Risk Allocation: Issues Arising in the Allocation of Risk as Between Operator and Non-operators for Breach of Statutory Obligation

*Erin Flaherty**

INTRODUCTION

The last decade in Australia has seen the introduction of stringent environmental legislation which imposes criminal liability for offences and automatic and direct personal liability for company directors, officers and other persons concerned in management. Substantial penalties and fines are also imposed for breach of statutory duties. Against this background, this paper sets out to examine a number of issues arising in the petroleum industry, namely:

- contractual allocation of risk in joint operating agreements ("JOAs");
- the legal classification of statutory obligations and the statutory allocation of risk;

* BA, B Juris, LLM. Solicitor, Sydney.

- the particular application of the above is to incorporated and unincorporated joint ventures;
- the efficacy of indemnities for criminal liability; and
- insurance.

Risk management

Before addressing these issues, a distinction may be drawn between risk management and risk allocation.

Risk management addresses the ways in which a particular company orders its internal affairs so as to "manage" the risks to which it is exposed in the conduct of its business. The management may involve pre-acquisition due diligence, compliance programmes and insurance. This topic has been well canvassed in previous AMPLA papers.[1] The focus of this paper, on the other hand, is the allocation of risks as between the joint venture participant and its co-venturers, whether by legislative fiat, the application of common law principles or contract.

CONTRACTUAL ALLOCATION

Risk is allocated in different jurisdictions in different ways. In the United States and the United Kingdom there are model form contracts, the principal features of which are as follows:

United States of America

In the United States the International Energy Committee of the American Corporate Counsel Association and the Association of International Petroleum Negotiators have published an operating agreement which has been accepted as an industry standard for international JOAs. This agreement is usually referred to as the AIPN Model Form. The indemnity and liability provisions are as follows:

> "4.6 Liability of Operator
>
> (A) Except as set out in this Article 4.6, the Party designated as Operator shall bear no cost, expense or liability resulting from performing the duties and functions of the Operator. Nothing in this Article shall, however, be deemed to relieve the Party designated as Operator from any cost, expense or liability for its Participating Interest share of Joint Operations.
>
> (B) The Parties shall be liable in proportion to their Participating Interests and shall defend and indemnify Operator and its

1. See C L Trenorden, "Environment—Risk Sharing" and C Stevenson, "Environment—Risk Sharing: Commentary" in [1993] *AMPLA Yearbook* 1-61 and J S Segal, "Environment Audits and Directors' Liability" in [1991] *AMPLA Yearbook* 236.

consultants, agents, employees, officers and directors (the "Indemnitees") from any and all costs, expenses (including reasonable attorneys' fees) and liabilities incident to claims, demands or causes of action of every kind and character brought by or on behalf of any person or entity for damage to or loss of property or the environment, or for injury to, illness or death of any person or entity, which damage, loss, injury, illness or death arises out of or is incident to any act or failure to act by Indemnitees in the conduct of or in connection with Joint Operations regardless of the cause of such damage, loss, injury, illness or death and even though caused in whole or in part by a pre-existing defect, the negligence (whether sole, joint or concurrent), Gross Negligence,[2] strict liability or other legal fault of Operator (or any such affiliate); provided that if any Senior Supervisory Personnel[3] of Operator engage in Gross Negligence that proximately causes the Parties to incur cost, expense or liability for such damage, loss, injury, illness or death then:

(Check one Alternative)

Alternative No 1—No Limitation
Operator shall bear all such costs, expenses and liabilities.

Alternative No 2—Joint Property Limitation
Operator shall bear only the actual cost, expense and liability to repair, replace and/or remove Joint Property so damaged or lost, if any.

2. Gross negligence is defined in the AIPN Model Form as "any act or failure to act (whether sole, joint or concurrent) by a Party which was intended to cause, or which was in reckless disregard of or wanton indifference to harmful consequences such Party knew or should have known, such act or failure would have had on the safety or property of another person or entity, but shall not include any error of judgment or mistake made by such Party in the exercise of good faith of any function, authority or discretion conferred on the Party employing such under this Agreement".
3. Senior supervisory personnel are defined in the AIPN Model Form as "any supervisory employee of a Party who functions as:
(Check one Alternative)
Alternative No 1—Field Supervisor Tier
Such Party's designated manager or supervisor who is responsible for, or in charge of onsite drilling, construction or production and related operations, or any other field operations; or
Alternative No 2—Facility Manager Tier
Such Party's designated manager or supervisor of an onshore or offshore installation or facility used for operations and activities of such Party, but excluding all managers and supervisors who are responsible for or in charge of onsite drilling, construction or production and related operations or any other field operations; or
Alternative No 3—Resident Manager Tier
Such Party's senior resident manager, who directs all operations and activities of such Party in the country or region in which he is resident, but excluding all managers or supervisors who are responsible for or in charge of installations or facilities, onsite drilling, construction or production and related operations, or any other field operations.
And, in any of the above alternatives, any employee of such Party who functions at a management level equivalent to or superior to the tier selected, or an officer or a director or such Party."

Alternative No 3—Financial Limitation
Operator shall bear only the first US$ of such costs, expenses and liabilities.

Alternative No 4—Complete Limitation
Operator shall bear none of such costs, expenses and liabilities.

(C) Notwithstanding the foregoing under no circumstances shall any Indemnitee (except as a Party to the extent of its Participating Interest) bear any cost, expense or liability for environmental, consequential, punitive or any other similar indirect damages or losses including but not limited to those arising from business interruption, reservoir or formation damage, inability to produce petroleum, loss of profits, pollution control and environmental amelioration or rehabilitation."

The allocation of risk to the operator where the liability is attributable to the senior supervisory personnel is of interest.

The non-operators agree to indemnify the operator for all costs, expenses and liabilities incurred by the operator and arising out of joint operations, even if caused by the operator's gross negligence (which definition includes intentional harm as well as reckless disregard of consequences) provided that if any senior supervisory personnel engages in gross negligence then one of the four alternatives listed above will apply. By distinguishing between the gross negligence of senior supervisory personnel and that of other employees, the AIPN Model Form appears to incorporate the "guiding mind approach" as it was developed by the House of Lords in *Tesco Supermarkets Ltd v Nattrass*.[4] Although that case concerned criminal conduct and may not apply to all instances of gross negligence, the court held that a corporation would only be liable for the acts of its employees where the requisite elements of the offence were performed by those considered to be the company's directing mind or controllers, namely the board of directors and other persons to whom such functions had been fully delegated.[5] In the AIPN Model Form, provision has been made to nominate specific personnel in that role (see the definition of senior supervisory personnel above). This approach is distinct from the vicarious liability approach enunciated in *Morgan v Babcock & Wilcox Ltd*[6] where the court held that a corporation was vicariously liable for the acts of its employees acting within the scope of their employment. Although the *Tesco* principle applies under common law, it has become increasingly common for statutes to provide expressly for vicarious liability.[7]

4. [1972] AC 153.
5. *Tesco Supermarkets Ltd v Nattrass* has been followed in Australia by *Trade Practices Commissison v Tubemakers of Australia Ltd* (1983) 47 ALR 719, *Universal Telecasters (Qld) v Guthrie* (1978) 18 ALR 531 and *Collins v State Rail Authority of NSW* (1986) 5 NSWLR 209.
6. (1929) 43 CLR 163.
7. See particularly s 84 of the *Trade Practices Act* (Cth) which provides that where it is necessary to establish the intent or conduct of a corporation, it is sufficient to show that a director, servant or agent of the corporation had that intent or engaged in that conduct.

Andrew Derman[8] has published an interesting discussion paper on the AIPN Model Form.[9] Given that some of the terminology used in the AIPN Model Form may find its way into Australian JOAs, his views are of interest. He states:

> "The issue of liability and the associated concepts of negligence and gross negligence has assumed importance in the corporate board room throughout the world. Valdez has become associated with Exxon. But had Exxon been acting as an operator or an agent for other companies, a royal legal battle would have been fought over whether Exxon should have assumed and been responsible for all related damages or only some proportionate amount. Environmental hysteria has taken hold in the United States and its seeds are spreading. Environmental damages may far exceed an enterprise's liabilities. On one hand, non-operators argue that they should not be liable for an operator's gross negligence. On the other hand, operators argue that they are not to financially gain from acting as operators (some do, of course) and they should not be exclusively liable for the horrendous financial ruin that may follow from an environmental accident.
>
> In an effort to be sensitive to some larger companies who frequently operate, the AIPN drafters included in the definition of gross negligence an additional provision which raised the standard of 'gross negligence'. To be liable a person or entity must not have only acted with gross negligence but the person or entity must have acted in bad faith. A person or entity would not be liable for an action which would otherwise be considered grossly negligent if the error of judgment or mistake was made in good faith while fulfilling any function, authority or discretion. The incorporation of such a subjective criteria does nothing less than effectively emasculate the definition of gross negligence and operator's liability. Is this result desirable? I would consider deleting this limitation or, more radically, replacing the current language with some variation of the following: 'Gross Negligence means wilful misconduct or such wanton and reckless behaviour as amounts to a wilful and utter disregard of avoidable and foreseeable consequences'."[10]

With regard to the extent of the operator's liability for gross negligence the AIPN Model Form offers four alternatives. Under the first alternative the operator is responsible for all costs and expenses; under the second alternative the operator is responsible only for the actual cost and liability to repair or replace and/or remove joint property damaged or lost; under the third alternative the operator is liable for an agreed amount and thereafter the joint account will assume responsibility for such costs and liabilities and, finally, pursuant to the

8. Chief Counsel, International and US Exploration, Oryx Energy Company.
9. A B Derman, "International Oil and Gas Joint Ventures: A Discussion with Associated Form Agreements". Natural Resources, Energy and Environmental Law Section Monograph Series No 16. Published by the American Bar Association.
10. Ibid, p 17.

fourth alternative, the operator will not be individually liable for any costs and liabilities. In reviewing these alternatives Derman states:

> "This fourth alternative totally emasculates the concept of liability for gross negligence. Some members of the drafting committee insisted on the inclusion of this provision. They argued that no party would wish to operate unless they believed they could control their exposure. On the other hand, it is hard to imagine a non-operator agreeing to select alternative no 4. Future drafters should seriously consider deleting this alternative."[11]

In any event, the operators' liability under the first three alternatives is further limited in that the operator is not individually liable for any cost and/or liability for environmental, consequential, punitive or other similar indirect damages or losses, including those arising from business interruption, reservoir or formation damages, inability to produce petroleum, loss of profits, pollution control and environmental amelioration or rehabilitation.

United Kingdom

The indemnity provisions contained in the British National Oil Corporation Pro-forma JOA are set out in Appendix 2 of Stuart Barrymore's complementary paper on this topic. See above, p 179.

The indemnity provisions provide that the operator shall not be liable for any loss or damage resulting from the negligence of the operator, its servants, agents, contractors or employees and shall not be liable in excess of its percentage interest in the joint venture unless there is some culpable conduct in the management of joint operations on its part. The operator is required to assume personal liability for any loss or damage suffered as a result of its wilful misconduct.[12] Some more recent JOAs provide that the operator will only be personally liable in the case of wilful misconduct on the part of senior managerial personnel.

In the conduct of joint operations, the operator, its servants, agents, contractors or employees must act in a proper and professional manner in accordance with the methods and practices customarily used in good and prudent oil and gas field practice and with that degree of diligence and prudence reasonably exercised by experienced operators engaged in a similar activity under similar circumstances and conditions. The operator also assumes personal liability whenever it fails to obtain and maintain insurance. From a review of a number of JOAs, it seems to be standard practice for the operator to arrange insurance for property

11. Ibid, p 109.
12. The term "wilful misconduct" is defined in the BNOC pro-forma as "an intentional and conscious or reckless disregard of:
    (i) any provision of the JOA; and/or
    (ii) any Programme,
    not justifiable by any special circumstances, but shall not include any error of judgment or mistake made by any director, employee, agent or contractor of the Operator in the exercise, in good faith, of any function, authority or discretion conferred upon the Operator."

damage and other risks. The operator will not, however, be personally liable if it has used all reasonable endeavours and then promptly notified the non-operators that it has been unable to acquire or maintain the relevant insurance. Finally, the BNOC pro-forma provides that the operator will not be liable to any non-operator for any consequential loss, including but not limited to, inability to produce petroleum, lost production or loss of profit.[13]

Liability for pollution damage is not specifically dealt with in the BNOC pro-forma; however, it appears that there is an emerging trend in the North Sea for the operator to be strictly liable.[14] This is in keeping with the approach already adopted in the North Sea under the International Convention on Civil Liability for Oil Pollution Damage, 1969, the Offshore Pollution Liability Agreement ("OPOL") between Denmark, West Germany, France, Ireland, The Netherlands, The United Kingdom and Norway and the Tanker Owners' Voluntary Agreement Concerning Liability for Oil Pollution ("TOVALOP") between tanker owners and charterers. The Convention and the Agreements impose strict liability on operators or tanker owners and provide coverage for pollution damage claims or pollution mitigation expenses subject to limits of $US25 million per occurrence and $US50 million in aggregate annually. OPOL and TOVALOP are funded by contributions from members.[15]

Australia

Assuming the operator conducts operations as agent for the non-operators,[16] the usual liability and indemnity provisions in the JOA will allocate risk by providing that the operator will not be liable for loss or damage incurred by the non-operators as a result of activities undertaken by the operator on their behalf and further that the non-operators will indemnify the operator for loss or damage incurred in the conduct of joint operations even though that loss or damage may be incurred as a result of an error of judgment or negligence on the part of the operator.[17] The usual exception to this exclusion is loss or damage occasioned by the gross negligence or wilful misconduct of the operator.

13. The above summary is taken from an unpublished paper entitled "An analysis of the Standard Form of Joint Operating Agreement in the UK" presented by N Pitjal at a conference organised in 1993 by the University of Dundee—Centre for Petroleum and Mineral Law and Policy.
14. Ibid.
15. For further details see P N Swan, "Ocean Oil and Gas Drilling and the Law" (1979) *Oceana Publishing* 156 and P Rose, "Marine Oil Pollution Laws in Australia" in [1991] *AMPLA Yearbook* 175.
16. Stuart Barrymore, "Risk Allocation in Joint Ventures", above, pp 156-179.
17. A clause indemnifying a person or entity against damage or loss caused by that party's negligence, where it also indemnifies against damage otherwise arising, will not be effective unless it is clearly expressed to have such an effect. See *Halsbury's Laws of England*, Vol 20, 4th ed, para 350.

An exception to both the non-operators' indemnity and the exclusion for gross negligence or wilful misconduct is consequential loss or damage, typically expressed to include pool formation, reservoir damage, lost production or loss of profits.[18] One of the reasons for this exclusion, being a point often overlooked in the drafting of JOAs, is that each of the categories of loss or damage referred to in the exclusion is incurred by the joint ventures themselves rather than by third parties. It is one thing for non-operators to forgo a claim against the party they have selected to conduct joint operations; it is something quite distinct for the non-operators to relinquish a right to indemnity by the operator should there be a third party claim precipitated by the gross negligence or wilful misconduct of the operator or its employees or agents. If the operator was not relieved of liability for consequential loss or damage, few joint venturers would ever willingly assume the role of operator. By way of example of the application of the relief, if as a result of the operator's gross negligence or wilful misconduct a tank storing the non-operators' oil were to be destroyed, the operator would be liable for the cost of replacement of the tank but the non-operators would have no claim against the operator for their loss of profits in respect of the oil.

In most Australian JOAs, the operator also agrees to indemnify the non-operators for any loss or damage they suffer (excluding consequential loss) as a consequence of the operator's gross negligence or wilful misconduct.

Set out below are two examples of indemnity provisions appearing commonly in Australian JOAs:

Example one

"1. Liability of Operator

1.1 The Operator shall not be liable to the other Parties for any loss or damage incurred by them as a result of any activities of the Operator in the conduct of Joint Operations, unless the loss or damage is the result of the Operator's Gross Negligence or Wilful Misconduct.[19] Under no circumstances whatsoever shall the Operator acting in that behalf and not as the owner of a Participating Interest be liable for any consequential loss or damage (including formation or reservoir damage, lost production, or loss of profits) whatsoever or howsoever occurring.[20]

18. Ibid, pp 8 and 9.
19. In the joint operating agreement from which this example was taken "gross negligence" is defined as, "such wanton and reckless conduct as constitutes or raises the belief that it constitutes, an utter disregard for the harmful, foreseeable and avoidable consequences which result from it" and "wilful misconduct" is defined as "such acts or omissions as are done, or omitted to be done, intentionally and so as to raise the belief that they were the result of a conscious indifference to the rights or welfare of those who are or may be thereby affected".
20. For a discussion on the meaning of "whatsoever or howsoever caused" see *Wright v Tyne Improvement Commissioners* [1968] 1 All ER 807.

1.2 Except as provided in this Clause, each Party agrees, in the proportion severally that its Participating Interest bears to the aggregate Participating Interest of all the Parties, to indemnify and hold harmless the Operator from and against all losses, claims, damages and liabilities incurred by the Operator arising out of the conduct of Joint Operations by the Operator or the Operator's duly authorised agents or independent contractors in accordance with this Agreement.

(i) A party shall not be required to indemnify and hold harmless the Operator in the event of the Gross Negligence or Wilful Misconduct of the Operator, its duly authorised agents or independent contractors.

(ii) There shall be no indemnity under this Clause to the extent that the Operator is covered by insurance purchased in accordance with this Agreement or to the extent that the Operator in purchasing or maintaining insurance pursuant to this Agreement, would have been covered by insurance.

1.3 The employees, agents and contractors of the Operator shall be under the sole direction and control of the Operator and shall not be considered to be employees, agents, or contractors of the other Parties."

Example two

"1.1 The Operator shall have no obligation or liability for any loss or damage by, in or under this Agreement or otherwise in connection with or in relation to Property, Sole Risk Property or any other related property whatever or Operations, Sole Risk Operations or any other related operations whatsoever, except to the extent that such loss or damage results from Wilful Misconduct[21] of the Operator, any director, employee or agent of the Operator, any Affiliate of the Operator or any director, employee or agent of the Affiliate, provided that under no circumstances shall the Operator or its Affiliates (or their respective directors, employees or agents) be liable directly or indirectly in respect of any pollution, pool formation or structure damage, lost production, loss of profits, or consequential loss or damage, whatsoever or howsoever occurring.

1.2 Except to the extent that the Operator is obliged or liable as aforesaid, each party shall severally to the extent of its Percentage Interest indemnify and keep indemnified the Operator and its Affiliates and their respective directors, employees or agents against all or any obligation or liability for loss or damage of whatsoever description suffered,

21. In the joint operating agreement from which this example was taken wilful misconduct is defined as "such wanton or reckless act or omission not justified by any circumstances as amounts to a wilful and utter disregard for the harmful consequences thereof".

sustained or incurred by, in or under or in relation to this Agreement or its performance or otherwise or in relation to Property, Sole Risk Property or any other related property whatsoever, or Operations, Sole Risk Operations or any other related Operations whatsoever."

The critical distinguishing feature in the two examples is the fact that Example Two excludes from the liability of the operator pollution loss or damage occasioned by the wilful misconduct of the operator or its affiliates (or their respective directors, employees or agents). This is similar to the AIPN Model Form which relieves the operator of liability for environmental liability and liability occasioned by pollution control and environmental amelioration or rehabilitation. Example Two goes on to require the non-operators to indemnify the operator, its affiliates (or their respective directors, employees and agents) from the liability so caused. This form of indemnity raises the following questions which are central to the topic of this paper:

1. What is the legal characterisation of environmental and pollution liability? Is it criminal or civil?
2. As a matter of law, can the operator, its affiliates (or their respective directors, employees or agents) be indemnified in respect of environmental and pollution liability or is the indemnity unenforceable either—
   (a) because the liability is criminal; or
   (b) because it defeats legislative intent?[22]
3. If the liability is criminal and the operator is their agent, are the non-operators liable to conviction as principals?
4. If the liability is occasioned by the gross negligence or wilful misconduct of the operator, can the non-operators (as principals) enforce an indemnity given to them in respect of that liability by the operator?

22. The enforceability of an indemnity clause or reimbursement clause has been the subject of judicial review in the United States.
Section 107(e) of CERCLA provides that:
"(1) No indemnification, hold harmless, or similar agreement or consequence shall be effective to transfer from the owner or operator to any other person the liability imposed under this section.
(2) Nothing in this section shall bar any agreement to insure, hold harmless, or indemnify a party to such agreement for any liability under this section."
In *Marden Corp v CGC Music Ltd* 804 F 2d 1454, 1459 (9th Cir 1986) this section was interpreted to mean that private parties are free to contract out of liability but that such a contract does not alter any party's accountability to the government. The court also held that the indemnity clause did not apply to statutory claims, only claims for breach of contract.
In *AM International v International Forging Equipment* 743 F Supp 525 (ND Ohio 1990) which involved an interpretation of s 107(e) of CERCLA the District Court of Ohio held that an indemnification clause or hold harmless agreement could not bind the parties as it would defeat legislative intent to permit large corporations to exert economic power over weaker corporations to force the transfer of liability as a cost of doing business. It would be difficult to imagine an Australian court interfering with a contractual agreement to indemnify however, the United States experience is an interesting reminder of what could happen.

5. Can the non-operators obtain insurance to effectuate the indemnity given in favour of the operator, if the liability is criminal and they are principals? And
6. Can the operator obtain insurance to effectuate the indemnity given in favour of the non-operators, if the liability is criminal, if the liability is occasioned by an unlawful act which is not criminal or if the liability is occasioned by the deliberate act (wilful misconduct) of the operator, or its affiliates (or their respective directors, employees or agents)?

CHARACTERISATION OF STATUTORY OBLIGATIONS

Whether a statute creates a criminal offence will be a question of interpretation. In *R v Lennox-Wright*[23] the court held that where an act is commanded or prohibited by statute, disobedience is prima facie criminal, unless criminal proceedings manifestly appear to be excluded by the statute. The use of the word "offence" does not necessarily assist. The word is sometimes used to describe a criminal act but not always. In *Brown v Allweather Mechanical Grouting Co*[24] the court held that a failure to do something prescribed by a statute may be described as an "offence", even though no criminal sanction is imposed and a pecuniary penalty is prescribed and recoverable as a debt.

If the word "penalty" is used, as distinct from "fine", the general rule is that the penalty is recoverable as a debt.[25]

Most environmental statutes impose criminal liability by specifying a mental element (mens rea) as a constituent element of the crime, by specifically stating that the offence is a criminal offence or by imposing strict liability.[26]

Generally, a person does not incur criminal liability unless he or she intended to bring about, or recklessly brought about, those elements which constitute the crime. Expressions such as "intentionally", "recklessly", "knowingly", "permitting" and "unlawfully" are fundamental to ground the mens rea required for the commission of a criminal offence.[27] A person may be convicted if he or she has negligently brought about the constituent elements of a crime or, in the case of strict liability, even though he or she has acted without intention, recklessness or negligence. Offences of strict liability normally impose liability on persons who have "caused" or "permitted" the offence to occur.[28]

23. [1973] Crim LR 529.
24.]1954] 2 QB 443.
25. *Halsbury's Laws of England*, op cit, para 11.
26. Strict liability is defined in the criminal context as follows ". . . a person can incur criminal liability even though he has acted without intention, recklessness or negligence in relation to one or more of the elements of that crime". See the leading case of *Alphacell Ltd v Woodward* [1972] AC 824, followed in Australia by the New South Wales case of *Majury v Sunbeam Corporation Ltd* [1974] NSWLR 659.
27. *R v Sender (No 2)* (1982) 44 ALR 139 at 146 and *He Kaw Teh v The Queen* (1985) 157 CLR 523 at 533.
28. *Alphacell Ltd v Woodward* [1972] AC 824.

In general, a corporation is in the same position as a natural person and may be convicted of common law and statutory offences including offences of strict liability and those requiring mens rea.[29]

Applying these principles to the *Petroleum (Submerged Lands) Act* 1967 (Cth), ("PSLA") it is possible to characterise the statutory obligations as follows:

Criminal Offences (fines, imprisonment)		**Civil Offences** (penalties)		
Sections	19	34	96	117
	39	35	97	120
	60	38J	98	121
	72	38K	100	122
	74	82	101	124
	133	84	107	125
	104E	85	111	126
	157	90	112	

By way of further example, ss 29 and 49 of the *Petroleum Act* 1967 (WA) creates criminal offences, whereas ss 44 and 76(i) impose civil penalties.

As noted in an earlier AMPLA paper,[30] most environmental protection legislation enacted in recent years creates criminal liability and in some instances imposes automatic personal criminal liability on directors and managers for the acts of their corporations and agents.[31] This is the case in New South Wales and Victoria.[32]

New environmental legislation is currently being considered or has just recently been introduced in Queensland, South Australia, Western Australia and Tasmania also imposing or seeking to impose criminal liability.[33]

ALLOCATION OF STATUTORY OBLIGATIONS

The joint venture participants may incur statutory liability in one or more of the following capacities:

- as an owner of joint venture assets (such as land, plant and equipment) or the "occupier" of premises;

29. See, however, the recent High Court decision of *Environment Protection Authority v Caltex* (1994) 68 ALJR 127 in which the court decided that corporations were not entitled at common law to claim a privilege against self incrimination.
30. Segal, op cit at 236ff.
31. Ibid at 241.
32. *Environmental Offences and Penalties Act* 1989 (NSW) and the *Environmental Protection Act* 1970 (Vic).
33. In Queensland the Environmental Protection Bill is currently before Parliament. In South Australia the *Environment Protection Act* 1993 is due to commence in July 1994. In Western Australia and Tasmania environmental legislation is currently being reviewed.

- as the operator of the joint venture or "person" in control;
- as the principal in an agency agreement whereby the operator is considered at law to be the agent for a participant in the venture;
- as a participant on the operating committee with a role which affects the control of the joint ventures operations;
- as a person who "causes" or "permits" pollution under state environmental laws;
- as a licence or permit holder the PSLA, State Petroleum Acts or State environmental laws.

As an example, under the *Environmental Protection (Sea Dumping) Act* 1981 (Cth) it is an offence for any person to dump waste from an Australian platform. This offence is committed by each of:

- the owner of the platform;
- the person in charge of the platform;
- the owner of the wastes or other matter.

A non-operator may incur direct statutory liability either as a part owner of the platform, of the oil or of other waste discharged. In this example, liability is strict and attaches to each person involved.

In addition, although a non-operator will not usually be in a position to "cause" or "permit" pollution, the nature of the relationship between the operator and the non-operators may, at law, mean that a non-operator could be deemed to "cause" or "permit" pollution.

Where there is a relationship involving control of the operator by the non-operators (either as agent or independent contractor), the actions of the operator may be ascribed to the non-operators. The extent of exposure to liability of a non-operator for the offences by an operator would depend on the degree of control exercised in the particular circumstances.

This issue involves an evaluation of the scope and degree of the non-operator's control in both the day-to-day management and overall decision making functions of the operator and whether the operator was acting within the scope of its authority.

It would be difficult to envisage a circumstance in which it could be said that an operator committing a serious environmental offence was acting within the scope of its authority. For less serious offences, such as a breach of licence conditions, it is possible to envisage such circumstances, particularly where the offence is one of strict liability. With respect to less serious "strict liability" offences (for example, breaches of environmental licences), it is unclear whether fines or penalties will be treated as criminal or civil.

Where the operator is the sole registered holder of a licence, permit or authority, under the PSLA or the various State Petroleum Acts, liability for environmental offences cannot be traced back to non-operators as these Acts impose liability only on the legal owner of the tenement. Unlike some State environmental laws, these Acts do not impose liability on "directors, managers and persons concerned in the management" of the company.

In the circumstances where a non-operator is registered as the holder (whether solely or jointly) of any licence, permit or authority issued under the PSLA or a State Petroleum Act, the environmental obligations imposed under that Act may be enforced against the non-operators as most legislation imposes joint and several liability on the legal or registered owners of the licence, permit or authority.

Application to incorporated and unincorporated joint ventures

Unlike the PSLA and the State Petroleum Acts, most State environmental laws extend liability from the person or entity which is directly responsible for environmental pollution or damage to directors, managers or "persons concerned in the management" of corporations. Leaving aside the issue of whether the non-operators are liable as principals, this raises the question whether, if the operator commits an offence, can a non-operator be a "manager" or "person concerned in the management" of the operator? The use of this expression contemplates liability for a category of persons not necessarily employed by the operator, committing the offence. To rebut this liability a non-operator would argue that, whilst it may have been concerned in the management of the joint venture, it was not concerned in the management of the operator.

In the case of an unincorporated joint venture comprising a number of unrelated parties, one of whom has agreed to act as agent for the others for the sole purpose of conducting joint operations, one would ordinarily expect the non-operators to be remote from the day-to-day management of the operator. To impose liability on the non-operators for the actions of the operator on the basis of their being "concerned in the management" would seem to be drawing a long bow. On the other hand, in the case of an incorporated joint venture where each participant nominates a director to the board of the joint venture operating company, it may be more difficult for the non-operators successfully to mount an argument that they were not "involved in the management" of the operator. The determining factor will, of course, be the extent of influence and control over the operating company. As environmental laws in Australia tend to use "control" as the basis for imposing liability on a wider group of potential offenders, the less "control" the participants have over the operator or the operating company, the more remote the prospect of attracting liability under State environmental laws.

Applicability of State environmental laws to petroleum permits

An interesting side issue to the allocation of statutory obligations is the applicability of State environmental laws to offshore petroleum permits issued by the Commonwealth under the PSLA.

The effect of the *Coastal Waters (State Powers) Act* (Cth) 1980 is that the States' legislative power applies to offshore waters within three nautical miles of the coastline. However s 9(i) of the PSLA explicitly provides that those State laws which relate to matters connected with offshore exploration and production of natural resources apply in the "adjacent area", which is defined as the area between the three-nautical-mile limit and the outer limit of the continental shelf. The territorial limits of the Commonwealth's jurisdiction under the PSLA are also defined by reference to the adjacent area.

Whilst s 9 of the PSLA contemplates jurisdiction for both Commonwealth and State Governments, State jurisdiction is limited by s 9(6)(b) which only gives effect to State laws to the extent that they are not inconsistent with the law of the Commonwealth, including the PSLA. This is confirmed by s 13 which provides that the later parts of the PSLA concerning exploration and exploitation of petroleum have effect notwithstanding anything in the earlier parts of the Act, including s 9.

In these circumstances the State laws relating to the environment would only apply if they were not inconsistent with the PSLA or other Commonwealth laws.[34]

In the determining inconsistency the courts will interpret a Commonwealth law to determine whether the Commonwealth intended to cover the field having regard to the subject matter of the law. Even if there is not a direct inconsistency, the Commonwealth law will prevail if it discloses the requisite intention.[35]

The PSLA contains a number of provisions which would seem to demonstrate an intention to occupy fully the field of exploration and exploitation in a permit area, including the environmental aspects of such activities.[36] Accordingly, it may be argued that the presence of these wide powers evidences an intention by the Commonwealth to regulate all aspects of activities associated with petroleum exploration and recovery and therefore that any State environmental law will be inconsistent.

It must be noted however, that the regulatory aspects of the PSLA are limited to the permit, lease or licence area. State laws could therefore still have an application in relation to activities in the permit area which cause environmental damage outside the area, such as an oil spill.

34. Section 109 of the Australian Constitution provides that any State law which is inconsistent with any Commonwealth law will be invalid to the extent of the inconsistency and Commonwealth law will prevail.
35. J Crawford, "The Constitution and the Environment" (1991) 13 *Sydney Law Review* 11.
36. Sections 27, 38c and 52 in relation to the right to explore and recover petroleum, including provision to take adequate measures for the protection of the environment; s 157 authorising the designated authority to issue directions and make regulations in respect of a wide range of matters, including environmental matters; and s 97 requiring all exploration activities and recovery activities to be conducted in a proper and workmanlike manner in accordance with good oil field practice.

ENFORCEABILITY OF THE INDEMNITY PROVISION

The extent of liability under a contractual indemnity will depend upon its terms and each case will be governed by its own facts and circumstances. On the basis of freedom of parties to contract as they wish, courts have upheld many and varied indemnities.[37] Notwithstanding this freedom, neither an express contractual indemnity nor an implied indemnity, as in the relationship of principal and agent,[38] will be enforceable in respect of the consequences of a transaction involving a crime.[39] In *Beresford v Royal Insurance Co Ltd*,[40] Lord Atkin stated the principle, "a man is not to be allowed to have recourse to a court of justice to claim a benefit from his crime whether under a contract or gift". This is so whether the party involved in the transaction knew that its actions constituted a criminal offence at the time, or, being ignorant of the nature of the offence, had full knowledge of the circumstances rendering them an offence.

Similarly, an indemnity is unenforceable if the transaction to which it relates is contrary to public policy.[41] In *In Estate of Crippen*[42] the court held that contractual rights accruing to a party as a direct result of his commission of a felony or misdemeanour were unenforceable as being against public policy.

The general rule is espoused in *Halsbury's Laws of England* as follows:

> "Punishment inflicted by a criminal court is personal to the offender and the civil courts will not entertain an action by him to recover an indemnity against the consequences of that punishment, nor in general does public policy permit an indemnity to be enforceable in respect of expenses which the offender has incurred by reason of being compelled to make civil reparation for his crime."[43]

Given that the usual contractual allocation of risk is achieved by way of indemnity provisions, where that risk is the consequence of a criminal act it must be that the indemnity will be unenforceable. Similarly, the breach of a statutory obligation by the operator constituting a criminal offence appears to nullify the operator's right to indemnification by the non-operators. By way of corollary, if the operator has indemnified the non-operators against criminal liability caused by the operator's gross negligence or wilful misconduct, the non-operators may not be able to obtain the benefit of that indemnity if they are primarily liable for the offence.

37. For examples of different types of indemnities see *Halsbury's Laws of England*, op cit, para 354.
38. Barrymore, op cit, p 5.
39. *Smith v White* (1866) LR 1 Eq 626.
40. [1938] AC 586 at 598.
41. *Burrows v Rhodes* [1899] 1 QB 816; *Haseldine v Hosken* [1933] 1 KB 822.
42. [1911-1913] All ER 207.
43. *Halsbury's*, op cit, para 359.

INSURANCE

As noted by Barrymore, "Insurance is an integral part of risk management and is woven with the risk transfer effected by indemnities and other exclusion clauses".[44] Given the views stated above on the enforceability of contractual indemnity clauses is it possible to obtain insurance to allocate the risk engendered by breach of statutory obligations?

Before proceeding to consider this issue, the following quote seems particularly apt as an indication of the state of the insurance industry in relation to pollution and environmental liability.

> "Of course the whole basis of that awful mess of litigation that exists in oil pollution is one where both sides are hopelessly polarised. The industry is saying everything is covered regardless of deliberate acts, regardless of knowledge, regardless of this, that or the other, regardless of policy language, regardless of the clear intent of the parties at the time, everything is covered, whereas insurers on the other hand have tended to go to the other extreme and argue a certainty where no certainty exists, argue deliberate acts where to some extent and in some cases I suspect carelessness is a better description. The result of that, as we all know, is an absolute beanfeast for the attorneys and the potential catastrophic damage, as we are already seeing in the draft legislation, to the insurance industry world wide."[45]

It is a principle of insurance law that it is contrary to public policy to insure against the consequences of a criminal act. The courts have supported this principle where intentional acts have been committed and/or proven "absolute" liability attaches to the individual.[46] To provide indemnity under these circumstances would undermine the deterrent purpose of the statute imposing the criminal liability and thus be contrary to public policy.

In addition, liability for fines and penalties is almost universally excluded from insurance policies. It is the general view that the courts would prohibit recoverability of an indemnity for such liability on either of the following grounds:

1. Insurance will not provide protection in respect of liabilities intentionally incurred;
2. It is against public policy to enforce a contract of insurance that provides an indemnity in respect of conduct that is punished by statute. The purpose of this rule is to ensure that the conduct prescribed by the legislation is not encouraged and that the deterrent objects of the statute are not rendered ineffective.[47]

44. Barrymore, op cit, p 24.
45. D D Peng, "An Underwriter's View—Insurance and Legal Issues in the Oil Industry" International Energy and Resources Law and Policy Series (1992), University of Dundee, p 9.
46. [1911-1913] All ER 207.
47. M W Waller, "Insurance for Environmental Risks", published by BLEC Books, [1993] *Environmental Liability Law*.

It is usually the second of these principles that will be relevant in determining the insurability of fines and penalties.

Notwithstanding this exclusion, it is common for environmental legislation to impose fines and penalties in the following circumstances:

(a) on persons causing contamination or pollution, whether or not reasonable care was taken to avoid the contamination or pollution; and

(b) on directors and officers of corporations who fail to ensure that the corporation complies with the provisions of the legislation, although the failure was not intentional and even if the failure was only as a result of carelessness.[48]

The issue then is whether it would be against public policy to enable an offender to obtain an indemnity under a policy of insurance in respect of the consequences of a criminal act or the fines resulting therefrom, where either all reasonable care could not have avoided the act or the imposition of the fine or the offender has simply been negligent and has not recklessly or wilfully engaged in conduct which leads to the imposition of the fine. In circumstances where the offender has taken all reasonable care and is strictly liable there should be an argument that it would not be against public policy to allow the offender to obtain an indemnity in respect of fines imposed. An argument could be mounted that nothing would be achieved by way of deterrents by imposing the fine as the circumstances which gave rise to the offence could not have been avoided.

Some support for this proposition can be gained from *Halsbury's Laws of England* where the following passage appears:

> "Criminal Acts of the Insured
>
> The general rule of public policy is that a person cannot recover an indemnity under an insurance policy in respect of deliberate conduct on his part which is against the criminal law. Different considerations probably arise where a breach of the law, even of the criminal law, arises, not so much from the inherent nature of something deliberately done but from inadvertance, stupidity, ignorance or even reckless folly."[49]

Waller[50] states, "the current position in the United Kingdom appears to be that, provided that there is no intention to breach the statute and the offender was not negligent or at least grossly negligent, considerations of public policy may not prevent the offender obtaining an indemnity from an insurer in respect of the fine and costs associated with the prosecution. A similar trend also appears to be emerging in the United States."[51]

48. See as examples, s 13 of the *Contaminated Land Act* 1991 (Qld) and ss 6, 8A, and 8B of the *Environmental Offences and Penalties Act* 1989 (NSW).
49. *Halsbury's Laws of England*, 4th ed, vol 25, para 724.
50. Waller, op cit at 212.
51. Waller, op cit at 213.

The following is a typical set of exclusions in a Control of Well Policy:

"Exclusions

There shall be no indemnity or liability under this section for:

(a) any loss of or damage to any drilling or production equipment at the site of any well insured herein;

(b) . . .

(c) any claim arising directly or indirectly from seepage, pollution or contamination if such seepage, pollution or contamination:

(i) is deliberate from a standpoint of the assured or any other person or organisation acting for or on behalf of the assured; or

(ii) results directly from any condition which is in violation of or non-compliance with any governmental rule, regulation or law applicable thereto: notwithstanding the foregoing, this exclusion does not apply with respect to any such condition which at the time of loss is in the process of being corrected by a schedule or programme to the extent that the assured is in compliance with such schedule or programme."

Some insurance policies include an innocent assured or joint venturer clause along the following lines:

"Notwithstanding any due dilligence provisions contained within this policy it is understood and agreed that this policy shall not be prejudiced by any act or omission of the operator, owners, joint venturers or managers where the assured is an innocent joint venturer save always that the principal assured shall act with due dilligence and as a prudent assured in the operations covered under this policy."

The view prevailing in the insurance industry is that such a clause would not preserve the non-operators' right to be indemnified under a public liability or control of well policy, if the pollution loss or damage resulted from the wilful misconduct of the operator or its related parties. Typically, the operator acts as the agent of the non-operators and, as previously stated, it is a basic principle of insurance law, founded in public policy, that an insured cannot recover under a policy of insurance if the loss or damage for which the policy is intended to provide an indemnity was deliberately caused by the insured or was caused by the unlawful conduct of the insured.

This area will require a more creative approach to the insurance of environmental risks and the statutory allocation and limitation of environmental risks. For example, the German *Environmental Liability Act* of 1990 introduced the following features:

1. Strict liability of current and former operators of specified facilities for environmental damage. Presumption of causation of environmental damage where a particular facility is inherently likely to cause damage which subsequently occurred.

2. A "cap" or limit on the liability of operators for bodily injury and property damage.
3. Financial responsibility requirements which can be satisfied in the form of liability insurance or in the form of an indemnity agreement or guarantee either made by the federal or State governments or accompanied with appropriate security.[52]

SUMMARY

Given the conclusions set out above, further thought should be given to the indemnity clauses in JOAs.

To reiterate, the main conclusions are:

1. Where the liability is criminal, such as is the case in most environmental statutes, the operator cannot enforce the indemnity given by the non-operators.
2. If liability is criminal and the operator is the agent of the non-operators, the non-operators may be liable to conviction as principals, for example, under strict liability offences. Alternatively, the non-operators may be liable as "persons concerned in the management" of the operator.
3. The non-operators will not be able to rely upon insurance, on grounds of public policy, to effectuate an indemnity given in favour of the operator, if the liability is criminal and the non-operators are principles or "persons concerned in the management" of the operator.
4. Conversely, the operator will not be able to rely upon insurance to effectuate an indemnity given in favour of the non-operators (such as an indemnity for pollution liability caused by the operator's gross negligence or wilful misconduct) for the reasons given above.
5. Even if the liability is not criminal, it may not be possible to rely upon insurance, because there may be an exclusion in the policy for pollution liability resulting "directly from any condition which is in violation of or non-compliance with any governmental rule, regulation or law".
6. More creative insurance and or legislative schemes are required to deal with the imposition of criminal liability on participants in the petroleum industry.

52. Waller, op cit at 215.