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Fossil Fuels | Oil

BP Reaches \$18.7 Billion Agreement to Settle Deepwater Horizon Spill

Agreement represents the largest fine of its kind on a single entity in U.S. history and parallels numerous regulatory reforms to address offshore drilling safety

June 20, 2015

Policy Brief

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Key Takeaways:

- BP agreed to settle all federal, state and local claims for \$18.7 billion, with payments to be spread over 18 years
- The agreement increases BP's financial certainty, but its reduced cashflow could lead the company to become a takeover target in the current low oil price environment
- New draft regulations would establish design and operational requirements for critical well control equipment used in offshore oil and gas drilling operations

Entities Mentioned:

- Bureau of Ocean Energy Management
- BP Plc
- Bureau of Safety and Environmental Enforcement
- Congressional Research Service
- Department of Agriculture
- Department of the Interior
- Department of Justice
- Environmental Protection Agency
- Gulf Coast Ecosystem Restoration Council
- Halliburton
- National Oceanic and Atmospheric Administration
- Texas Commission on Environmental Quality
- Transocean Deepwater Inc
- U.S. Coast Guard

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[New Offshore Oil Regulations Respond to Key Failures of Deepwater Horizon Spill](#)

[New Oil Economics Drive Export and Tax Debate](#)

Insight for Industry – BP’s \$18.7 Billion Fine Largest in U.S. History

On July 2, 2015, the U.S. Department of Justice (DOJ) announced that BP agreed to pay approximately \$18.7 billion to settle federal and state claims over the 2010 Deepwater Horizon oil spill disaster in the Gulf of Mexico (GOM). If approved by court, the agreement would result in the largest civil settlement with a single entity in U.S. history, though the figure is billions less than was originally sought. BP would pay the amount over 18 years in installments of approximately \$1.1 billion per year, and would take BP’s total liabilities related to the oil spill to \$54 billion.

BP will pay penalties over 18-year period

After the 2010 Deepwater Horizon oil well blowout, which killed 11 oil workers and caused 4.9 million barrels of oil to spew into the ocean over an 87-day period, BP was faced with a range of potential penalties under the Clean Water Act (CWA). Court decisions since September 2014 ruled that BP was grossly negligent and was responsible for spilling more than 3 million barrels of oil into GOM, causing the company to face up to \$13.7B in CWA penalties. Under the July 2 settlement, BP would pay \$5.5B over 15 years and the remainder will cover environmental and economic claims. That figure is much closer to the \$3.7 billion BP originally set aside for CWA penalties than the \$13 billion sought by the federal government.

The agreement removes uncertainty for oil companies and resolves the unknowns in BP’s accountabilities for the Deepwater Horizon oil well blowout. The settlement’s 18-year time span serves to mitigate impacts to BP’s cash flow. BP expects the settlement to add \$10B to the \$44B it has reserved for spill-related costs. The settlement would end five years of litigation over the oil spill tragedy and enable the federal and state governments to invest in billions to advance efforts to restore the Gulf Coast environment and economy. According to BP’s Chief Executive Officer, Bob Dudley, the agreement provides BP with greater clarity and business certainty, allowing the company to continue assessing up to 50 oil and gas projects around the world. However, it remains to be seen how the penalties will impact BP’s ability to grow its oil production while maintaining its dividend payments to shareholders. Merger and acquisition activity in the oil sector has been tempered in the wake of Shell’s \$70 billion takeover of BG Group, however, other major oil companies, such as ExxonMobil, could look to make a bid for BP, given that the penalties will be particularly costly in the current low price oil price environment.

Oil price downturn and size of penalties has increased speculation that BP could become takeover target

BP to Settle Civil Claims for the Deepwater Horizon Oil Spill over 18 Years

BP’s July 2 agreements with the federal government and five states – Alabama, Florida, Louisiana, Mississippi, and Texas – include CWA civil penalties, natural resource damages (NRD), and economic claims of impacted state and local governments. The settlement – subject to a consent decree, public comment process, and court approval – would address outstanding federal and state claims resulting from the Deepwater Horizon disaster, ending five years of litigation. The NRD, CWA, and state claims will be made at the rate of approximately \$1.1B per year for most of the payment period.

The preliminary settlement is the result of litigation by DOJ and several federal agencies including the U.S. Coast Guard, Environmental Protection Agency (EPA), National Oceanic and Atmospheric Administration (NOAA), Department of the Interior (DOI), and Department of Agriculture (USDA). The settlement consists of:

- \$5.5B CWA penalty

- \$8.1B in NRD including \$1B that BP previously committed for early restoration
- \$700M to specifically address any future NRD unknown at the time of the agreement and to assist in adaptive management needs
- \$5.9B to settle claims by state and local governments for economic damages caused by the spill
- \$600M in total for other claims, including reimbursement of NRD assessment costs and unreimbursed federal expenses due to the spill

Eighty percent of the CWA penalty will go to restoration efforts in the affected states pursuant the Resources and Ecosystems Sustainability, Tourist Opportunities, and Revived Economies of the Gulf Coast States Act (RESTORE Act). The NRD payment will fund Gulf restoration projects as designated by the federal and state NRD trustees. According to BP, the agreements would increase its cumulative pre-tax charge associated with the oil spill incident by approximately \$10 billion from \$43.8 billion at the end of the first quarter.

BP's costs related to oil spill will exceed \$50 billion

BP Agreement Ends Years of Litigation With Federal and State Governments

Litigation started immediately in the aftermath of the Deepwater Horizon oil spill. On December 15, 2010, DOJ filed a civil and criminal suit against BP, Transocean and Halliburton for CWA violations in the U.S. District Court for the Eastern District of Louisiana. The case was consolidated with lawsuits filed by state governments, individuals, and companies under Multi-District Litigation docket MDL No. 2179 before U.S. District Judge Carl Barbier. In 2011, BP agreed to pay \$1 billion to support early restoration projects in the GOM to address damages caused by the spill.

In November 2012, the U.S. District Court in the Eastern District of Louisiana, charged BP with 11 felony manslaughter charges, obstruction of Congress, and violations of the CWA and Migratory Bird Treaty Acts. BP and DOJ agreed to a criminal penalty settlement of approximately \$4 billion, which was approved the court in January 2013. In December 2012, the court approved a \$525 million settlement between BP and the Securities and Exchange Commission (SEC) in civil securities fraud charges, including statements concerning the leaking well's estimated flow rate.

In February 2012, DOJ and MOEX Offshore 2007 LLC agreed to a \$70 million civil penalty settlement, with an additional \$20 million in supplemental environmental projects. At the time of the 2010 oil spill, MOEX owned approximately 10 percent of the Macondo well lease.

In November 2012, EPA announced suspension of BP Exploration and Production, Inc. and 25 BP entities from certain future contracting activities, including government procurement contracts, due to criminal conviction in the Deepwater Horizon case. BP did not participate in a November 2012 lease sale administered by DOI. In March 2014, EPA lifted the suspension and debarment after BP agreed to safety, ethical, and corporate governance obligations.

BP was not allowed to participate in a November 2012 offshore lease sale

In January 2013, DOJ announced civil and criminal penalty settlements with Transocean, the owner and operator of the Deepwater Horizon drilling rig. In the civil settlement, Transocean agreed to pay \$1 billion, of which 80 percent is earmarked for the Gulf Coast Restoration Trust Fund pursuant to the RESTORE Act and the remainder to the Oil Spill

Liability Trust Fund. In the guilty plea agreement for criminal charges, Transocean agreed to pay \$400 million.

Three-Phase Court Trial Clarifies Legal Risks

The U.S. District Court in the Eastern District of Louisiana pursued a three-phase trial to ascertain the liabilities of responsible parties, quantify the amount of oil spilled, and determine CWA penalties.

On September 4, 2014, the court issued findings for the Phase I trial, taking into account the unique risks of deep-water drilling and omissions by responsible parties. The court ruled that the oil spill was the result of BP's "gross negligence or willful misconduct." It apportioned 67 percent liability to BP, 30 percent to Transocean, and 3 percent to Halliburton. It held BP's conduct as reckless and that of Transocean and Halliburton as negligent.

BP determined to be 67 percent liable for oil spill

On January 15, 2015, the court issued its findings for the Phase II trial, taking into account the conduct to stop the spill (source control) and the quantity of oil actually discharged into GOM (quantification). The court found that 4 million barrels of oil released from the reservoir; after deducting the Collected Oil from this amount per the parties' stipulation, in order to calculate the maximum possible civil CWA penalty, the court determined that 3.19 million barrels of oil discharged into GOM.

The final Phase III trial aimed to determine the amount of civil penalties taking into account the penalty factors enumerated under CWA. The U.S. sought the maximum civil penalty of up to \$13.7 billion unless mitigating circumstances exist.

Ongoing Gulf Coast Restoration Activities

According to the Congressional Research Service (CRS), BP has spent more than \$14 billion in cleanup operations and paid more than \$15 billion to the federal, state and local governments, and private parties for economic claims and expenses, including reimbursements for spill-related response costs. To date, settlements from responsible parties total to approximately \$6 billion. BP agreed to pay \$1 billion to support early restoration projects. In December 2012, the court approved a settlement agreement between BP and many plaintiffs establishing a court-supervised program to award economic claims from individuals and businesses, but does not involve governments, shareholders, or drilling moratorium-related claims. Except for \$2.3 billion limit for seafood compensation, the settlement is not capped; as of March 31, 2015, the settlement program had awarded more than \$5 billion.

In July 2012, the President signed into law the RESTORE Act, which established the Gulf Coast Ecosystem Restoration Council. The RESTORE Act dedicates 80 percent of administrative and civil penalties related to the Deepwater Horizon spill to the Gulf Coast Restoration Trust Fund to support programs, projects, and activities that restore and support the Gulf Coast environment and economy. The Department of the Treasury is responsible for the RESTORE Act compliance and auditing procedures and administers two grant programs – Direct Component and Centers of Excellence Research Grants Program (Figure 1). The Direct Component sets aside 35 percent for eligible activities proposed by the Gulf Coast states and the Comprehensive Plan Component sets aside 30 percent, plus

half of interest earned on Trust Fund investments, to be managed by the Gulf Coast Ecosystem Restoration Council. The Spill Impact Component allows entities representing the Gulf Coast States to use an additional 30 percent for eligible activities pursuant to state expenditure plans and Council approval. The Treasury Department opened the process for affected Gulf Coast states and municipalities to apply for grants from the fund in fall of 2014.

The Gulf Coast Restoration Trust Fund allotment comprises five categories:

- 35 percent equally divided among the five states for ecological restoration, economic development, and tourism promotion
- 30 percent plus interest managed by the Gulf Coast Ecosystem Restoration Council for ecosystem restoration
- 30 percent divided among the states according to a formula to implement state expenditure plans subject to approval by the Gulf Coast Ecosystem Restoration Council
- 2.5 percent plus interest for the Gulf Coast Ecosystem Restoration Science, Observation, Monitoring and Technology Program within the Department of Commerce’s NOAA
- 2.5 percent plus interest allocated to the states for Centers of Excellence Research grants focused on science, technology, and monitoring related to Gulf restoration.

Figure 1 – Gulf Restoration Trust Fund Allotment



***Supplemented by interest generated by the Trust Fund (50% to Gulf Coast Ecosystem Restoration Council, 25% to Science Program, 25% to Centers of Excellence)**

Source: Gulf Coast Ecosystem Restoration Council

On July 1, the Treasury Department announced the award of \$4 million to the Texas Commission on Environmental Quality to establish two Centers of Excellence, providing

the first grant under the RESTORE Act. The Texas OneGulf Center of Excellence will cover all five RESTORE Act eligible categories, focusing on disaster research response, coastal data integration, as well as environment, human health, and safety. The Subsea Systems Institute will cover offshore energy development, research and technology, intending to improve sustainable and safe development of GOM energy sources.

Deepwater Horizon Well Blowout Prompted Reforms and Regulatory Developments to Address Offshore Drilling Safety

In response to the Deepwater Horizon blowout, the government began implementing a spate of regulations that tightened safety and operational standards on the offshore oil and gas industry. First, due to perceived poor performance immediately following the Deepwater Horizon spill, the Minerals Management Service, which previously regulated oil and gas activity on the outer continental shelf, was split into the Bureau of Ocean Energy Management (BOEM), the Bureau of Safety and Environmental Enforcement (BSEE) to carry out the offshore energy management and enforcement functions. The BSEE strengthened preparedness and planning regulations for offshore oil and gas companies through new requirements for well design, production systems, blowout prevention, and well control equipment (Table 1). Most recently, on April 13, BSEE proposed regulations to establish design and operational requirements for critical well control equipment used in offshore oil and gas drilling operations. The draft rule responds to a key technical failure that triggered the spill incorporating recommendations made after the 2010 Deepwater Horizon tragedy and updates BSEE regulations to reflect industry best practices. The EPA has also announced rules related to some of the environmental impacts associated with the Deepwater Horizon spill. On January 13, EPA proposed amendments to Subpart J of the National Oil and Hazardous Substances Pollution Contingency Plan (NCP), which addresses use of dispersants and other chemicals and biological agents to respond to oil spills in U.S. waters.

While tightening regulations, the DOI has also placed GOM as the focal point for present and future offshore oil and gas activity. The DOI’s draft 2017-2022 offshore lease program, released in January, prioritizes GOM development over Alaskan, Atlantic, and Pacific areas. The program is projected to open approximately 80 percent of estimated undiscovered technically recoverable oil and gas resources on the OCS.

Table 1 – BSEE Efforts to Improve Deepwater Offshore Drilling Regulations

| Date | Regulation | Description |
|-------------|--|---|
| April 2015 | Proposed Well Control Rule | Would update existing regulations to reflect industry best practices and recommendations made after the 2010 Deepwater Horizon incident |
| August 2013 | Proposed Rule to Strengthen Offshore Safety and Best Practices | Would implement best practices and update regulations on offshore production safety systems and equipment |
| April 2013 | SEMS II Final Rule | Enhances 2010 SEMS rule to provide greater protection by supplementing operators’ SEMS programs |

| | | |
|---------------------|------------------------------|---|
| August 2012 | Drilling Safety Rule | Addresses well bore integrity and well control equipment and procedures to enhance safety of OCS oil and gas activity |
| October 2010 | Workplace Safety Rule | Makes mandatory the previously voluntary practices in the API's Recommended Practice 75 for offshore drilling in federal waters |

Source: BOEM

According to CRS, in response to the Deepwater Oil spill disaster, Senate and House committees in the 111th Congress held more than 60 hearings and members introduced more than 150 legislative proposals related to oil spill issues.

- The Coast Guard Authorization Act for 2010 (H.R. 3619), enacted on October 15, 2010 includes substantial provisions for oil spill prevention.
- The RESTORE Act, enacted on July 6, 2012, to facilitate grants for restoration projects in the Gulf states.
- The Pipeline Safety, Regulatory Certainty, and Job Creation Act of 2011 enacted on January 3, 2012 increases civil penalties safety violations, requires automatic and remote-controlled shutoff valves on new transmission pipelines, and directs analysis of leak detection systems to issue necessary requirements.
- The Consolidated Appropriations Act, 2012, enacted on December 23, 2011 contains provisions that affect OCS development.
- The Howard Coble Coast Guard and Maritime Transportation Act of 2014 encourages the development of agreements among Arctic nations to coordinate oil spill prevention and response capabilities.

Disclosures Section

RESEARCH RISKS

Regulatory and Legislative agendas are subject to change.

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