Offshore

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OFFSHORE BULLETIN

Welcome to the June 2014 edition of our Offshore Bulletin.

The Texas Supreme Court is set to review the landmark ruling of the US Fifth Circuit Court of Appeals that BP was entitled to US$750 million under Transocean's insurance policies as an additional insured (see our June 2013 Bulletin). With the assistance of David Sharpe of Lugenbuhl, Wheaton, Peck, Rankin & Hubbard, we revisit the questions that the Supreme Court will be considering, and examine the rival arguments of the parties and interested industry associations.

There is an increasing trend in the English courts to interpret exclusion clauses as narrowly as possible, sometimes with unanticipated results. We examine a recent example of this.

With the Russia-Ukraine hostilities having turned to a dispute over Ukraine's gas bills, Gazprom are threatening to cut off gas supplies to Ukraine, prompting fears in Europe of another gas crisis such as took place in 2006 and 2009. Fortunately, thanks to new pipelines via Belarus and the Baltic Sea to Germany, Europe is already less dependent on Ukraine's pipelines than in 2009. Other alternative sources of gas supply are also envisaged, and we consider the alternatives under development in Azerbaijan and Cyprus.

Finally, the maximum sulphur content of fuel in Sulphur Emission Control Areas (including the North Sea) is to be cut from 1% to 0.1% from 1 January 2015. With fuel costs already rising, this is likely to have a significant financial impact on vessels such as OSVs. We look at how the Supplytime charterparty forms apportion liability in the event of damage caused by the supply of unsuitable fuels.

If you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin or your usual contact at HFW.

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hfw Update: BP's US$750 million additional-insured win in jeopardy

The Texas Supreme Court is presently considering the fate of BP's March 2013 victory in a legal skirmish with Transocean and its pollution insurers arising out of the *Deepwater Horizon* disaster. To distinguish the case at issue from the numerous other rulings that have been issued in the *Deepwater Horizon* litigation, the case is sometimes referred to as *Ranger Insurance*, the name of the lead plaintiff in the original declaratory-judgment action against BP.

...insurers would be well-advised to scrutinise their policy wording to ensure it places the intended limits on the scope of additional-insured coverage.

EMILIE BOKOR-INGRAM, ASSOCIATE

As reported in this Bulletin last June,[1] the US Fifth Circuit Court of Appeals ruled in March 2013 that BP was entitled to coverage as an additional insured under Transocean's insurance policies, giving BP access to US$750 million under Transocean's insurance to cover pollution-related liabilities arising out of the *Deepwater Horizon* oil spill, even though Transocean was not responsible for those liabilities under the underlying contract.[2] The broader question is whether an offshore energy-services contract can define the scope of additional-insured protection that is conveyed by a separate insurance policy, or whether any limitation must be in the policy itself.

In response to the court's adverse ruling last March, Transocean and its insurers petitioned the Court of Appeals to reconsider. In August 2013, the Court of Appeals did something unusual but not unprecedented: the Court ruled that *"this case involves important and determinative questions of Texas law as to which there is no controlling Texas Supreme Court precedent,"* so the Court withdrew its March 2013 opinion and "certified" what it considers to be the dispositive questions to the Texas Supreme Court. In effect, the federal Court of Appeals has asked the state's highest court to answer dispositive questions of state law (as opposed to federal law) before the federal court will resume its own deliberations.

The Texas Supreme Court accepted the certification, docketed the case as an appeal by BP,[3] and requested briefs from all parties. The case is now fully briefed and the Texas Supreme Court has just scheduled oral argument for 16 September 2014.

The federal appeals court certified *"the following determinative questions of Texas law to the Supreme Court of Texas."*[4]

1. Whether *Evanston Ins. Co. v. ATOFINA Petrochems., Inc.*[5], compels a finding that BP is covered for the damages at issue, because the language of the umbrella policies alone determines the extent of BP's coverage as an additional insured if, and so long as, the additional insured and indemnity provisions of the Drilling Contract are 'separate and independent'?
2. Whether the doctrine of *contra proferentem*[6] applies to the interpretation of the insurance coverage provision of the Drilling Contract under the *ATOFINA* case[7], given the facts of this case?

As is customary to allow the state court leeway in responding, the federal court disclaimed *"any intention or desire that the Supreme Court of Texas confine its reply to the precise form or scope of the questions certified."*

Although the certified questions are posed by the Court of Appeals, the parties answer the questions quite differently, and support their answers with contrasting rationales.

BP summarises the appeal as *"an insurance case governed by the plain language of the policies, and there is no language in the Policies — none whatsoever — that limits the scope of BP's insurance coverage for the Deepwater Horizon oil spill to the scope of Transocean's wholly separate and more limited commitment to indemnify BP in the Drilling Contract."*[8] In BP's view, *"indemnity and insurance are entirely separate forms of risk*

transfer," and the insurers are to blame if the scope of insurance coverage is broader than the scope of the contractual indemnity: *"If the parties had so intended, it would have been easy for Appellees, whose ranks include some of the world's most sophisticated insurers, to insert standard language into the Policies restricting coverage "only to the extent" of Transocean's indemnity commitment. They did not do so, and Insurers cannot rewrite the Policies to add those restrictions now."*[9]

In Transocean's view, the indemnity and insurance provisions are complementary, and the appeal *"concerns the interplay between Transocean's Insurance Policies and its Drilling Contract with BP. BP seeks additional-insured coverage for a liability that BP assumed in the Drilling Contract, namely, the liability for massive subsurface-originating pollution from the Macondo well oil release in the Gulf of Mexico."*[10]

Transocean's underwriters, who are potentially exposed if the court eventually rules in BP's favour, portray the appeal as involving a stranger to the insurance policy (BP) who seeks benefits not intended by it or by the named insured (Transocean) in the contract that triggered BP's additional insured status in the first place: *"the interested insurers do not seek to restrict the available coverage. Rather, this dispute is about whether Transocean, the named insured that paid the premiums for the policies at issue, is entitled to the coverage for which it bargained, or whether BP, an additional insured that bargained by separate contract with Transocean for limited benefit from that coverage, can claim the policies' coverage as its own, possibly leaving none for Transocean."*[11]

Several trade associations have also filed amicus curiae (friend of the court) briefs. In support of BP, the National Association of Manufacturers (NAM) argues that *"nothing on the face of the policy unambiguously limits the scope of additional insured coverage or clearly imports any potentially limiting language from the drilling contract."*[12]

In contrast, the International Association of Drilling Contractors (IADC) argues, *"The insurance provisions of drilling contracts are intended to support and complement the allocations of responsibility in the indemnity sections; they are not intended to overturn the indemnity provisions and render them worthless."*[13]

Most recently, B&G Risk Strategies LLC has also urged the Court to allow the underlying contract to be considered in circumstances where that contract is *"the condition precedent or prerequisite to coverage under [the additional insured] provision".*[14] B&G argues that *"Allowing the Additional Insured unrestricted access to the Named Insured's policy is not what the Named Insured agreed to provide in the underlying contract ... In fact, the contract between the Named Insured and the Additional Insured stated the exact opposite – that the Named Insured's obligation was only to name the third party as an additional insured for those liabilities for which the Named Insured had an obligation to indemnify the third party."*[15]

B&G also comments that *"It is not always practical or possible to adjust the policy language for a Texas-specific issue where the insurance program is being negotiated in different layers with insurers located all over the world, and where the policies are meant to operate seamlessly across multiple jurisdictions."*[16]

Uncertainty will reign until the Texas Supreme Court answers the certified questions and the federal Court of Appeals rules in the underlying case. Stay tuned. Until then, our closing admonition in the June 2013 Bulletin bears repeating: insurers would be well-advised to scrutinise their policy wording to ensure it places the intended limits on the scope of additional-insured coverage.[17]

For more information, please contact Emilie Bokor-Ingram, Associate, on +44 (0)20 7264 8463 or emilie.bokor-ingram@hfw.com, or your usual contact at HFW, or David Sharpe, Counselor at Law at Lugenbuhl, Wheaton, Peck, Rankin & Hubbard.

1 HFW Offshore Energy Bulletin. (June 2013) at http://www.hfw.com/Offshore-Energy-Bulletin-June-2013.

2 In re Deepwater Horizon – Ranger Ins. v BP P.L.C., 710 F.3d 338 (5th Cir. 2013), opinion withdrawn on rehearing by In re Deepwater Horizon – Ranger Ins. v BP P.L.C., 728 F.3d 491 (5th Cir. Aug. 29, 2013).

3 Texas Supreme Court docket no. 13-0670. The Texas Supreme Court's docket sheet, which contains links to the briefs and other filings, is publicly available at the following web link: http://www.search.txcourts.gov/Case.aspx?cn=13-0670.

4 In re Deepwater Horizon – Ranger Ins. v BP P.L.C., 728 F.3d t 500.

5 256 S.W.3d 660 (Tex. 2008).

6 Contra proferentem is a rule of contract interpretation according to which ambiguities are construed against the party that drafted the document. Id. at 499.

7 256 S.W.3d at 668.

8 BP's Reply Brief at 1 (Summary of Argument).

9 Id.

10 Transocean's Response Brief on the Merits at ix.

11 Brief of Certain Underwriters at Lloyd's at 2.

12 NAMS Amicus Brief at 4.

13 IADC Amicus Brief at 14.

14 B&G Risk Strategies LLC Amicus Brief at VI.A.

15 B&G Risk Strategies LLC Amicus Brief at VI.B.

16 B&G Risk Strategies LLC Amicus Brief at VI.E.

17 Article by Emilie Bokor-Ingram at http://www.hfw.com/Offshore-Energy-Bulletin-June-2013#page_2.

The pitfalls of exclusion clauses in oil and gas contracts

In *Glencore Energy UK Ltd v Cirrus Oil Services Ltd*[1], *Glencore* had agreed to sell blended crude oil to *Cirrus*. *Cirrus* planned to sell the crude oil on to a third party; however, that third party refused to accept the oil from *Cirrus* on the basis that it was blended. *Cirrus* in turn refused to accept the crude oil from *Glencore*.

Glencore claimed damages for Cirrus' refusal to accept the crude oil pursuant to s.50(1) of the *Sale of Goods Act 1979* (the Act). Where there is an available market, such damages are normally determined by the difference between the contract price and the price the seller could have obtained in the market (s.50(3) of the Act).

In defence, Cirrus relied on an exclusion clause in the alleged sales contract:

" ... in no event ... shall either party be liable to the other ... in respect of any indirect or consequential losses or expenses including ... loss of anticipated profits ... whether or not foreseeable."

Cirrus argued that Glencore's claim was a claim for loss of anticipated profit, and therefore excluded.

The Court's decision

The Commercial Court held that Glencore's claim for damages (contract price less market price) was not a claim for loss of profit (which would be calculated on the basis of contract price less cost price). The Court also found that this position was not affected by the fact that Glencore had been able to terminate its contract with its supplier without loss.

As the claim was not for loss of profit, it did not fall within the exclusion clause and consequently Cirrus' defence failed and Glencore's claim succeeded.

Conclusion

This case is another good example of the Court construing exclusion clauses very narrowly, and declining to find that a particular head of loss is excluded where the contract wording is not sufficiently clear.

Parties wanting to exclude a particular loss should therefore ensure that their contract terms are sufficiently clear and specific to achieve this aim.

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WILLIAM GIDMAN, ASSOCIATE

1 [2014] EWHC 87 (Comm)

Energy politics and new gas opportunities in Azerbaijan and Southern Europe

The Ukrainian crisis will strengthen EU leaders' resolve not only to see to the rapid completion of the Southern Gas Corridor, but also to support offshore oil and gas exploration in the Eastern Mediterranean.

Few will have forgotten the disputes between Ukraine and Russia which in 2006 led to Russia cutting off all gas supplies passing through Ukrainian territory (a situation repeated in 2009/2010). This was the catalyst for the European Council to seek a new EU energy and environment policy, the outcome of which was the EU Energy Security and Solidarity Action Plan, identifying the development of a Southern Gas Corridor to supply Europe with gas from Caspian and Middle Eastern sources.

Azerbaijan (the Shah Deniz gas field) is the primary source of gas for the Southern Gas Corridor. Shah Deniz was discovered in 1999 and is one of the world's largest gas-condensate fields, with 40 trillion cubic feet (over 1 trillion cubic metres) of gas in place. It is located on the deep water shelf of the Caspian Sea, 70km south-east of Baku, in water depths ranging from 50 to 500 metres. Shah Deniz is an unincorporated joint venture between the UK's BP, Azerbaijan's SOCAR, Norway's Statoil, Russia's Lukoil, France's Total, Iran's NICO and Turkey's TPAO, and is operated by BP on behalf of its consortium partners under a production sharing agreement.



There are some very interesting energy politics at play here. Apart from transporting Azeri gas into Europe, Azerbaijan is also looking to get a foothold in European energy distribution assets, having recently signed a deal with the Greek government – which HFW advised on – to acquire a two-thirds stake of DESFA for €400 million.

ALEXIS KYRIAKOULIS, PARTNER

On 28 June 2013, the Shah Deniz consortium partners announced TAP (the Trans Adriatic Pipeline), which will be approximately 870km in length and will connect with TANAP (the Trans Anatolian Pipeline) and the South Caucasus Pipeline, as the winner of the so-called "pipeline race" to transport the gas into Europe.

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Meanwhile in Europe itself, Cyprus is advancing its efforts to exploit the recently discovered Aphrodite gas field, which it hopes will help pull the country out of its economic crisis. Named after the goddess of love, the field could contain up to six trillion feet of cubic gas. Just 0.5 trillion cubic feet of gas could provide Cypriots with energy for 25 years, leaving ample reserves for export to Asia and Europe, according to Cyprus' Energy Minister Giorgos Lakkotrypis.

The idea that, apart from shale gas, Europe could also benefit from Mediterranean offshore gas is inching towards reality. Greece recently launched an international tender for a study to assess the feasibility of a proposed pipeline to transmit gas from Israel and Cyprus in an effort to reduce dependence on Russian supplies. The Eastern Mediterranean Pipeline is designed initially to carry 8 billion cubic metres a year of Israeli and Cypriot gas. It would stretch from Israel's Leviathan natural gas field to Greece and on to European markets through the IGI-Poseidon pipeline, led by Italian utility Edison and state-controlled Greek utility DEPA.

Of course, all these projects are hugely capital-intensive, and so the cash-strapped countries in Southern Europe will need to find ways to attract significant amounts of investment from oil majors, infrastructure funds, etc. if any of this is to become reality.

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Who bears the risk of supplying off-spec bunkers to supply vessels?

There has been much recent press expressing concerns about poor quality and off-spec bunkers as well as the impending cut of sulphur emission limits from 1 January 2015. These concerns have been echoed by Jens Maul Jørgensen, the new chairman of the International Bunker Industry Association, who recently described off-spec bunkers as a serious problem.

In the offshore industry, bunkers are currently often a greater expense than daily hire rates, meaning the supply of bunkers is a major financial commitment for charterers.

The standard liability position under the Supplytime forms is the "knock-for-knock" provision, whereby each party bears the risk and responsibility for injuries and losses affecting its own employees and equipment, i.e. "your people, your property, your problem".

Under Supplytime 89, any damage cause to a vessel's engine or machinery, and any time lost due to breakdowns, as a result of off-spec bunkers supplied by charterers would still be for owners' account. In the Supplytime 2005 form, in response to increasing claims due to off-spec bunkers, damage due to the supply of *"unsuitable"* bunkers is carved out of the knock-for-knock regime under clause 10(d). This places liability on the charterers for any *"unsuitable"* fuel used and supplied by charterers which causes damage to the vessel. *"Unsuitable"* is not a term of art or a defined term in the contract. However, in its explanatory notes, BIMCO has confirmed that charterers will be liable if they provide fuel that is contractually 'on-spec' but nevertheless causes damage to the vessel's engine (for example due to additives by the bunker suppliers).

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PAUL DEAN, PARTNER

In any event, both Supplytime forms include a "hazardous and noxious substances" clause making charterers always responsible for any losses, damages or liabilities suffered by owners caused by *"hazardous and noxious substances"*. It is arguable that bunkers, even if used as fuel rather than carried as cargo, fall within the IMO Convention on the Carriage of Hazardous and Noxious Substances by Sea 1996. In that case, any losses caused by defective bunkers would fall outside the knock-for-knock regime in both Supplytime forms.

Some commentators have suggested that the carve-out in the 2005 form and the possibility that bunkers could be "hazardous and noxious substances" cannot be right. It remains to be seen if this will be addressed in the next edition of Supplytime which BIMCO has recently announced is being undertaken. In the meantime, charterers need to be aware of their potential exposure.

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Conferences and events

Oil Council 2014 Africa Assembly
Paris
24–25 June 2014
Attending: Robert Follie, Tunde Adesokan and Guillaume Mezache

FLNG World Congress 2014
Singapore
25–26 June 2014
Presenting: Matthew Blycha

15th FPSO Congress 2014
Singapore
30 September–1 October 2014
Presenting: Paul Aston

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