A Regulatory Shellacking

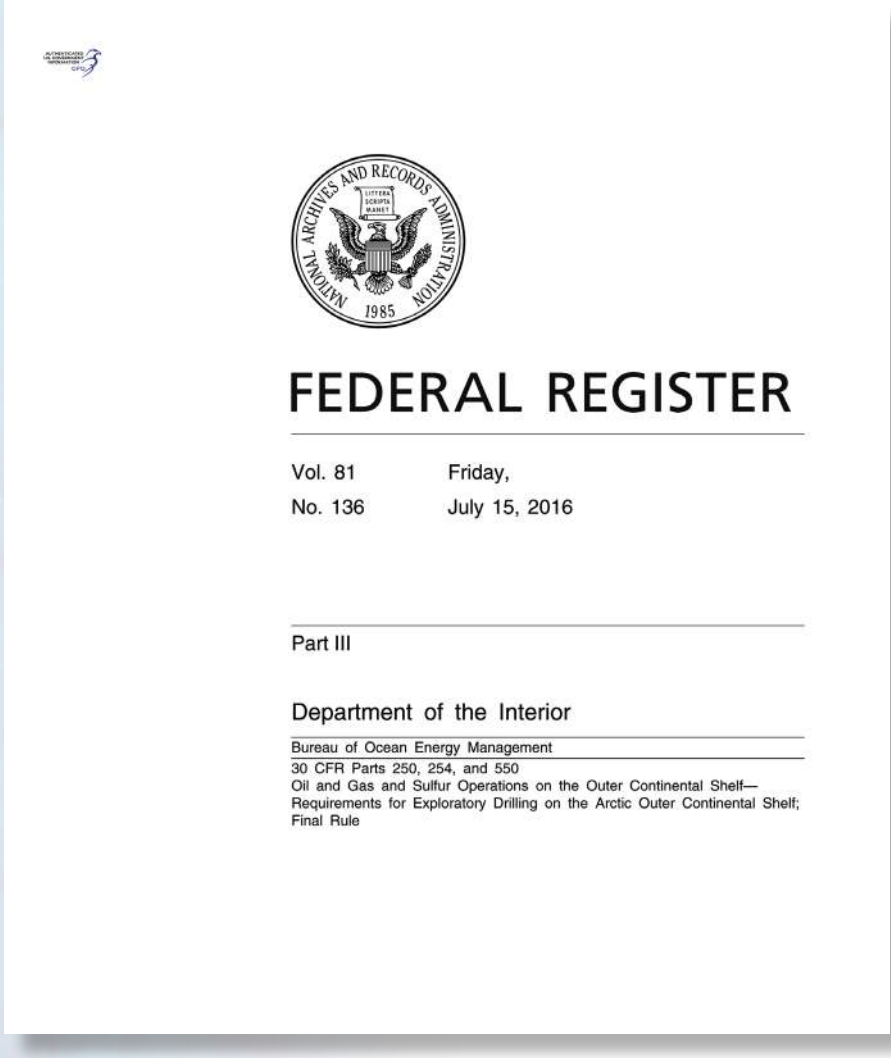
BOEM finalizes rules for Arctic OCS operators

By R. Isaak Hurst

The definition of shellacking is "to beat someone up repeatedly." With that idea in mind, it is no exaggeration to say that Royal Dutch Shell took a regulatory and legal shellacking between 2010 and 2015. And it wasn't just a beating from Uncle Sam either; indeed, Native communities, states, NGOs, and even kayaktivists stepped into the ring with Shell to do battle over its right to drill in the Arctic. As we are all aware, Shell won many (if not most) of the legal and regulatory battles it was dragged into. Ultimately, however, Shell lost the war.

Shell memorialized its surrender of the Arctic OCS on September 28, 2015, when it announced in a statement that it would cease further exploration activity in offshore Alaska for the near future. One of principal reasons cited by Shell for pulling out of the Arctic was because of "the challenging and unpredictable federal regulatory environment in offshore Alaska." Challenging indeed. Over the span of five years, Shell was involved in a myriad of high-profile regulatory and legal battles. Interestingly, however, and nearly one year after Shell conceded its Arctic claims, the regulatory fight for the Arctic is still waging in Washington, DC's congressional halls.

On July 15, 2016, the Department of the Interior (DOI), acting through the Bureau of Ocean Energy Management (BOEM) and the Bureau of Safety and Environmental Enforcement (BSEE), finalized the regulatory requirements for exploratory drilling on the Outer Continental Shelf (OCS) and published the Final Rule in the Federal Register. This Final Rule focuses solely on the OCS within the Beaufort Sea and Chukchi Sea Planning Areas (herein the "Arctic OCS") and, according to DOI, "is designed to help ensure the safe, effective, and responsible exploration of Arctic OCS oil and gas resources, while protecting the marine, coastal, and human environments and Alaska Natives' cultural traditions and access to subsistence resources."



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Many commentators, however, claim these new regulations are duplicative, cost prohibitive, and will likely prevent any further investment in offshore oil and gas exploration in the Arctic OCS in the immediate future.

Below is a brief review of the more controversial aspects of the rule; however, before getting into those details it is worth reviewing some of the more historic events that have led to an increase in the legal and regulatory affairs of the Arctic OCS.

Background—Shell's Legal and Regulatory Adventures in the Arctic

- **The April 2010 Deepwater Horizon Oil Spill:** The April 2010 Deepwater Horizon oil spill in the Gulf of Mexico shifted the offshore regulatory landscape in a number of ways. First, BOEM, a branch of the DOI, assumed control over the approval of exploration plans, and another DOI branch, BSEE, assumed responsibility for approving Oil Spill Response Plans (OSRPs). Second, following a moratorium on all oil and gas drilling, the DOI issued new rules regarding the content and analysis that operators should provide with its OSRPs. In response, Shell was required to update it OSRPs for the Chukchi and Beaufort seas in May 2011, again in early 2012, and again in August 2014. The DOI eventually approved of Shell's OSRP, but the costs for regulatory compliance were significant. With that, Shell did not exaggerate when it stated that the regulatory environment of the Arctic OCS was "unpredictable."

- **The *Noble Discoverer*, the *Kulluk*, and the *Fennica*:** Although Macondo kicked off enhanced regulatory oversight from the US government, the July 14, 2012, storm that caused the *Noble Discoverer* to drag its anchor while being moored outside Dutch Harbor furthered the argument that these operations needed more regulatory oversight. Images of the *Noble Discoverer*, which appeared to show the rig grounded on the rocky beaches of Unalaska, started showing up on news channels across the world. Although the US Coast Guard (USCG) later determined the vessel never touched ground, the incident provided Greenpeace and other NGO's with a lot of regulatory ammo against Shell.

  On December 31, 2012, the *Kulluk* ran aground in the Gulf of Alaska. Similar to the *Noble Discoverer*, images of this rig bobbing perilously close to the jagged shores of Kodiak were not doing Shell any favors—especially for its regulatory PR battle. This incident kicked off a barrage of regulatory investigations by the Environmental Protection Agency, USCG, and DOI. Shortly after the grounding, Environmental Protection Agency issued a statement saying Shell had violated its permits under the Clean Air Act for both of its Arctic drill ships. Subsequently, both the USCG and the DOI launched an expedited investigation into Shell's 2012 operations in the Arctic. The DOI review found that Shell was not fully prepared to carry out drilling in the Arctic and recommended further review and overall improvement of the program. As a consequence, and under pressure from investors, government agencies, and environmental groups, on February 27, 2013, Shell announced that it would "pause its exploration drilling activity for 2013 in Alaska's Beaufort and Chukchi seas to prepare equipment and plans for a resumption of activity at a later stage."

  On July 3, 2015, one of Shell's two icebreakers, the *Fennica*, hit a rock just outside of Dutch Harbor and put a thirty-nine-inch gash in its hull. The USCG later determined the *Fennica* struck an uncharted shoal in the area, but the PR regulatory spin was immense: "The damage to the *Fennica* due to traveling through shallow water is yet another example of Shell's reckless attitude in its pursuit of unburnable Arctic oil," reported one commentator. Shell's regulatory PR situation went from bad to worse after the *Fennica* was forced down to Portland for repairs. From there, local protesters tried to block the vessel, going so far as to suspend themselves from the St. John's Bridge over Portland's Willamette River. Indeed, for regulatory PR purposes, the *Noble Discoverer*, the *Kulluk*, and the *Fennica* did as many favors for Shell as the iceberg did for the *Titanic*.

- **The Kayaktivists:** In June of 2015, Shell, Foss Maritime, and the Port of Seattle decided to bring the *Polar Pioneer* into Seattle's Terminal 5. The idea was simple: lease terminal space, create tax revenue, and support hundreds of jobs in doing so. Shortly thereafter, however, the City of Seattle and a coalition of environmental groups sued the Port of Seattle and Foss Maritime, arguing that Shell did not have the right kind of permit to moor the *Polar Pioneer* in Elliot Bay. This incident not only led hundreds of kayakers paddling out to Elliot Bay to protest the *Polar Pioneer* presence but also led to an economic spat between Alaska and Washington political leaders. Foss and the Port of Seattle were eventually victorious in its case, but the "Shell-No" movement will not be forgotten anytime soon.

Federal Court—Shell Offshore v. Greenpeace

In a related lawsuit, Shell obtained a temporary restraining order from the district court in Alaska barring Greenpeace protestors from boarding and interfering with operations on twenty-nine vessels that Shell planned to use for its Arctic operations. The case arose after six individuals had boarded a Shell heavy transport vessel in the Pacific Ocean and scaled the drilling vessel the transport vessel was carrying. Shell was successful and the court ordered temporary restraining order put a five hundred yard barrier around each of the twenty-nine vessels while they were in transit. Later on, a district court held Greenpeace in contempt for violating this temporary restraining order when its activist hung from the St. John's Bridge in Portland in an effort to block the *Fennica*.

Ninth Circuit Court of Appeals

In another lawsuit, which made it all the way to the Ninth Circuit Court of Appeals, a group of twelve organizations challenged the DOI's approval of Shell's Chukchi Sea exploration plan for 2015, claiming that it violates both the Outer Continental Shelf Lands Act and the National Environmental Policy Act. The district court found for Shell, determining that the BSEE's approval wasn't arbitrary or capricious, and the Ninth Circuit agreed.

Indeed, the quest for Arctic oil and gas resources is not for the legal or regulatory faint of heart. Now, however, the DOI, via BOEM and BSEE, are adding to the regulatory challenges that Arctic operators will need to overcome. Below is a short summary of the finalized rules.

Enhanced SCCE Capabilities

The DOI's new rules require OCS operators to have enhanced Source Control Containment Equipment (SCCE) capabilities. This rule requires operators to have access to capping stacks, a cap and flow system, and a containment dome: all of which are capable of controlling a worst case discharge when using a Mobile Offshore Drilling Unit (30 C.F.R. § 250.470(f); 30 C.F.R.§ 250.471). In addition, this rule requires operators provide a detailed descriptions of (i) its contractor's SCCE capabilities; (ii) an inventory of regional SCCE supplies and services; (iii) proof of contracts or membership agreements with entities that would be providing the operator with necessary SCCE or related supplies; (iv) a detailed description of how the operator plans to inspect its SCCE; and (v) a detailed description of a plan that ensures that all members of the operating team have the necessary training to deploy and operate SCCE equipment in the Arctic OCS (30 C.F.R. § 250.470(f)(1) – (5)).

DOI's logic behind this rule is fair and was well received by industry. Although a capping stack, cap and flow system, and containment domes are readily available and accessible in the Gulf of Mexico, they are not in the Arctic. Moreover, the best way to minimize the effects of spilled oil is to prevent it from entering the water in the first place, which is why having a strong SCCE program in place is a critical part in reducing the impacts of a spill. One commenter, however, stated that BOEM and BSEE significantly underestimated the costs associated with SCCE, which were estimated to total $681.9 million over ten years, but in reality, that they should be between $996.9 million to $1.36 billion over the ten-year period.

Relief Rig Requirement

Arguably the most controversial requirement, BSEE now requires operators to have access to a separate relief rig, staged at a location such that it could arrive on site, drill a relief well, kill and abandon the original well, and abandon the relief well prior to expected seasonal ice encroachment at the drill site—all within forty-five days after the loss of well control (30 C.F.R. § 250.471(a)). As an example, BSEE notes the relief rig could be stored in harbor, staged idle offshore, or actively working, as long as it would be capable of physically and contractually meeting the proposed forty-five-day maximum timeframe.

Again, this rule is not without controversy. Some commenters recommended that BSEE remove the relief rig requirements entirely because the availability of several alternative technologies, such as capping

stacks, prepositioned capping devices, and subsea isolation devices are proven to be better suited to control an out-of-control well, thus negate the need to require a relief rig. However, BSEE determined that a relief rig is currently the most reliable option for permanently killing and plugging an out-of-control well. In the published rule, BSEE stated that "[t]his equipment is fundamental to safe and responsible operations on the Arctic OCS, where existing infrastructure is sparse, the geography and logistics make bringing equipment and resources into the region challenging, and the time available to mount response operations is limited by changing weather and ice conditions, particularly at the end of the drilling season."

Reliable Weather and Ice Forecasting

In 2012, Shell was forced to abandon its first well in the Arctic Ocean because of sea ice moving into the area. In light of the threats posed by ice and extreme weather events, BOEM and BSEE now require that operators include a description of their weather and ice monitoring and forecasting capabilities for all phases of their exploration program, as well as their alert procedures and thresholds for activating ice and weather management systems (30 C.F.R. § 250.188). For example, § 250.188 requires the operator to report to BSEE information on various incidents, including sea ice movement that may affect operations or trigger ice management activities and any unexpected "kicks" or operational issues that could result in the loss of well control (30 C.F.R. § 250.188(c)).

Similar to the relief rig requirement, this rule is not without controversy. Some commenters felt the ice management reporting requirements are too subjective and vague, while others commenters felt these reporting requirements would necessitate nearly constant communication with BSEE regarding sea ice movement and conditions. BSEE disagreed and felt these requirements were necessary since BSEE would need sufficient time to oversee the safety of an operator's reactions and prepare to respond, if a response is necessary, due to a safety or environmental incident resulting from an ice event.

Arctic OSRPs

The final rule now requires operators to develop and implement an OSRP that accounts for the unique Arctic OCS operating environment and has the necessary equipment, training, and personnel for oil spill response on the Arctic OCS (30 C.F.R. § 254.55). For example, these OSRP must demonstrate that the operator has the spill response resources, equipment, personnel, and strategies necessary to efficiently and effectively respond to a worst case discharge. No exploratory drilling may commence prior to BSEE's approval of OSRP, which must be consistent with applicable Federal regulations and guidance (30 C.F.R. § 254.1 – 55). There was very little controversy around the proposed OSRP regulations, but it is worth noting that Shell's OSRP, which was approved by BSEE in 2015, is 438 pages long.

Reducing Pollution from Arctic OCS Operations

The final rule now requires operators reduce their environmental footprint in the Arctic (30 C.F.R. § 250.300). Specifically, BSEE now requires operators "capture of all petroleum-based mud and associated cuttings from Arctic OCS exploratory drilling operations to prevent the discharge of such pollutants into the marine environment." (30 C.F.R. § 250.300(b)(1)) These changes come after many Arctic stakeholders, primarily Alaska Native Tribes, expressed concern that mud and cuttings from exploratory drilling could adversely affect marine species (e.g., whales and fish) and their habitat and compromise the effectiveness of subsistence hunting activities.

Commenters were generally supportive of the pollution prevention requirements, but some requested that the regulations be expanded to include the capture of all "water-based" mud and cuttings as well—not just "petroleum-based" mud and cuttings. BOEM and BSEE disagreed. The bureaus made a note that there is no evidence to suggest that "water-based" mud and associated cuttings are sufficiently problematic in all circumstances to justify a uniform capture requirement and noted that the Regional Supervisor also has discretion to require the capture of cuttings from operations that utilize water-based mud—should he or she choose to do so (30 C.F.R. § 250.300(b)(2)).

The Overall Cost of Regulatory Compliance

The Regulatory Impact Analysis (RIA) for this final rule estimates that the new requirements could result in compliance costs for the industry of $2.05 billion over ten years. The provisions of the rule subsumed within the regulatory baseline are estimated to cost $1.83 billion over a ten-year analysis period. These figures, however, were subject to a barrage of criticism.

For example, one commenter asserted that the bureaus' estimated costs in the initial RIA are drastically low, sometimes by several orders of magnitude, and that the cost to industry is $10 billion to $20 billion higher over the ten-year period. Another commenter asserted that the initial RIA incorrectly estimated the per-rig operating cost at $2 million per day because it fails to take into account that rigs and vessels contracted for Arctic exploration are contracted on an annual basis. The commenter noted that, based on an estimated one hundred drilling days available in the Chukchi Sea, the revised accounting results in an effective daily operating cost of $7.5 million per day per rig when the full cost of "ownership" is taken into account. In another example, several commenters questioned the cost of familiarization with the requirements of this rulemaking. The commenter added that there would be an ongoing need to educate staff and contractors, resulting in 250 hours of labor per year for review in subsequent years. BOEM and BSEE agreed with that commenter's figures and even stated that each operator will spend 120 hours a year assuring new personnel's familiarity with the rules. Indeed, there was no shortage of criticism with the DOI's estimated cost of compliance with its new regulations, and it appears these new regulations are going to cost a lot of money.

Icy Regulatory Waters

The quest for Arctic oil and gas resources is not for the faint of heart, nor for those with less-than-deep pockets. Interestingly, however, BOEM and BSEE do not anticipate that these new requirements, or their associated costs, will prevent lessees and operators from conducting exploratory drilling on Arctic OCS leases. In fact, BOEM claims that its final rule will provide additional clarity and specificity and should assist the oil and gas industry to plan better and to more effectively conduct exploratory drilling on the Arctic OCS with lower risk. BOEM's position, however, is laughable. Although the DOI's final rule provides some clarity to these icy regulatory waters, the reality is that the existing legal and regulatory environment, coupled with the high costs associated with new regulations, will undoubtedly detract operators from investing in the Arctic OCS for the near future. ☼

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