinct nature of insurance contracts in reaching its conclusion.¹⁶⁹

In light of this holding, a party desiring to clarify that defense costs will be paid on an ongoing basis during the pendency of a suit (versus after a decision on the merits) should do so explicitly in the applicable contract.

(6) Insurance Coverage

The availability and procurement of insurance coverage for certain liabilities and losses provides an additional complication to enforcement of indemnification provisions and to the collection of indemnified amounts. U.S. maritime precedent generally holds that an insurance obligation takes priority over an indemnification obligation, and that a party entitled to indemnification must first exhaust available insurance where insurance coverage for the losses is in place.¹⁷⁰ Insurance requirements allow parties to mitigate the risk that a counterparty to an agreement will not have the financial wherewithal to cover its contractual losses and liabilities. However, the requirement to exhaust a party’s own insurance coverage before collecting any indemnification amounts can have a negative impact on that party’s insurance claim rate (and accordingly the cost of insurance), and to some extent subverts the purpose of contractual indemnity by shifting the risk of loss back to the party procuring insurance. In light of this,

¹⁶⁸ See *Order As To Indemnities* at 1009.

¹⁶⁹ *Id.* at 1009.

¹⁷⁰ *Tullier v. Halliburton Geophysical Servs., Inc.*, 81 F.3d 552, 553 (5th Cir. 1996).

offshore contract drafters and negotiators should carefully craft insurance provisions to provide that insurance coverage can only apply to a limited scope to specific risks.

V. CONCLUSION

In the aftermath of the Macondo well incident, the oil and gas industry was forced to reassess the risk and nature of offshore drilling. The decisions of the Eastern District Court of Louisiana and the Fifth Circuit marked the boundaries of owners and operators under the Clean Water Act and the Oil Pollution Act and the enforceability of risk management provisions in drilling contracts. Further, changes to the statutory regime with respect to offshore drilling were contemplated as a result of the magnitude of the Macondo well incident, but not many materialized into new laws or regulations. While no drastic changes were made immediately following the Macondo well incident that would change the risk profile of offshore drilling operations, such changes could come in the future.