COZEN O'CONNOR

PIPELINES, TANKS AND BLOWOUTS, "OH MY!"

SPECIAL CONSIDERATIONS IN SUCCESSFUL PURSUIT OF ENVIRONMENTAL RECOVERY CLAIMS

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Responding to pipeline ruptures, leaking storage tanks and oil and gas well blowouts often presents your insureds with immediate and daunting challenges: providing proper emergency response, notifying and coordinating response efforts with various governmental agencies, planning and execution of complex remediation efforts and, inevitably, assessment of liability exposure as a potentially responsible party.

Not to be forgotten in the aftermath of such environmental incidents, however, is the need to explore contemporaneously the prospects for a successful recovery against third parties. This article will explore some of the more salient challenges for a successful recovery against third parties within the context of one hypothetical and one recent case study.

I.

HYPOTHETICAL

Facts

A large underground pipeline ruptures. The pipeline is owned and operated by Global Pipeline Company ("Global"). As a result of the rupture, 500,000 gallons of gasoline spill out onto a ranch owned and operated by Texas Cattle Company ("Texas Cattle"), some of which drains into a nearby creek.

Digging out around the rupture reveals a 15 year old 30" O.D. steel pipe. The pipe reveals a gaping rupture along a longitudinal weld seam as well as localized corrosion.

The National Transportation Safety Board ("NTSB") issues a report suggesting that the rupture resulted from either a defective weld or corrosion or both.

Global initiates a massive cleanup and remediation effort largely paid for under its liability policy. Texas Cattle bides its time waiting to see how the cleanup and remediation proceeds. Meantime, downstream landowners file multiple lawsuits seeking damages.

Global (and its insurer) evaluate the prospects for recovering damages, including the costs of cleanup and remediation, against the maker of the pipe based on an allegedly defective weld seam.

Standing Issues Who Owns the Claim?

Often the party undertaking the cleanup and remediation (Global) is a potentially responsible party rather than the landowner (Texas Cattle). In its own right, Global may have state and federal law claims for the damages to the pipeline itself and for any profits lost as a result of the shutdown of the pipeline. Often, however, the vast majority of the costs expended relate to the cleanup and remediation of the surrounding land. This is a point of critical significance since state law often restricts the recovery for an injury to real property to the *owner* of the property. Hence, while Global (and its insurer) may be the party actually spending the money to remediate the site, only the landowner (Texas Cattle) may have a right to sue other potentially responsible third parties for the cost of the cleanup and remediation.

There are several strategies Global might employ to avoid the impact of this limitation. First, Global might seek to settle any claims against it held by Texas Cattle and obtain an assignment of Texas Cattle's rights against third parties. Alternatively, Global might seek to enlist Texas Cattle in the recovery action as a co-plaintiff. Some of the pluses and pitfalls of these strategies are addressed later in this article.

Very often the costs of cleanup and remediation is paid for under a liability policy issued to a responding party (Global). This is significant because the claim for recovery will not be a "subrogation claim." Rather, the recovery claim is one for "contribution."

Seeking a recovery for "contribution" raises a variety of issues, among them: choice of venue, the economic loss doctrine, the collateral source rule and the effect of settlement on one's right to seek contribution from non-settling joint tort-feasors.

Venue Selection Issues

In the hypothetical, landowners along the creek (downstream from the spill) filed various lawsuits in the aftermath of the rupture. Generally these suits are filed in the counties where the

landowners reside in an attempt to bring these claims in the forum most sympathetic to the plaintiffs. Depending on which suit makes it to trial first, bringing Global's claims against the pipe maker in the "downstream landowner suits" might potentially avoid problems of res judicata, collateral estoppel and issue preclusion (once a jury has made an adverse determination of fact against Global it may be binding on Global in other lawsuits).

On the other hand, bringing a contribution action separately may afford an opportunity to bring the recovery claim in a location somewhere other than the site of the spill. Pursuing this approach may also put Global on a more equal footing with third party pipe maker. Global can prosecute the claim as a plaintiff, standing as one "big company to another" (as opposed to bringing a third party claim as a defendant in a suit brought by "innocent landowners").

Economic Loss Issues

The economic loss doctrine states that there can be no recovery in tort for purely economic losses. The rationale for the preclusion of economic loss recovery in tort is based on the recognition that the economic loss doctrine represents "the fundamental boundary between contract law, which is designed to enforce expectancy interests of the parties, and tort law, which imposes a duty of care and therefore encourages citizens to avoid causing physical harm to others." The United States Supreme Court has recognized the doctrine but held that it does not bar recovery in tort for losses based on personal injury or injury to "other property."

As a result of the economic loss rule, Global would be barred from seeking to recover damages to the pipeline itself in tort. Rather, it would be forced to proceed under the law of contracts. Typically, the statute of limitations for contract claims arising from the sale of a product begins to run on the date the product is first delivered. In the context of this hypothetical, while the limitations period varies from state to state, it is unlikely that a contract claim would be available to Global with respect to pipe first delivered 15 years prior to the actual

loss. Similarly, the economic loss rule would bar Global's recovery for any lost profits arising out of the shutdown of the pipeline for repairs.

A more thorny issue involves the question of whether damage to Texas Cattle's land would constitute "other property" in the context of a suit brought by Global. In other words, can the property of another (here the ranch) satisfy the "other property" exception? While clearly the ranch is property other than the product which was the subject of the contract (the pipe), the fact that Global is discharging a liability obligation rather than repairing its own property may render the remediation losses "economic" when viewed from Global's perspective.

Collateral Source Rule

Imagine a defendant who negligently burned down the plaintiff's home seeking to defend the case on the basis that the plaintiff suffered no loss because his homeowner's insurance paid to rebuild the structure. The law provides that the defendant is not entitled to the benefit of insurance contract between the plaintiff and the plaintiff's insurer; that is, the defendant may not deduct the monies received by the plaintiff from this "collateral source" to reduce the plaintiff's damages.

Unfortunately, the application of the collateral source rule in the context of this hypothetical is far more difficult. Recall that the cleanup and remediation efforts are being largely funded by Global's insurer. This liability policy was not purchased by Texas Cattle, the landowner. Thus, it is arguably not a "collateral source." The significance is that the cleanup and remediation of Texas Cattle's land being undertaken by Global (and its insurer) may reduce the damages for which only Texas Cattle is entitled to seek recovery.

This appears to be an area of unsettled law and potentially subjects Global and its carrier to a rather significant Catch 22. While Global is legally obligated under a variety of statutory enactments to undertake cleanup and remediation, the claim for cleaning up the ranch is owned

by the landowner. Yet, at the same time, the remediation may well have the effect of reducing the landowner's claim to zero depending on the success of the remediation effort.

What Happens if Global Settles with Texas Cattle and Proceeds with its Contribution Claim Against the Pipe Maker?

In order to avoid the standing and collateral source issues, it may occur to Global (and its insurer) to settle Texas Cattle's claims against Global (taking an assignment of those claims). Depending on the forum, *this might be fatal to Global's recovery*. In Texas (and a variety of other states) a settling tort-feasor (Global) cannot seek contribution against a non-settling tort-feasor (the pipe maker). Accordingly, before making any attempt to settle the claim one must understand the law of the applicable forum. See Exhibit "A" hereto for a 50 state comparison of the effect of settlement on contribution claims against non-settling defendants.

On the other hand, Global might seek to enlist Texas Cattle as a co-plaintiff when bringing the third party claim against the pipe maker. If Global elects to pursue this route, great care must be taken to characterize the remediation of Texas Cattle's land as something other than a settlement. In order to document this relationship properly, a variety of independently negotiated agreements might be necessary: a pro-rata agreement addressing the recovery and apportionment of costs, an express reservation of claims by Texas Cattle against Global, an agreement tolling the statute of limitations (pending the outcome of the third party claim and completion of the cleanup) and, if joint counsel is used, an agreement disclosing and waiving potential conflicts of interest. Despite such agreements, one should expect to draw the challenge that, in substance, the claims have been settled. In seeking to defeat this challenge, it should be remembered that merely because Global attempts to remediate the site does not mean that those efforts will be successful. For example, there may remain a permanent injury to the value of the ranch based on the stigma of its having been involved in a pipeline rupture.

Federal Sources of Recovery

There are a variety of federal statutes which may provide great assistance in avoiding the impact of the standing, economic loss and collateral source issues addressed above. For example, the Federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), the Clean Water Act ("CWA") and the Oil Pollution Act of 1990 ("OPA") all provide for contribution rights against potentially responsible third parties. In particular, the OPA speaks in terms of "subrogation, indemnity and\or contribution rights." Pursuing a recovery under these statutes may also provide a basis for jurisdiction in a federal court (as they raise "federal questions"). Beyond that, these statutes may also set the measure of recovery at the cost of cleanup and remediation (as opposed to limiting recovery to the fair market value of the property being remediated).

These federal statutory enactments are not, however, without risk. Typically these statutes require some kind of "triggering event" in order to come within their reach. The OPA, for example, requires that the release of oil threatens "navigable waters." Yet, it must be remembered that such enactments constitute not only a sword in the hands of Global when pursuing the pipe maker, they may also constitute a sword in the hands of the downstream landowners. For this reason, liability counsel may wish to challenge the question of whether the creek in the hypothetical constitutes "navigable waters" so as to prevent the downstream landowners from maintaining an action under the OPA. In short, recovery counsel must at every turn coordinate its actions very closely with defense counsel.

Other Issues

Product identification often presents a challenge depending on the age of the pipe, the tank or blowout prevention equipment. Very often, particularly in the case of a long oil and gas pipeline, several suppliers will have supplied pipe to the project. The stampings are often worn

away and one must resort to "as-built surveys," job delivery tickets and other company records to establish the identity of the product's maker.

Statutes of repose are also of particular import in these cases. These so called "outside statutes of limitation" vary state to state. Pipe or tanks or other equipment in the ground longer than 15 years may well be outside most statutes of repose.

In analyzing the prospects for a successful recovery, one must also bear in mind the law of comparative fault in the relevant jurisdiction. In the hypothetical, even if the pipe weld turns out to be defective, it may be that Global's conduct during the installation of the pipeline and/or the maintenance of the pipeline bear some responsibility for the loss. For example, perhaps with proper maintenance procedures the crack at the weld seam could have been detected at some earlier point in time. Often cases involving large remediation efforts also involve a claim that the insured did not properly respond to the loss. When such assertions arise, it is important to bear in mind that the identity of the party in charge of the cleanup varies over the course of the hours, days and weeks following the incident. While the insured may be the party first charged with responsibility for the response, shortly thereafter that responsibility may fall to a variety of state and federal agencies. Thus, Global may not be entirely responsible for the wisdom of cleanup and remediation decisions made following the event.

Often after an environmental release of pollutants, various governmental entities may issue reports which weigh in on the cause of the event. For example, the National Transportation Safety Board ("NTSB") has jurisdiction for determining the cause of a pipeline rupture. Typically, the NTSB will issue its conclusions in one document and its underlying factual findings in another. While the factual findings, photographs and other recordations of the event are admissible, the NTSB's conclusions as to the cause of the event are not admissible.

As mentioned above, coordination with liability counsel is of particular importance in environmental cases. Invoking a federal statute may be helpful to the recovery claim but harmful to the insured's defense. Selecting a venue and the timing of bringing third party claims is also a subject requiring coordination. Finally, it is extremely important for recovery counsel and defense counsel to coordinate with regard to the selection, work product and opinions of experts.

II.

CASE STUDY

Facts

A group of investors was engaged in a drilling contract with Key Production Company ("Key Production") to drill a gas well in Custer County, Oklahoma to 15,300 feet. This well is known as the Sherry Beth 3-26 well. On May 12, 2001, the well had been drilled to total depth of 15,300 feet where four and a half-inch production casing was run down the hole and cemented in place. To complete the cementing process, the cement was displaced with water which was pumped down in the casing. The difference between the weight of the water and the cement created a differential pressure of 6,500 psi at the down hole float equipment, which exceeded the 5,000 psi working pressure of the float equipment.

Approximately 30 minutes after the cement was displaced by water, the well started flowing water back up out of the 4 ½ " production casing. The high-pressure water flow, which also prevented personnel access to the circulating head and the valves to stop the flow. The cement head manifold at the surface and the downhole float equipment are the only blow-out preventers in operation at this point in the drilling operation. The closed valves on the manifold head are designed to prevent flow from the casing. If the valves had been closed, this would have precluded flow out of the top of the well.

The location was abandoned, and after the well had unloaded (blown) all fluids, it blew dry gas for approximately two hours. The dry gas soon ignited and flames engulfed the rig substructure, derrick, draw-works and engine compound. This blowout incident occurred as a result of the apparent failure of float equipment associated with the rig. This allowed gas to flow from the wellbore into the casing.

Basin Consulting Services ("Basin Consulting"), who was hired by Key Production, was responsible for the safety of the overall drilling program and Schlumberger was responsible for the safety of the services provided by them. Basin Consulting was retained by Key Production to provide engineering services

and well site supervision. Both Basin Consulting and Schlumberger were onsite at the time of the occurrence. The float equipment was manufactured by Davis-Lynch, Inc. ("Davis-Lynch").

The Float Equipment

The float equipment installed in the well bore was Davis-Lynch standard stock float equipment. It was sold on consignment through Juluca (the Oklahoma distributor) which invoiced the sale to Key Production. The equipment was actually ordered by Denis Rauh of Basin Engineering, the onsite consultant. Rauh testified that he explained to the sales people at Juluca that it was a deep well, high pressure, using P110 casing with a clear fluid (water) as a displacement fluid. Rauh's testimony is that this information should be sufficient information to put Juluca (as agent of Davis-Lynch) on notice of the fact that Key Production needed high pressure (in excess of 5,000 psi) equipment and to give the customer less than high pressure equipment would risk catastrophe. Rauh testified that he did not supply Juluca or Davis-Lynch with a specific PSI rating for the equipment. In other words, he did not ask for float equipment that could handle a differential pressure of 6,500 psi. He merely said that he wanted "high pressure" float equipment. Davis-Lynch and Juluca deny they received a proper and clear request for high pressure float equipment form Rauh, Basin or Key Production.

Critical Issues

The ultimate issue in this case is whether Davis-Lynch and Juluca are responsible to the plaintiffs for supplying an underrated piece of equipment. Given the contractual setting (the joint operating agreement) and industry practice, an unavoidable large amount of responsibility must be assumed by Key Production as the lead operator. Accordingly, Key Production's agents, including the onsite consultant Basin Engineering and the cementing company, Schlumberger, must share a responsibility for the activities at the well site leading to the blow out.

It is clear from the circumstances that the selection of the underrated float equipment is perhaps the single most significant fact in this case. Key Production argues Davis-Lynch and Juluca remain responsible for supplying an underrated valve because they were given plenty of information to put them on notice that high pressure equipment was being requested and, in the face of that obvious request, they supplied underrated, standard equipment. The claims against Davis-Lynch and Juluca include product liability, breach of implied and express warranty claims, breach of contract and negligence claims.

Davis Lynch and Juluca by way of defense point to Basin Engineering, Schlumberger and Key Production and argue that Key Production breached their obligation to the rest of the group to make sure the equipment was appropriate for the task. Davis-Lynch and Juluca argue that a more specific request for the proper float equipment could have been made, one that specified the actual differential pressure across the valve. They criticize the use of the light weight water as the displacement fluid. They criticize the practice of leaving the valves on the cement head open, which allowed the gas to vent to the atmosphere and ultimately to ignite to cause the fire and consequently damage to the rig and well.

Technology

In a highly technical case, one issue that always comes up is how to explain the technical issues to the jury. In this case, the parties used a computer animation to show the drilling and cementing of the gas well. There were also several visual aids and a glossary of terms that were presented to the jury. In a case that requires understanding of many specialized technical issues, the party that makes the technology accessible to the jury has an advantage.

Hiring the Right Experts

Due to the nature of drilling operations taking place almost three miles underground, blowout cases are often largely circumstantial. It should be explained to the jury, through qualified experts, what the standard of care is in the industry for drilling operations, the mode of failure of the well, and any metallurgical issues. Specific to this case study, a warnings expert was critical due to the breakdown in communication between Key Production and Juluca and Davis-Lynch regarding the ratings for the float equipment used in this well.

There was also a damages issue in the case regarding the voluminous invoices that were generated as a result of the blowout, fire and drilling of the replacement well. A CPA was hired to bolster the credibility of the damages on this point.

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