Closer to an EU-wide safety and liability regime for offshore oil and gas

Following the Deepwater Horizon incident in 2010, the EC and Member States have focused on measures to minimise the risk of major offshore oil and gas accidents occurring, to minimise the impacts when accidents do occur and to ensure that appropriate compensation and liability regimes are in place. The Parliament has now approved a new offshore oil and gas safety Directive, and the EC's work in assessing the need for a new civil liability regime in the EU is continuing. In the UK, the financial responsibility requirements applicable to offshore operators have been clarified. In this briefing, we discuss the key implications for the industry of these recent regulatory developments.

The Proposed Directive

There are approximately 1,000 offshore oil and gas installations in operation in the EU, of which almost half are in UK waters. The UK offshore safety regime is regarded as the "gold standard", as a result of reforms following the Piper Alpha incident in 1988. The UK also responded swiftly to the Deepwater Horizon incident, through the Oil Spill Prevention and Response Advisory Group ("OSPRAG"). However, a number of the offshore installations are in waters with less well-established regimes, and there is no consistent, comprehensive risk management or civil liability regime in the EU, and financial security requirements vary between Member States.

The Deepwater Horizon incident sparked renewed interest in regimes for managing the risks of offshore oil and gas activities and dealing with the impacts of major incidents. The EC has focused on ensuring that the safety of offshore oil and gas activities is appropriate and consistent across the EU, and has looked at various policy options to achieve the objectives of preventing major accidents from occurring as a result of offshore oil and gas activities.

To this end, the EC published, in October 2011, an initial proposal for a Regulation on the safety of offshore oil and gas activities. However, the initial proposal was met with opposition by Governments, including the UK Government and by the industry. The industry has responded more positively to the decision of the Parliament's Energy Committee in October 2012 that a Directive would be more appropriate, and in February this year the Parliament and the Council reached a political agreement that the proposal will take the form of a Directive. The proposed Directive, which will establish a framework aimed at reducing the occurrence of major incidents and limiting the consequences of major incidents when they do occur, has now been approved by the Parliament.

Given the existing regime in the UK, it is not expected that wholesale changes will be required. However, we set out below the key aspects of the proposed Directive in relation to financial responsibility and liability focusing on the impact on the industry in the UK.
Key Provisions of the Proposed Directive

General Principles
The proposed Directive sets out "general principles of risk management", namely that Member States shall ensure that:

- Operators are required to ensure that all suitable measures are taken to prevent major accidents from offshore oil and gas operations;
- Operators are not exonerated from their responsibility by the fact that actions or omissions leading or contributing to major accidents were carried out by contractors; and
- Should a major accident occur, operators take all suitable measures to limit the consequences for human health and the environment.

The language in the proposed Directive, which requires the taking of "all suitable measures" differs from the current requirement in the UK, namely that the control measures be implemented to reduce the risks to "as low as reasonably practicable". The term "all suitable measures" is not defined in the proposed Directive, but arguably imposes a more onerous standard.

Licensing and Financial Responsibility
The proposed Directive requires that the licensing authorities in Member States take into account:

- The risks, hazards and other relevant information related to the licensed area concerned and the particular stage of operations; and
- The applicant's financial capacity, including any financial security and capacity to cover liabilities deriving from the operation, in particular liability for environmental damages.

The proposed Directive requires Member States to ensure that licensing authorities do not grant a license unless they are satisfied that the applicant has provided evidence that adequate provision has been or will be made, by way of financial security, to cover liabilities from operations, including liability for environmental damage. The position in the UK in relation to financial responsibility in the aftermath of the Deepwater Horizon incident is discussed further below.

Extension of the Environment Liability Directive
The proposed Directive makes it clear that the licensee is financially liable for the prevention and remediation of environmental damage caused by operations carried out by, or on behalf of, the licensee or any operator participating in the operations on the basis of a contract with the licensee.

In addition, the proposed Directive will amend the Environmental Liability Directive so that liability for damage is extended to the exclusive economic zone (200 nautical miles from the coastline) and the continental shelf under the Member States' jurisdiction. At present, liability applies only to damage within territorial seas (12 nautical miles from the coastline).

It is significant that liability will be on the licence holder and not the operator. This means that the parties to offshore oil and gas contracts may need to revisit the indemnities and other clauses in their contracts allocating liability between the licence holder and the operator (and other contractors).

Managing Major Hazards
Operators will be required to submit a major hazards report to the relevant authorities for assessment (and to make appropriate adjustments over time). The major hazards report for a production installation will be required to include:

- A description of the installation and any association with other installations or connected infrastructure;
- A demonstration that all major hazards have been identified, their likelihood and consequences assessed and their control measures suitable so as to reduce risks of a major hazard event to persons and the environment to an acceptable level;
Details of equipment and arrangements to ensure well control, process safety, containment of hazardous substances, prevention of fire and explosion, protection of the workforce from hazardous substances and protection of the environment from a major event; and
- Details of the arrangements to protect persons on the installation from major hazards and to ensure their safe escape, evacuation and rescue.

Operators will be required to prepare an internal emergency plan describing the action to be taken in the case of an emergency.

The proposed Directive will apply to existing and future operations, and the requirement to submit a major hazards report will clearly create a significant burden for existing operations. While this is similar to the existing safety case in the UK, it will also need to take environmental matters into account.

**Regulatory Oversight**

The proposed Directive contains provisions designed to ensure the independence of authorities in Member States. Member States will need to ensure that there is a structural separation between the functions relating to offshore safety and environment and functions relating to economic development such as licensing. This may have an impact in the UK because, at present, the demarcation is that the Department of Energy and Climate Change ("DECC") has responsibility for licensing and environmental matters, and the Health and Safety Executive has responsibility for safety matters.

Member States will also be required to prepare emergency response plans to cover the offshore installations in their jurisdiction.

**EU Civil Liability**

As highlighted by the Deepwater Horizon incident and as recognised by the EC, the cost of responding to and recovering from a major offshore oil or gas accident has the potential to bankrupt the company responsible and transfer the financial risk to the relevant Member State, as well as causing significant financial damage to the local community. Accordingly, alongside the development of the proposed Directive (which is directed at ensuring the safety of offshore oil and gas activities) the EC is examining civil liability regimes and financial security mechanisms to ensure compensation for offshore oil and gas incidents is available in a comprehensive and harmonised way across the EU.

As part of this work, the EC has commissioned Maastricht University to carry out a study of civil liability provisions in Member States to identify available financial security mechanisms. The report, which is due shortly, will assist the EC to develop policies to ensure the EU has a comprehensive liability regime.

**Availability of Traditional Damages**

Critically, while some Member States have regimes in place for determining liability and paying compensation, there is uncertainty as to the effectiveness of these mechanisms to deal with large-scale transboundary accidents. In addition, liability to address environmental damage is common among Member States (in accordance with the Environmental Liability Directive) but there is no harmony between civil liability regimes. Indeed, many Member States do not have specific regimes to deal with civil liability.

In the UK, for example, for damages to be awarded, the injured party has to have suffered an actual loss such as personal injury or loss of or damage to property (and resultant economic loss). However, while economic losses directly consequential upon physical damage are recoverable, pure economic loss may not be recoverable. In the context of an offshore oil or gas accident, this would mean, for example, that local fisherman may not have an avenue to obtain compensation for the impact to their livelihoods (although under the proposed Directive, licensing authorities would be required to assess the applicant's ability to meet such costs). This is in contrast to the position in the US where there is strict liability under the Oil Pollution Act, and the Oil Spill Liability Trust Fund provides for claims of up to 1 billion USD to be paid in categories of compensable damages including natural resources, real and personal property, subsistence uses, revenues, profits and earning capacity.
The Need for a Comprehensive Regime

Accordingly, the EC is seeking to ensure a comprehensive regime to determine civil liability and to ensure that there is financial capacity for all costs to be covered. The proposed Directive will impose additional financial capacity requirements at the licensing stage and extends the application of the Environmental Liability Directive. However, the question of financial capacity and traditional damages, as well as the available market mechanisms, is being considered by the EC separately.

At present, the most well-known market mechanism is the Offshore Pollution Liability Association ("OPOL"). Although OPOL is a voluntary fund, membership is mandatory in order to obtain licences to engage in offshore oil and gas activities in UK, and some other, waters. This requirement is not, however, imposed universally across the EU and accordingly, the EC is concerned to ensure a harmonious approach.

UK Financial Assurance

Shortly after the Deepwater Horizon incident, Oil and GAS UK formed OSPRAG with a remit to:

- Review offshore drilling practices in the UK continental shelf and the regulatory arrangements to assess the industry's ability to prevent major incidents and respond to major incidents when they occur; and
- Assess the adequacy of financial provisions.

OSPRAG's final report, "Strengthening UK Prevention and Response" was published in September 2011. It sets out the recommendations stemming from OSPRAG's review, including the recommendations from the "Insurance and Indemnities Review Group" which looked at the increasing the robustness of the industry's financial responsibility for oil spill clean-up and compensation.

Following OSPRAG's final report, DECC has confirmed that it requires assurance that appropriate resources are available to control, respond to and compensate for incidents. DECC will undertake checks on a company's finances before granting a licence which will include checking its ability to carry out the agreed work programme and checking that sufficient funds are available in the event of an incident.

With input from the industry, DECC has developed guidance for offshore oil and gas operators on the demonstration of financial responsibility before consent is granted for exploration and appraisal wells. The guidance, which took effect from 1 January 2013, provides that operators will be able to satisfy assurance requirements by:

- Demonstrating their credit rating is sufficient;
- Proving suitable insurance is in place;
- A parent company guarantee; and
- Any combination of the above.

It requires that the level of financial responsibility that operators need to demonstrate for a particular well should be calculated by establishing the combined:

- The cost of control of the well; and
- The cost of financial remediation and compensation from pollution.

Amendments to the guidance may be required to give effect to the proposed Directive.

Next Steps

It is expected that the proposed Directive will be formally approved by the Council shortly (subject to any last minute procedural surprises). While the proposed Directive will apply to all Member States, landlocked countries and those with no offshore oil and gas activities will need to apply only a limited number of its provisions. Member States with offshore oil and gas activities will have two years to transpose the proposed Directive into national legislation, and the proposed Directive will take effect for existing installations in five years.
The EC is also awaiting the Maastricht University report which will feed into the EC’s consideration of policy options to strengthen and harmonise civil liability regimes. The proposed Directive calls for the EC to report on the availability of financial security instruments and on the handling of compensation claims, with appropriate proposals, by 31 December 2014.