Exposure to environmental liabilities now the single biggest financial risk for oil companies and contractors

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Macondo: oil companies hit with copycat liabilities

Nigeria, Brazil, Ecuador and China. What do they have in common?

In the last 18 months, they have each sought to impose liabilities on oil companies for pollution incidents that massively exceed, on a per barrel basis, the fines that have been or may be imposed upon BP by the US authorities for the Macondo/ Deepwater Horizon spill.

Everyone has been focusing on Macondo/ Deepwater Horizon because four million barrels of oil spilt into the Mexican Gulf. BP stands to be fined up to $4,000 per barrel of oil under the US Clean Water Act. However, the recent Nigerian fine of $11.5bn imposed on Shell for the Bonga FPSO incident amounts to $250,000 per barrel of oil spilt. The claim that was, until recently, being advanced by the Brazilian public prosecutor against Chevron for the Frade spill amounts to a staggering $4.5m per barrel of oil spilt. Transocean, the drilling rig owner, was also punished by being temporarily banned from operating at all in Brazilian waters.

- Since Macondo, producing states have been imposing massive and disproportionate liabilities on oil companies for oil spills.
- Fines have been dressed up as damages claims and vice versa.
- Now arguably the biggest single exposure for participants in the oil industry and could deter activity.

Implications

First, the received wisdom that environmental damage liability is manageable because there are very few jurisdictions in the world that permit the imposition of a fine (in the genuine sense) of more than $100m no longer holds good.

Second, what is emerging is a lack of any clear distinction between fines and civil law damages. Fines are supposed to punish wrongdoing and are imposed by state authorities. Damages are generally meant to compensate individuals for damage to property and economic interests. The $20bn civil damages claim brought against Chevron for the Frade spill was justified on the basis of the damage it supposedly caused. However, that appears to have been negligible, not least because the spill happened 370km from shore. It looks more like a fine than damages. But Chevron had already been fined about $17m by the Brazilian authorities.

Third, it should not be assumed that these liabilities have no effect outside the jurisdictions that impose them. The Ecuadorian government has recently made significant progress in enforcing its $19bn 'damages' claim against Chevron in the United States for pollution caused to the Amazon during the 1970s and 1980s. The 'damages' award was more than doubled by an Ecuadorian Court from its previous level of $8.6bn because Chevron refused to apologise for the pollution.

Fourth, the prospect of having to deal with corporate-threatening liabilities could discourage certain contractors from continuing to participate in the industry at least in some parts of the world.

Conclusion

The US authorities' response to the Macondo blowout has triggered copycat behaviour by governmental bodies in oil-producing jurisdictions around the world. As a consequence, liability in respect of environmental damage is emerging as one of the biggest single exposures for participants in energy exploration and production, and their risk carriers.

We would remind the members that P&I cover under the club's Standard Offshore Rules can respond to fines imposed for accidental discharge or escape of pollution from the entered unit, but this is at the discretion of the club's board and is subject to a sublimit of $50m.