

OFFSHORE INDUSTRY COMPENSATION REGIME

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ABSTRACT

The principal provisions for compensation for loss or damage relating to an escape or discharge of oil are derived from Regulations made under the authority of the United Kingdom (“UK”) Parliament and obligations imposed on operators under the Common Law of the UK augmented by schemes supported by the oil and gas industry. Regulations provide model clauses for production licenses which require the Licensee to prevent the escape of petroleum to sea. The model clauses include (a) a clause requiring the Licensee to comply with any reasonable instructions from the Minister with a view to ensuring that funds are available to meet costs attributable to the release or escape of petroleum and (b) a clause that the Licensee indemnifies the Minister against all costs, charges, claims and demands made against the Minister in connection with the License “or any thing done or purported to be done in pursuance thereof”. The Common Law applies to the facts relevant to each case and entitles a party to recover compensation for loss or damage reasonably foreseeable as a consequence of the incident. The principal industry scheme is that provided by membership of OPOL. This allows operators to demonstrate responsibility to pay compensation for remedial measures and pollution damage up to US\$250m per incident. The OPOL scheme encourages expeditious remedial action and provides claimants on a strict liability basis with access to arrangements which are designed to bring about a quick settlement of claims without the expense of Court proceedings. By the imposition of a condition in their license, DECC require all operators in UK waters to be a member of OPOL. The Rules of

OPOL require a member to demonstrate financial responsibility for their obligations under the OPOL Agreement by achieving a set credit or financial strength rating.

INTRODUCTION

The compensation regime affecting stakeholders in the offshore industry in the UK draws on legislation and laws from a number of sources supplemented by arrangements put in place by the oil and gas industry. This short paper focuses on the relevance of Regulations made under the authority of the UK Parliament, the UK Common Law and Industry Schemes.

LEGAL AND REGULATORY PROVISIONS

In the UK activities in connection with the exploration for and production of oil and gas are heavily regulated. The relevant laws are designed to ensure that operators of Offshore Facilities are subject to and observe a range of obligations to ensure the safety of people working offshore and protection of the environment. In the UK there are four main sources of obligations affecting compensation in relation to offshore activities:

1. The European Union
2. UK Parliament and the Scottish Parliament
3. UK Common Law
4. Industry Schemes

The European Union

The Environmental Liability Directive 2004/35/CE has been given effect in the UK by Regulations made under the authority of the UK and Scottish Parliaments. The Regulations contain provisions for the prevention and remediation of pollution damage and are based on the principle that the polluter must pay for loss and

damage which they have caused. However the Regulations do not have effect in offshore UK waters.

The Minister of State under the authority of the UK Parliament in 2008 made The Petroleum Licensing (Production) (Seaward Areas) Regulations which affect a License to search and bore for and get petroleum from 6 April 2008. Earlier Licenses are subject to the relevant Regulations in force when a License was granted. The Regulations set out the terms of model clauses applicable to a License. Clause 23 (9) provides:

“ The Licensee shall comply with any reasonable instructions from time to time given by the Minister with a view to ensuring that funds are available to discharge any liability for damage attributable to the release or escape of Petroleum in the course of activities connected with the exercise of rights granted by this licence; but where the Minister proposes to give such instructions he shall before giving them-

- (a) give the Licensee particulars of the proposal and an opportunity to make representations to the Minister about the proposal; and
- (b) consider any representations then made to him by the Licensee about the proposal.”

I am not aware of this provision having been used but it clearly has the potential to play an important role in connection with compensation for loss or damage “attributable to the release or escape of Petroleum”.

Clause 38 may also be relied on in the event of an incident and this provides:

“The Licensee shall at all times keep the Minister effectually indemnified against all actions, proceedings, costs, charges, claims and demands whatsoever which may be made or brought against the Minister by any third party in relation to or in

connection with this licence or any matter or thing done or purported to be done in pursuance thereof.”

UK Common Law

UK Common Law provides that a legal obligation owed by a party and the corresponding right provided to another party can be created by a decision of a court. This is known as Common Law and the status of the obligation and right so created is equal to those created by an Act of the UK Parliament. The Common Law relating to compensation in respect of offshore activities is based on the fundamental proposition that “a man has a Duty of Care to conduct himself in such a way as to avoid harm to others, where a reasonable man would have seen that such harm could occur”. This statement was made in the “snail in a bottle” case of *Donoghue v Stevenson* decided in the House of Lords [then the highest Court in the UK] in 1932. The test articulated in that case has been applied in a diverse range of circumstances since 1932 and has also been revised to make it more specific and explicit but the central feature of a duty to conduct yourself in a way which will avoid harming another remains applicable today. To obtain compensation under the Common Law following an incident a claimant needs to establish the party against whom the claim was made:

1. owed the claimant a duty of care
2. breached that duty
3. caused the claimant loss or damage.

The compensation payable to a claimant is intended to place the Claimant in the position which would have existed had the wrong not occurred. However the damages to be awarded are limited to exclude those which the law would consider to be too remote. It is clear that under the Common Law each case has to be

considered by reference to the facts of that case and that any damages awarded will be for loss or damage of a type that is reasonably foreseeable as a consequence of the legal wrong which has been committed.

INDUSTRY SCHEMES

The legal obligations of Operators in the UK are supported by initiatives by the oil and gas industry. Of these the most significant are the OPOL Scheme and the Financial Responsibility work being taken forward by Oil and Gas UK.

The OPOL Scheme

The Department of Energy and Climate Change require every operator engaged in exploration for oil and gas or the production of oil and gas in UK waters to be a member of OPOL. OPOL is a company whose members consist of around 130 companies active in exploration or production of oil and gas in UK waters.

The Purpose of OPOL

The purpose of OPOL is to provide a scheme which offers a quick and efficient means to settle any claims for remedial damage and pollution damage and which results from a discharge of oil in UK waters. OPOL also provides operators with a means to demonstrate financial responsibility of an operator in the event of an incident and encourages quick remedial action. Finally OPOL provides a guarantee that in the event of a member failing to meet its obligations under the OPOL Agreement, all other members will join together to meet the obligations which that member owed.

Scope of Loss and Damage

The OPOL Scheme covers the cost of remedial measures and pollution damage. Remedial measures means reasonable measures taken by any party from any of whose Offshore facilities a discharge of oil occurs, and of which such party is the

operator, and by any Public Authority to prevent mitigate or eliminate pollution damage following such discharge of oil or to remove or neutralize the oil involved in such discharge, excluding however, well control measures taken to protect, repair or replace any such Offshore facility. Pollution Damage means direct loss or damage [other than loss of or damage to any Offshore facility involved] by contamination which results from a discharge of oil. The OPOL Scheme does not provide for losses in respect of the costs of well control – these are a matter for the operator.

Procedures for Resolving Claims

The OPOL Scheme provides that an operator has strict liability for the consequences of an oil spill as covered in the OPOL Agreement and the Rules of the Company. The Scheme has been developed as a mechanism to avoid the expense and delays which are likely to be experienced in Court proceedings in the event of a claim. The Scheme encourages public authorities to ensure any necessary remedial action is taken promptly and provides other third parties who have suffered Pollution Damage with a route for prompt settlement of their claims. The Scheme calls for claims to be made to an operator within one year of an incident.

Overview of the OPOL Scheme

The Scheme is not a fund. Rather it complements any liability which an operator has for the consequences of an incident. It requires a member of OPOL to demonstrate financial responsibility under the OPOL Agreement. This can be done in a number of ways:

1. Insurance

A member must demonstrate that they have in place insurance from a company acceptable to OPOL of not less than US\$ 250m per incident and US\$500m in the annual aggregate. A maximum deductible of US\$10m in respect of any one

occurrence is permitted. To be acceptable to OPOL the insurer must have one or more of the following credit or financial strength ratings: “A-” or higher from Standard & Poor’s; “A-“ or higher from A. M. Best; “A3” or higher from Moody’s; “A” or higher from Fitch; and/or the equivalent from another internationally recognized credit rating agency acceptable to OPOL.

2. Guarantee

A member may obtain a guarantee from a guarantor acceptable to OPOL. The guarantor requires to possess a rating from an agency as outlined in paragraph 1 above.

3. Self Insurance

A member may demonstrate financial responsibility through self-insurance. In such a case the member has to meet the rating standard set out in paragraph 1 above. This approach provides a clear cut method to demonstrate the financial responsibility of members of OPOL.

Financial Responsibility Guidelines

In addition to the arrangements provided by the oil and gas industry in the UK to compensate third parties through operation of the OPOL Agreement, the industry is engaged in the development of Guidelines to demonstrate the financial responsibility of operators in UK waters. This work is being lead by Oil and Gas UK.