Risks Assumed in Drilling Contracts – Global Comparisons

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How certain risks
Risks Assumed in Drilling Contracts – Global shift
Comparisons in different drilling contracts
BACKGROUND

- Past Decade - Insurance claims involving drilling rigs
- Noted US-Canada differences in contract wording
- 2003 SPE Paper

**SPE Paper Number 79895**

*Risks Assumed In Drilling Contracts: Global Comparison and Case Histories*

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What do companies do with risk?

- Absorb / self-insure

- Contract out of risk by transferring to another party
  - Transfer to insurance company
  - Transfer to party in contract
DRILLING CONTRACT PARTIES

- Operator or “Operator Group”
- Contractor or “Contractor Group”
- Parties outside of the contract are often referred to as “Third Parties”
The “Liability and Indemnity” section in most drilling contracts allocates responsibility for loss of equipment, personnel injury, and pollution.

Each party responsible for their own losses subject to a “Standard of Care.”
STANDARD OF CARE

- Standards of Care include
  - CANADA (CAODC/CAPP) - regardless of fault, or howsoever caused
    - If not specifically dealt with in the contract each party is responsible for loss or damage resulting from their own negligent or wilful acts or negligent or wilful omissions.
  - US (IADC) - regardless of when or how such damages or destruction occurs; and without limit and without regard to the cause or the negligence or any party or parties, whether single, joint or concurrent, active or passive.
  - MANUSCRIPT CONTRACTS – some manuscript contracts we have seen will allocate responsibility for what is normally an Operator’s risk to a Contractor if the cause was due to the Contractor’s negligent or willful actions.
STANDARD OF CARE – CASE HISTORY

- YEAR: 1990  PLACE: UNITED STATES
- Operator retained mud engineer as subcontractor
- Contract specified Operator responsible for rig if damage caused by Operator gross negligence
- Mud Engineer fell asleep and missed pressure increase
- Blowout ensued. Operator responsible for rig.
STANDARD OF CARE

- Some contracts do not provide definitions, while others do.
- CANADA (CAODOC/CAPP) does not define what it means by “negligent or wilful” in provisions 10.10 and 10.11.
- OFFSHORE MANUSCRIPT
  - Contractor responsible for “the first US $5,000,000 per occurrence or series of occurrences arising out of or relating to any single event of pollution or contamination resulting from the Gross Negligence or Wilful Misconduct of Contractor Group during the conduct of the Work.”
  - “Gross Negligence” or “Wilful Misconduct” means either intentional, conscious or reckless behaviour that constitutes in effect a wilful and wanton disregard for harmful, avoidable and foreseeable consequences.
SPECIAL RISKS

- Unsound Location
- Down-hole Equipment
- Deliberate Well Firing
- Damage Caused by Corrosive Fluids
- Well Control (Blowout)
- Operator Takeover
- Loss of Hole
- Underground or reservoir damage
- Consequential loss (loss of hire, delay, loss of revenue)
“10. In the event subsurface conditions cause a cratering ... of the location surface ... and loss or damage to the rig or its associated equipment results therefrom, Operator, without regard to other provisions of this contract, including Paragraph 14.1, reimburse Contractor to the extent not covered by Contractor’s insurance, for all such loss or damage including paying force majeure rate during repair...” IADC US Daywork Land (1994)
In contrast, Canada’s standard contract requires the Operator pay all rig damages, not just the uninsured portion.

Canada’s contract protects the Contractor in cases where there is third party damage.

No cross reference to other provisions in the contract.

Canada’s contract does not, however, require the Operator pay day rates during repair.

“10.5 ...Operator shall be responsible for preparing a sound location fully capable of supporting the Contractor's Equipment, ... Operator has superior knowledge of the Drilling Site and shall advise Contractor of any subsurface conditions including, but not limited to, mines, caverns, streams or springs that could result in the cratering or the shifting of the location surface during the course of drilling or completing the Well. If any such conditions are encountered and result in the cratering or shifting of the location surface, Operator shall be liable for and shall defend and indemnify Contractor's Group for all actions, claims, losses, costs, damages and expenses resulting from such conditions, including, without limitation, any loss of, damage to, or destruction of Contractor's Equipment and payment of any costs necessarily incurred to protect Contractor's Equipment and Contractor's personnel, regardless of the negligence or other fault of any member or members of Contractor's Group or howsoever arising. “
“605 (b) Operator will be responsible for the furnishing of any information relating to seabed, soil or subsurface conditions that Operator possesses. However, in the event Operator possesses such information and makes it available to Contractor, Contractor understands and agrees that Operator assumes no liability for, and does not warrant, the accuracy or currency of any information provided to Contractor.”

This wording is favorable to the Operator.
UNSOUND LOCATION – CASE HISTORY

YEAR: 1948  PLACE: ALBERTA
## UNSOUND LOCATION – CASE HISTORIES

- **Leduc, Alberta – 1948 - Atlantic Oil Company** – lost circulation and high flow rates caused the ground under the surface casing to rupture and the rig collapsed into a crater shooting up sparks and igniting the oil flames were 150 m high.

- **Cessford, Alberta – 1977 - Gamma Resources** – rig completely disappeared down a crater after high pressure gas broke the formation at the shallow surface casing shoe.

- **Lake Peigneur, Louisiana – 1980 - Texaco** - drilled into an arm of the Diamond Crystal salt mine 1,228 feet below Lake Peigneur; the lake, rig, platform, eleven barges, the Delcambre Canal, and lakeside property went down the vortex into the salt mine.
DOWN-HOLE EQUIPMENT – CASE HISTORY

- United States, 1997

- During drilling operations Contractor’s drill pipe and in-hole equipment valued at USD 1.5 million was lost in the hole due to Contractor’s sole negligence.

- Contract provisions differ with respect to which party would pay for this damage.
DOWN-HOLE EQUIPMENT

- Two different contract wordings change the outcome of responsibility:

1. “Operator shall be responsible for and hold harmless and indemnify Contractor for loss or destruction of or damage to Contractor's drill pipe, drill collars, subs, reamers, bumper subs, stabilizers and other in-hole equipment....” (no Standard of Care) IADC Offshore US 1997

2. “Operator shall be responsible for and hold harmless and indemnify” Contractor for Claims (normal wear excepted) for Contractor's drill pipe, drill collars,... and other in-hole equipment when such equipment is being used in the hole below the rotary table ... and only in the event such damage, loss or expense is not caused by the sole or gross negligence or willful misconduct of Contractor or Contractor's Personnel....” OFFSHORE GULF OF MEXICO (Manuscript)
DELIBERATE WELL FIRING – CASE HISTORY

- YEAR: 1999
- PLACE: BRITISH COLUMBIA
DELIBERATE WELL FIRING – CASE HISTORY
DELIBERATE WELL FIRING

- “Operator shall at all times assume all of the risk of and be solely liable for any loss of, damage to or destruction of Contractor's Surface Equipment ...:
  
  (c) caused by Operator intentionally firing a Well in order to gain control of any blowout or wild well, except in circumstances where Operator has intentionally fired the Well:
    
    (i) in good faith and acting reasonably to assure the safety of on-site personnel or other persons or to prevent the occurrence of environmental damage; or,
    
    (ii) when required to do so by a regulatory authority of competent authority;

regardless of the negligence or other fault of Contractor's Group ...”.

CAODC/CAPP 2001
DELIBERATE WELL FIRING

- No known occasion where a safety or regulatory condition was not met

- The only way the responsibility for the rig would shift from the Contractor to the Operator is if the well was lit without a good reason

- Nevertheless, the presence of this provision in the contract would avoid finger-pointing and the potential for litigation
Litigation (Canada – CAODC CAPP Contract)

- Previous version of CAODC contract in place
- Well kicked when tripping out of the Mannville; crew initially kept tripping
- Kick to surface in 20 minutes
- Well could not be shut in
- Deteriorated; 15 hours later, rig ignited

YEAR: 2000  PLACE: Alberta
Contractor sued Operator for loss of rig and economic loss $4.5M

Details of the cause and the contract wording were the focus of the Contractor’s allegations

Contract “Knock-for-Knock” – Operator responsible for well control costs, Contractor responsible for loss of rig

Operator counter-sued for well control costs $6M (Legal Strategy)
LITIGATION – CASE HISTORY

- Contractor focused on provision 14.1 “Contractor and operator respectively agree to comply with all laws, rules and regulations, federal, provincial, municipal and territorial, which are now or may become applicable to the drilling and completion of the Well referred to in this Agreement arising out of the performance of such work.”

- An ERCB Interim Directive for the area required operators maintain a minimum overbalance of 1400 kPa before tripping out of the hole after penetrating the Mannville formation.

- The Operator’s defense team submitted that 1400 kPa would have been too high given the actual wellbore geometry.
### LITIGATION – CASE HISTORY

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<tr>
<th>Contractor Allegations</th>
<th>Operator Allegations (Counter Claim)</th>
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<tr>
<td>Operator failed to comply with ERCB directive, having inadequate mud weight for tripping.</td>
<td>Contractor failed to detect kick early and once detected, failed to stop tripping and run back to bottom.</td>
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<td>Contractor’s counsel submitted that Provision 12.1 (Contractor responsible for rig regardless of fault) could not be read in isolation of Provision 14.1 (Operator to comply with all rules and regulations).</td>
<td>The well control process was compromised by the drill bit being significantly off-bottom.</td>
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LITIGATION – CASE HISTORY

- Discontinuance of Actions were agreed the day before trial, preserving the “Knock-for-Knock” agreement.

- While the strength of the agreement was not tested in Court, a new provision was introduced into the Canadian contract in 2001 and will help to prevent similar disputes.
This clause was introduced in the 2001 CAODC/CAPP Standard Contract shortly after the blowout:

“10.13 For greater clarity, Contractor and Operator acknowledge and agree that:

(a) the purpose of this Article X is to allocate contractually between Contractor and Operator certain of the risks, responsibilities, and potential losses or liabilities associated with the operations and activities involved in drilling a Well under a Drilling Program; and,

(b) such allocation shall prevail in the place and stead of any other allocation of risks, responsibilities, or potential losses or liabilities that might be made on the basis of the negligence or other fault of either party or howsoever arising or any other theory of legal liability and notwithstanding the breach or alleged breach by either party of any provision of the Drilling Program not included in this Article X.”
CONCLUSIONS

- Contracts contain the key to risk assumption and the circumstances that can shift responsibility from one party to another.

- Contract variations across the globe have differences in risk allocation and these can lead to surprises – avoid by awareness.

- Clarity, definitions, cross-references... all help to avoid disputes.

- Operational and engineering decisions can result in circumstances that shift responsibility (notably - the special risk of unsound location).
Thank You

Questions?

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