

February 18, 2011

## Presidential Commission Recommends Significant Changes to Offshore Energy Production Practices, Regulation in Gulf of Mexico

On January 11, 2011, the National Commission on the BP Deepwater Horizon Oil Spill and Offshore Drilling (the "Commission"), which was created by President Obama to, among other things, recommend reforms to offshore energy production practices and regulation, issued its final report (the "Report").<sup>1</sup>

The Report makes certain significant recommendations, including the adoption of a combination of (i) prescriptive regulations at least as rigorous as the most rigorous regulations in effect in any other offshore field, enforced by a well-funded, independent governmental agency, and (ii) a safety and environmental management system emphasizing regular auditing and continuous improvement, based on the system currently in use in the North Sea offshore fields, implemented by an industry dedicated to development of a new safety culture.

To the extent that the Report's recommendations are adopted, its calls for higher fees, technological improvements, increased data gathering and increased worker training are likely to translate into a higher cost of doing business in the Gulf of Mexico. Companies with experience in operations off the east coast of Canada and in the North Sea may have some advantage in terms of implementation of the recommended safety and environmental management system.

On January 26, 2011, the co-chairmen of the Commission, William Reilly, former head of the U.S. Environmental Protection Agency, and Bob Graham, former Democratic Senator from Florida, testified jointly about the Report in back-to-back hearings of the House Committee on Natural Resources and the Senate Committee on Energy and National Resources. In their joint opening statement to each Committee, Reilly and Graham stated that "[d]rilling in deepwater does not have to be abandoned. It can be done safely," but cautioned that, as the Report concludes, safe drilling requires an overhaul of industry practice and government regulation.

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<sup>1</sup> The Report can be found at  
[https://s3.amazonaws.com/pdf\\_final/DEEPWATER\\_ReporttothePresident\\_FINAL.pdf](https://s3.amazonaws.com/pdf_final/DEEPWATER_ReporttothePresident_FINAL.pdf).

The Report's conclusions and recommendations were generally endorsed by Committee Democrats in the House and Senate, and House Democrats have introduced legislation designed to implement the majority of the Report's recommendations.<sup>2</sup>

Given the Republican control of the House, however, the legislation is unlikely to advance in its current form. Doc Hastings, a Republican from Washington State and the Chairman of the House Committee on Natural Resources, cautioned against "a rush to judgment or a rush to legislate." In response to Reilly and Graham's testimony, House and Senate Committee Republicans also voiced concerns about current conditions amounting to an effective moratorium on new drilling in the Gulf and off the north coast of Alaska, about waiting for the results of other ongoing investigations of the event, and finally about the credibility and predisposition against drilling of the members of the Commission.

While certain of the Report's recommendations could be implemented without legislation, by means of new regulations, crucial changes, like (i) enactment of higher fees on the industry to fund environmental reviews, (ii) independent, stable funding for governmental regulators, (iii) more funding for oil spill response research and development, and (iv) increases in the liability cap for oil companies under the Oil Spill Act, must be made through legislation.

In response to the Report, the American Petroleum Institute has stated that the industry has already taken significant action to improve safety in offshore oil and gas exploration and production consistent with the Report's recommendations, and is in the process of creating an industry safety program, based on API Recommended Practice 75, discussed below, which includes independent third party auditing. The Financial Times reported on January 31, 2011 that a working group of executives of and advisers to leading oil companies are preparing a plan, that could be launched within weeks, to create a safety organization for deep water drilling. It is not yet clear whether the organization will be part of the American Petroleum Institute.

Following is a more detailed summary of the Report's recommendations relating to improvements to industry practices and the relevant regulatory structure and practices.

**Recommendations for Industry.** The Report observes that, due to the fragmented nature of responsibility in deepwater drilling, "operating safety in this environment... demands a safety culture that encompasses every element of the extended drilling services and operating industry." The Report identifies certain safety programs implemented in connection with oil and gas exploration and production elsewhere in the world as creating the desired safety culture, for example, the Safety and Environmental Management System (SEMS) employed in

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<sup>2</sup> The full text of the proposed legislation, titled "Implementing the Recommendations of the BP Oil Spill Commission Act of 2011," can be found at [http://democrats.resourcescommittee.house.gov/sites/democrats.resourcescommittee.house.gov/files/2011-01-26\\_BPCommissionBillText\\_0.pdf](http://democrats.resourcescommittee.house.gov/sites/democrats.resourcescommittee.house.gov/files/2011-01-26_BPCommissionBillText_0.pdf). A summary of the legislation can be found at [http://democrats.resourcescommittee.house.gov/sites/democrats.resourcescommittee.house.gov/files/2011-01-26\\_SummaryOfDemocraticSpillResponseBill.pdf](http://democrats.resourcescommittee.house.gov/sites/democrats.resourcescommittee.house.gov/files/2011-01-26_SummaryOfDemocraticSpillResponseBill.pdf).

the North Sea and off the east coast of Canada and Shell's 'safety-case' worldwide risk-management approach to regulation (regardless of applicable local requirements).

To support the desired safety culture, the Report recommends an industry safety institute, independent of the companies in the industry, which would develop an initial set of safety and spill response standards benchmarked against global best practices, and supported by an industry-wide commitment to rigorous auditing and continuous improvement. The Report identified the API's Safety and Environment Management Plan (SEMP) Recommended Practice 75, based on the North Sea field's SEMS and incorporated by reference in the new workplace safety rules issued in 2010 by the Department of the Interior ("DOI"), as a reasonable starting point for the standards. The Report also recommends that companies require that their contractors and service providers comply with these standards.

**Recommendations for Regulators.** The Report envisions regulatory reform working in cooperation with the changes in industry safety practices to improve safety and spill response in the Gulf of Mexico's offshore oil and gas exploration and production industry.

As it did with respect to industry safety culture, the Report points to regulations governing operations in the North Sea field as an appropriate model. In the North Sea, the Report found that "prescriptive regulations are supplemented by the requirement that companies demonstrate to the regulator that they had undertaken a thorough assessment of risks associated with an activity and they had adequate safety and risk management systems to address those risks." In effect, the Report recommends that a SEMS comparable to that employed in the North Sea should be made mandatory in the Gulf of Mexico. The Report further recommends that risk assessment and management tools should be systematically updated to keep up with changes in technology, practices and risks in oil and gas exploration and production in the Gulf. The risk assessments should require development of a coordinated plan to manage risks, integrating all involved contractors in the safety management system. The Report recommends a 'continuous improvement' approach, including requiring regular (every 3-5 years) compliance audits of oil and gas exploration and production facilities in the Gulf as part of the SEMS.

The Report also notes the importance of comprehensive and continued information gathering, e.g., tracking and analyzing offshore incidents, safety trends and lagging and leading safety indicators, and recommends more detailed and rigorous reporting standards to that end.

The Report approves of the recent reorganization of the Minerals Management Service (MMS), the agency within the DOI that was primarily responsible for regulating offshore oil and gas operations, into three offices, responsible respectively for leasing and environmental science, for offshore safety and environmental enforcement, and for managing natural resource revenues. The Report notes that, after the blowout, the MMS issued a SEMP which resembled the North Sea model, and the DOI promulgated additional regulatory reforms on September 30, 2010, which addressed well casing and cementing, blowout preventers, safety certification, emergency response and worker training. The Report finds these reforms beneficial, but concludes that further regulatory reform should be implemented.

For example, the Report suggests that the regulations governing offshore operations in the Gulf should be at least as rigorous as those governing operations in the North Sea and off the

east coast of Canada and should be updated regularly based on a review of standards prevailing in other offshore oil and gas operations.

The Report emphasizes the importance of assuring the independence and integrity of governmental institutions and assuring that the governmental regulators have sufficient resources to carry out their tasks. To this end, the Report recommends that an independent agency be created within the DOI with enforcement authority over all aspects of offshore drilling safety, as well as structural and operational integrity of all offshore energy production facilities, including permit approval, inspections and audits, determining lease eligibility, approving environmental mitigation activities pursuant to the National Environmental Policy Act ("NEPA"),<sup>3</sup> collecting and analyzing data, promulgating prescriptive regulations, conducting technical review of leasing programs and spill response and containment plans, and investigating all accidents and other significant events.

The Report suggested that the necessary funds for the activities of this agency be generated through increased fees on the oil and gas industry, authorized by Congress and/or the DOI.

Among its specific recommendations are revision and strengthening of NEPA policies and practices in the offshore drilling context, through, e.g., developing an applicable NEPA handbook for regulators and requiring environmental impact statements in more circumstances, e.g., for five year lease plans and for specific lease sales in high risk areas, reducing the area covered by leases, allowing 60 days, not 30, for the agency's approval of exploration plans, with the clock running from a completed application, and establishing a framework for long-term coastal and marine spatial planning.

The Report recommends strengthening oil spill response, planning and capacity, through developing procedures for responding to spills of national significance, augmenting the National and Regional Response Teams, strengthening state and local involvement, increasing research and development expenses for oil spill response technology, developing new regulations to govern the use of dispersants, and ending the use of offshore barrier berms in spill response.

In order to improve well-containment technologies, the Report recommends improving source control expertise through governmental research, developing the ability to make accurate flow rate estimates, requiring offshore operators to provide detailed plans for source control as part of oil spill response plans, and implementing a more robust well design and approval process (requiring operators to demonstrate that (a) well components are equipped with sensors or other tools to obtain accurate diagnostic information and (b) wells are designed to mitigate risks to integrity during post-blowout containment efforts) .

In order to ensure financial responsibility of operators, the Report recommends increasing limits on responsible party liability and financial assurance requirements, increasing limits on

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<sup>3</sup> NEPA mandates procedures, including in some cases preparation of an environmental impact statement, for assessing the potential environmental impacts of certain federal actions, including certain permitting decisions, and procedures for mitigating identified environmental impacts.

damage payments under the Oil Spill Liability Trust Fund, improving auditing and monitoring of risk, and reviewing and, if necessary, improving the existing claim process.

The Report recommends promoting Congressional engagement to ensure responsible offshore drilling, through additional Congressional oversight of offshore safety and environmental risks, annual oversight hearings on the state of technology, application of process safety and environmental protection by appropriate Congressional hearings, and submission by each of the Secretary of the Interior and the Inspector General of the DOI of an annual report to the public on offshore energy development activities.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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