

ENERGY EXPERT: ISSUES IN FOCUS

A quarterly review of disputes and complex issues in the hydrocarbon production and processing industries.

Baker & O'Brien, Inc.

www.bakerobrien.com

January 2014

When “All Risks” May Not Cover “All Losses”

Jury Trial, United States

By Scott Jensen

An international crude oil trading company entered into an agreement with a refiner in which the trader agreed to provide crude oil feedstock to the refiner. The refiner agreed to process the crude oil, on a waterborne cargo-by-cargo basis, into petroleum products on the trader's behalf. The parties negotiated a “deemed” yield of products—based on the crude oil quality—which represented the trader's product “lifting” entitlement for that cargo. In the refining industry this is referred to as a “toll” processing agreement. In a tolling process the owner of the feedstock simply pays the refinery a fixed fee (the toll) to utilize the refinery's equipment, in the same way that one pays to use a toll road or pipeline. To protect against loss, the trader in this case took out an “All Risks” insurance policy.

The trader kept a careful accounting of its available lifting entitlement for each product based on the crude oil processed. However, after many cargoes had been processed, when the

trader sought delivery of a large volume of one of the products, it was informed that there was insufficient product available. An onsite investigation resulted in a claim that the refiner had been selling product for its own account, had sometimes failed to meet the deemed yields, and had been filling current lifting obligations with product from the next cargo—not unlike a “Ponzi” scheme. The trader filed a lawsuit against the refiner, as well as making a claim of loss against its insurance provider. The insurance company denied coverage based on the fact that the All Risks policy did not cover losses incurred through poor refinery processing.

Baker & O'Brien was engaged to serve as expert in the trial and to verify the extent of the losses incurred, as well as to evaluate whether the bulk of the losses were due to the refiner's “theft” of product—which was a covered event in the policy— or to inefficient processing. Our report was entered into evidence and we testified at trial.



Operations and Maintenance Contracts – Not Always What They Seem

ICC Arbitration, London

By Peter Halliday

Following the construction of a large, 42-inch crude oil pipeline system in the Eastern Hemisphere, an international owner (the “Owner”) entered into a contract with a regional service provider (the “Operator”) to operate and maintain (“O&M”) the pipeline, storage terminal, and loading facilities.

Pipeline System Overview

Total Length, miles:	1,000+
Diameter, inches:	42
Throughput:	Up to 1 Million B/D

The Operator served on an “arms-length” basis and was paid based on the volume of crude oil delivered. Soon after start-up, a number of pipeline defects became apparent. Also, disagreements arose over who should provide some of the equipment needed to service the facilities. Finally, the parties were unable to agree on the essential O&M personnel required and their associated overhead costs. The Operator initiated an arbitration to recover unpaid amounts, lost profits, and unrecovered costs. The Owner responded that the amounts claimed were not owed—alleging that the costs and overheads were either already included in the agreed payments under the O&M contract

or, in the case of equipment defects or failures, because the root cause analyses and mitigations were still in progress.

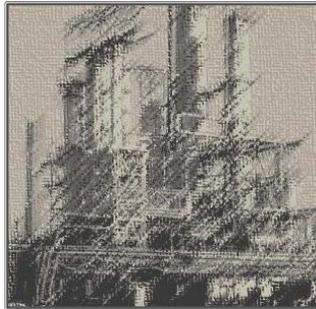
Baker & O’Brien was engaged to review available records relating to the issues in dispute and to provide an expert opinion on: (1) whether the defects were due to improper design, operation, maintenance, and/or installation; (2) whether all equipment necessary to operate and maintain the facilities was part of the Operator’s contractual scope of work; (3) what industry practice would suggest, given the geography of the installations, as to the number of O&M personnel needed; and (4) what the associated overhead costs of those personnel would typically comprise. During our investigation, we inspected the terminal and several of the pump stations and related facilities to review O&M philosophies and challenges. Based on our findings and our experience with similar facilities in other parts of the world, we prepared an expert report and a rebuttal report, which were submitted in evidence, and testified at hearing.

Old Refineries Never Die – Nor Do They Just Fade Away

Jury Trial, United States

By Dan Finelt

Residents in a small rural town in the Northern Plains alleged that hydrocarbon contamination discovered in the town’s vicinity was from a nearby refinery that had been shut down for almost 50 years. Because a major oil company had acquired the refinery operator’s business a few years earlier, the residents sued the oil company. The refinery had been built in the 1920s and was one of a multiplicity of small refining facilities that once dotted the U.S. landscape. In such times, proximity to crude oil feedstock was a major consideration, and refineries sprung up wherever an ample supply of crude oil was available. However, few such plants remain in operation today. In this case, the refinery was closed in 1961 when the crude field had run dry, and the facility was dismantled. Fifty years later residents claimed that hydrocarbons spilled by the original refinery operator continued to pollute the town’s soil and groundwater.



Baker & O’Brien was engaged to provide evidence relating to: (1) typical standards of care for refinery operations during the period 1920–1960; (2) typical maintenance practices during the same period; and (3) technology for hydrocarbon leak detection that existed at that time, compared to modern methods available today. In conducting our investigation, we reviewed early depositions taken from former refinery employees to assess whether the plant’s operating practices appeared to be consistent with the standards of care and leak detection procedures of the day. Our investigation demonstrated how refineries operated under much different requirements 50 years ago, compared with current standards and practices. Our expert report on such matters was instrumental in facilitating a settlement between the parties.

Consulting Support for Complex Commercial Disputes

When faced with complex commercial disputes in the energy-related industries, clients often turn to Baker & O'Brien for its independent and objective support. For over 20 years, the firm's consultants have employed their engineering knowledge, industry experiences, and commercial acumen to provide assistance on a wide range of matters. Our project experience includes disputes involving operational incidents, standards of care, asset valuation, commercial supply terms, product quality, large engineering and construction projects, and intellectual property.

Our clients include many of the world's largest law firms, insurance providers, and operating companies. Law firms rely upon Baker & O'Brien to evaluate

technical and commercial aspects of a case and provide expert testimony. Our analyses, conclusions, and expert testimony have been heard by judges, juries, and arbitration panels around the world. On insurance matters, clients rely upon Baker & O'Brien's assistance for investigation of industrial accidents, and quantification of resultant property damage and business interruption losses. We are also called upon to assist insurers in subrogation actions by evaluating causation theories and claims for damages.

We would welcome the opportunity to discuss our qualifications in more detail as they relate to your specific area of interest.

Dallas Corporate Office



12001 N. Central Expressway
Suite 1200
Dallas, TX 75243
Phone: 1-214-368-7626

Houston



1333 West Loop South
Suite 1350
Houston, TX 77027
Phone: 1-832-358-1453

London



146 Fleet Street
Suite 2
London EC4A 2BU
Phone: +44-20-7373-0925

Baker & O'Brien, Inc. is an independent, professional consulting firm specializing in technology, economics, and management practice for the international oil, gas, chemical, and related industries.

www.bakerobrien.com