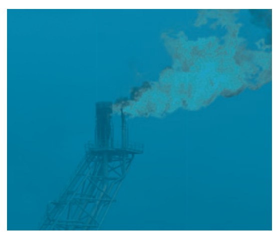
Offshore

June 2015



## Welcome to the June edition of our offshore bulletin.

In this edition of the bulletin we review the Polar Code, which is expected to come into force on 1 January 2017. This code will be mandatory and will apply to new vessels constructed on or after that date. Older vessels will be required to meet the code by their first intermediate or renewal survey (whichever comes first) after 1 January 2018.

We then review an English Court of Appeal case which concerned an industry standard for offshore wind turbines, which was wrong and, as a result, the 20 year design warranty provided was impossible to meet. The cost to rectify the problems was €26.25 million.

There is an increasing trend in England and elsewhere to regulate the offshore industry as a result of the Deepwater Horizon tragedy. In this respect we consider two new regulations which implement the EU Safety of Offshore Oil and Gas Operations Directive. The two regulations concern:

- The obligation on the owner/operator to prepare a "safety case".
- The granting and transfer of licences for offshore petroleum operations.

Finally we consider the conclusion of the Deepwater Horizon litigation in Texas between BP and Transocean (sometimes referred to as Ranger Insurance).

If you require any further information or assistance on any of the issues raised in this edition, please do not hesitate to contact any of the contributors or your usual contact at HFW.

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# Green light for the Polar Code

**The Marine Environment Protection Committee (MEPC) of the International Maritime Organization (IMO) met for its 68th session from 11-15 May 2015 at the IMO headquarters in London where it adopted the environmental element of the International Code for Ships Operating in Polar Waters (the Polar Code). MEPC also adopted associated amendments under the International Convention for the Prevention of Pollution from Ships (MARPOL), making the Polar Code mandatory.**

The adoption follows on from the approval of the safety element of the Polar Code in November 2014 by the Maritime Safety Committee (**MSC**), including related amendments to make it mandatory under the International Convention for the Safety of Life at Sea (**SOLAS**). As a result, vessels operating in the polar regions will have to comply with strict environmental and safety requirements, specific to the volatile conditions in the two polar regions.

Although the Polar Code certainly makes the first step in enhancing Arctic marine safety and environmental protection, critics remain disappointed that the code "does not go far enough".

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The Polar Code encompasses a full range of requirements, relating to design, construction, equipment, operational, training, search and rescue and environmental protection matters pertinent to vessels operating within polar waters. The latest environmental requirements which have been adopted include:

- Prevention of pollution by oil: discharge into the sea of oil or oily mixtures from any vessel is prohibited. Oil fuel tanks must also be separated from the vessel's outer shell.
- Prevention of pollution by noxious liquid: discharge into the sea of noxious liquid substances, or mixtures containing such substances, is prohibited.
- Discharge of sewage is prohibited unless performed in line with MARPOL Annex IV and requirements in the Polar Code.
- Discharge of garbage is restricted and only permitted in accordance with MARPOL Annex V and requirements in the Polar Code.

As this completes the process required to make the Polar Code mandatory, it is expected that the code will enter into force on 1 January 2017 and will apply to new vessels constructed on, or after, that date. Vessels constructed before that date will be required to meet the applicable requirements of the Polar Code by their first intermediate or renewal survey (whichever occurs first) after 1 January 2018.

Although the Polar Code certainly makes the first step in enhancing Arctic marine safety and environmental protection, critics remain disappointed that the code "does not go far enough". Environmental organisations have expressed their concern that the Polar Code fails to fully protect the South Pole, for example, as the regulations still permit raw sewage to be discharged beyond 12 nautical miles from land. There has also been concern that, while some vessels may carry the proper equipment, the Polar Code falls short at setting out exactly what should happen if an oil or chemical spill occurs. In addition, there is concern that heavy fuel oil use by vessels in the Arctic has not been prohibited (despite the fact that it has been banned in the Antarctic since 2010). It has been claimed that removing heavy fuel oil in the Arctic region would reduce black carbon emissions and the risk of oil spill damage, offering a dual benefit to the environment.

While these issues were not integrated by the IMO in the recent phase of the Polar Code (which was said to be specific to larger vessels such as oil tankers, bulk carriers and cruise liners), there should still be an opportunity for these issues to be addressed in phase two of the Polar Code which is expected to include additional categories of vessels such as yachts, fishing vessels and specialised craft.

Notwithstanding the criticisms, the Polar Code is a positive step forward for the shipping and offshore industries, in that it recognises the need to respond to the ever increasing number of vessels operating in polar waters, enhances the safety and environmental protection of these regions, and provides the international shipping world with a concrete set of mandatory provisions to bring those protections together.

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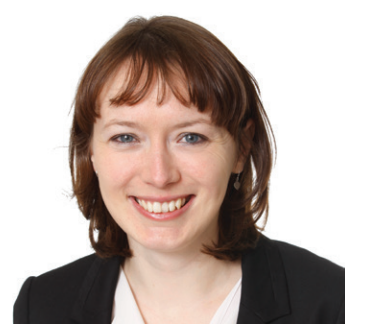
## Industry standard?

**The Court of Appeal[1] has held that a contractor which performed a contract in accordance with industry standards, as required by that contract, was not liable under a 20 year warranty for the design of wind farm turbines where there was an error in the applicable industry standard, resulting in hefty remedial costs being incurred.**

Højgaard contracted with E.ON that Højgaard would design, fabricate and install the foundations for turbines for a wind farm to be built in the Solway Firth at Robin Rigg. The contract included a requirement that Højgaard's design must accord with national and international rules and, in particular, an international standard for the design of offshore wind turbines published by classification society DNV and known as DNV-OS-J101 (**J101**). In addition, elsewhere in the contract, Højgaard warranted that the design would endure a lifetime of 20 years.

During 2009, while the wind farm was under construction, DNV realised that there was an error in an equation on which J101 was based, as a result of which the load-bearing capacity for turbine piles whose design complied with J101 was over-estimated by a factor of 10. As a result of this error, damage began to manifest itself in wind turbines built in compliance with J101, including wind turbines on the Robin Rigg wind farm. The cost of the remedial works at Robin Rigg was €26.25 million. E.ON and Højgaard agreed to proceed with those remedial works, but applied to the court to resolve the issue of which party was liable to pay for them.

1 MT Højgaard A/S v E.ON [2015] EWCA Civ 407



Although the facts of this case were unusual, the judgment highlights the need for clear contractual drafting so that, in the event something goes wrong, the allocation of liabilities is clear, reducing the risk of disputes.

JENNY SALMON, ASSOCIATE

The court had to consider how to interpret the 20 year design warranty in combination with the requirement to comply with J101 in circumstances where compliance with J101 would not yield a 20 year design life. In the High Court, the judge decided that the 20 year warranty was additional to, but not inconsistent with, the other obligations on Højgaard under the contract, including the obligation to comply with J101. Højgaard was therefore held liable for the remedial costs. Højgaard appealed the decision.

Applying general principles of contractual interpretation, the Court of Appeal considered what a reasonable person in the position of E.ON and Højgaard would have understood the two requirements to mean. It concluded that such a person would know that the normal standard required in the construction of offshore wind farms was compliance with J101 and that such compliance was expected, but not absolutely guaranteed, to produce a life of 20 years. Therefore, as Højgaard had complied with J101, they were not liable for the cost of the remedial works.

Although the facts of this case were unusual, the judgment highlights the need for clear contractual drafting so that, in the event something goes wrong, the allocation of liabilities is clear, reducing the risk of disputes. This is all the more important as, while the principles used by the English Courts to interpret contracts are well established, it is not always easy to predict the outcome when those principles are applied to a complicated factual scenario. For complex and innovative projects, clear contractual provisions are of vital importance.

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# Offshore oil and gas: regulatory update

**Changes to offshore safety regulations are estimated to cost offshore businesses around £193.4 billion: a worthwhile cost to prevent another Deepwater Horizon?**

On 19 July 2015, new regulations will come into force in England and Wales applying to all offshore operators and owners, aimed at preventing major offshore incidents. The regulations implement the EU Safety of Offshore Oil and Gas Operations Directive (**OSD**)[1]. It provides a high level of protection and safety for offshore workers and the marine environment. The EU adopted the OSD on 10 June 2013 following the 2010 Deepwater Horizon incident, and after a comprehensive review of existing offshore regulations.

The Health and Safety Executive (**HSE**) and the Department of Energy and Climate Change (**DECC**), working in partnership, have established the Offshore Safety Directive Regulator[2] (as the Competent Authority) to implement the regulations.

We focus on two of the new regulations to be implemented: the Offshore Installations (Offshore Safety Directive) (Safety Case etc.) Regulations 2015 and The Offshore Petroleum Licensing (Offshore Safety Directive) Regulations 2015. We consider the potential effects of the new regulations, and what the offshore industry can do to prepare for their implementation.

1 Directive 2013/30/EU on the safety of offshore oil and gas operations

2 See http://www.hse.gov.uk/osdr/index.htm

It is therefore essential that an owner/operator has a thorough understanding of the risks that the installation is exposed to, and what mitigation is available.

## Offshore Installations (Offshore Safety Directive) (Safety Case etc.) Regulations 2015

### "Safety case" obligations

An owner/operator of an installation must prepare a "safety case" which sets out an installation's safety and environmental management system and control system for major accident hazards. The particulars of the "safety case" are set out in schedules 6 and 7 to the regulations and include:

- A corporate major accident prevent policy (**CMAPP**).
- A safety and environmental management system (**SEMS**).

An owner/operator must also establish a verification scheme to ensure that the plant for the installation is suitable and remains in good condition.

If there is a major accident, or an immediate risk of such an accident, the owner/operator is obliged to inform the competent authority.

It is therefore essential that an owner/operator has a thorough understanding of the risks that the installation is exposed to, and what mitigation is available.

It should also be noted that UK registered companies are required to provide the competent authority with information about accidents outside the EU in which they, or their subsidiaries, are involved as licensees, operators or well operators.

## The Offshore Petroleum Licensing (Offshore Safety Directive) Regulations 2015

### Granting and transferring offshore licenses

These regulations govern the granting and transfer of licences for offshore petroleum operations. The licensing authority (DECC), before granting an offshore licence or consenting to transfer an offshore licence, must take into consideration the sensitivity of the marine environment, and the technical and financial capability of the prospective offshore licensee. This is to ensure that ecosystems and special conservation areas are protected, and also a comprehensive system is maintained to manage and control offshore major hazards.

Under the regulations, no person may conduct an offshore petroleum operation who is not an operator in respect of that operation. An operator can be appointed by offshore licensees or the licensing authority (in exceptional circumstances). An appointment of an operator may be terminated if the competent authority considers that the operator no longer adequately fulfils the requirements of the OSD.

### Obligations on offshore petroleum licensees/operators

By regulations 9 and 10, the offshore licensee will be financially responsible for action to be taken to prevent or remediate environmental damages.

Non-compliance with the regulations is an offence under the regulations, punishable by a fine. This puts greater pressure on operators to comply with their obligations.

### What next?

The regulations include transitional arrangements which, broadly, allow existing installations until 19 July 2018 to comply. In the meantime, industry responses to the new regulations have been largely positive, although concerns have been raised as to how the changes will be implemented.

Greater transparency and good corporate governance systems are aimed to help offshore operations to comply with their obligations. Offshore licensees, owners, and operators should therefore review their current systems so that they are well placed to adapt to the changes.

Government guidance is expected to be issued shortly, which will assist offshore licensees, owners, and operators to implement the changes to the current law, especially as the transitional arrangements are complicated[3].

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3 Draft guidance has been issued by the OSDR at http://www.hse.gov.uk/osdr/guidance-regulations.htm

## hfw The Ranger ends

**For those regular readers of the offshore bulletin who have been following the BP and Transocean saga (sometimes referred to as Ranger Insurance), which flowed from the Deepwater Horizon disaster, there has recently been a surprising development.**

As reported in our June 2014 bulletin (http://www.hfw.com/Offshore-Bulletin-June-2014), the Texas Supreme Court had accepted the case as an appeal by BP and requested briefs from all parties, with oral arguments scheduled for 16 September 2014. The Court had been asked to decide whether:

1. *Evanston Ins. Co. v ATOFINA Petrochems, Inc.*[1], 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. The doctrine of *contra proferentem*[2] applies to the interpretation of the insurance coverage provision of the drilling contract under the ATOFINA case, given the facts of this case?

In a judgment issued on the 13 February 2015[3] the Texas Supreme Court held that while BP was an additional insured under Transocean's policies, this was only to the extent that Transocean had assumed responsibility in the drilling contract. BP was therefore not covered under the Transocean policies for the subsurface pollution because BP, not Transocean, had assumed liability for such claims.

The court chose not to answer the second question concerning the doctrine of contra proferentem as, based on their analysis, it was unnecessary.

In light of this result BP applied for a Motion for Rehearing on 22 April 2015. Then on the 27 May 2015 BP made an application to the Supreme Court of Texas withdrawing the Motion for Rehearing as a confidential settlement agreement had been reached. Further, it was agreed that the parties would move the United States Court of Appeals for the Fifth Circuit to dismiss the appeal In re Deepwater Horizon[4].

We have no way of knowing the details of the confidential settlement agreement, but, as the rehearing did not occur, it is the Texas Supreme Court's opinion of 13 February 2015 that remains the controlling precedent.

Ultimately the lesson to be learnt in relation at least to the insurance aspect of this incident is that all parties need to check the terms of the insurance to ensure that:

1. Appropriate cover is in place.

2. Any limits to the cover are clear.

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To read our previous articles concerning Ranger insurance, please go to: http://www.hfw.com/Offshore-Bulletin-March-2015 and http://www.hfw.com/Offshore-Bulletin-June-2014.

1 256 S.W. 3d 660 (Tex. 2008)

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

3 Texas Supreme Court's docket sheet. No. 13-0670

4 No. 12-30230

## Conferences and events

**India Salvage and Wreck Removal Conference**
Mumbai
2-4 July 2015
Presenting: Dominic Johnson

**Chamber of Shipping Seminar, Human Element and Accidents**
London
7 July 2015
Presenting: Kaare Langeland and Toby Stephens

**15th Energy in Western Australia Conference**
Perth
26-27 August 2015
Presenting: Alistair Mackie
Attending: Simon Adams and Caroline Brown

**5th Global FPSO Forum**
Galveston
15-17 September 2015
Presenting: Paul Dean and Chanaka Kumarasinghe

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