

Out in the Cold

Repeated Misadventures: Key questions for Shell on its Alaskan Arctic programme

Introduction

On 8th January 2013, the U.S. Interior Secretary, Ken Salazar, announced a review of the 2012 Alaskan Arctic offshore drilling programme “to review practices and identify challenges as well as lessons learned.” The review to be completed within 60 days will focus on the successive setbacks encountered by Shell during 2012. These include its failure to secure timely certification of its containment ship, the *Arctic Challenger*, the failure of safety testing on its containment dome; operational issues with its drilling rig the *Noble Discoverer* and the running aground of its other drilling rig the *Kulluk* on 31st December 2012¹.

Previous briefings (www.fairpensions.org.uk/arcticshell/investors) have detailed Shell’s numerous problems in the summer of 2012. This briefing provides information on Shell’s most recent setbacks namely the running aground of the *Kulluk* drilling rig off the coast of Alaska on 31 December 2012 and the recently announced findings of a coast guard inspection of its other rig the *Noble Discoverer*. It also highlights key questions for investors to ask Shell in light of these latest significant developments.

The Kulluk

On 21 December 2012, the 266 foot drilling rig, the *Kulluk* began its journey from Alaska to Seattle. Having no propulsion system of its own the rig was being towed by the tow vessel, the *Aiviq*. Following engine failure on the *Aiviq* a second towing vessel, the *Alert*, was brought to assist the *Aiviq* in towing the *Kulluk*. On 31st December in the midst of difficult weather conditions the *Kulluk* broke free from the *Aiviq*. Fearing for the safety of the crew of the *Alert*, the tow line to that vessel was disengaged. The *Kulluk* ran aground on Sitkalidak Island less than an hour later².

A major salvage operation was launched from the U.S. Coast Guard air station on Kodiak Island 40 miles away³. It is important to note that Shell’s drilling lease areas are 1,000 miles from a U.S. Coast Guard air station calling into question the ability to deal with an incident in a drilling area⁴.

Initial concern focused on the potential of a leak from approximately 140,000 gallons of ultra-low sulfur diesel and about 12,000 gallons of combined lube oil and hydraulic fluid on board.

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On 4th January 2013, the Independent published a story claiming that Shell's decision to move the *Kulluk* in late December was "motivated by a desire to avoid \$7m (\$4.3m) of Alaskan state taxes." Despite earlier statements supporting this claim Shell issued a further statement to say that favourable weather forecasts had mattered more than the tax environment⁵.

On 7th January 2013, Shell confirmed that the *Kulluk*, "has been safely towed to a safe harbour on Kodiak Island in the Gulf of Alaska, where it will undergo a thorough safety assessment before resuming its journey to its winter harbour for repairs and maintenance"⁷.

If significant repair work is required to the drilling rig this may delay Shell's plans to recommence its stalled Alaskan Arctic programme in 2013. The findings of the US Interior Department announced review may also result in the imposition of additional obligations.

“
It's fair to say that the current tax structure related to vessels of the [sic] type influenced the timing of our departure.

Independent, quoting a Shell spokesperson⁶
”

The Noble Discoverer

On 27th December 2012, Noble Corporation, the owner of Shell's other drilling rig, the *Noble Discoverer*, released a statement confirming that "it is working cooperatively and diligently to rectify deficiencies and maintenance issues raised by the U.S. Coast Guard during a recent inspection of the Company's drillship, the *Noble Discoverer*."⁸ The statement confirmed that the issues identified by the Coast Guard include the ship's propulsion and safety management systems. Noble Corporation also confirmed in its press release that it had discovered other 'potential regulatory non-compliance issues' including possible unauthorised discharges.

On 4th January 2013, CBS News reported that the U.S. Coast Guard had called in their criminal investigation team to investigate whether federal laws had been broken. CBS quoted a U.S. Coast Guard spokesperson as saying "the Coast Guard continues to review evidence and the investigation is ongoing."⁹

This follows previous issues with the *Noble Discoverer* including the issuing of an 'enforcement warning' for being a 'pollution source' in September 2012.¹⁰

It is unclear what impact if any these findings will have on Shell's 2013 drilling plans.

Conclusion

Shell has moved quickly to label the *Kulluk* incident as a "martime transit" issue unconnected to drilling activity. However, it is merely the latest in a summer long series of mishaps and operational failures for the company. What the New York Times has called "*Shell's repeated and early misadventures*"¹¹ should raise significant concerns about the viability of its proposed Alaskan Arctic drilling plans. The political and civil society response to the running aground of the *Kulluk* evidences the potential fallout of a significant incident in Arctic waters.

Shell's continuing refusal to publish an environmental and financial worst case scenario prevents investors from adequately assessing the risks of such an ambitious capital investment. The contradiction between the number and nature of the setbacks on the one hand and the confidence of company statements on the other call into question the level of Royal Dutch Shell board oversight of the Alaskan Arctic project.

It is important that investors follow the US government's lead and view this latest 'misadventure' as an opportunity for detailed re-assessment of the value of Shell's Arctic strategy.

Key questions for investors

- What level of oversight did Shell's board of directors exercise over the company's 2012 Alaskan Arctic plans and has this oversight increased in light of recent events?
- Who on the Shell board has direct personal oversight of the *Kulluk* salvage operation and the U.S. Department of Interior review?
- The *Kulluk* ran aground within 40 miles of a U.S. Coast Guard air station enabling a timely response to the incident. Will Shell provide detailed information on its response plan were such an incident to occur in either the Chukchi or Beaufort seas which are approximately 1,000 miles from a U.S. Coast Guard air station.
- What part did tax planning play in the decision to move the *Kulluk*?
- What steps did Shell take, following the issuing of an enforcement warning to the *Noble Discoverer* in September 2012, to ensure that maintenance and safety issues on the rig were being addressed by Noble Corporation? What steps is Shell taking now in light of the recent U.S. Coast Guard findings?
- Given the repeated problems with the *Noble Discoverer* what level of oversight will Shell exercise in future over safety and maintenance issues on the rig?
- No analyses have been published quantifying the specific oil spill response impediments in Shell's lease areas in the Chukchi and Beaufort seas. Has the company carried out a spill response gap analysis of its prospects in the Beaufort and Chukchi seas? If so, will the company make it available publicly? Without such an analysis it is not possible to accurately assess the risk posed to Shell by an oil spill in its Arctic operations.
- Does Shell have any plans to conduct more rigorous testing of its spill response equipment (particularly well containment devices) in Arctic conditions and simulating real-life conditions, and to make detailed disclosure of the conditions and results of these tests?
- Will Shell carry out an analysis of the environmental and financial worst-case scenario and make it available publicly?
- What is the current anticipated spend in 2013 on oil spill prevention and response related to Alaskan Arctic projects?

Further information:

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The opinions expressed in this publication are based on the documents specified in the end notes. We encourage readers to read those documents.

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Endnotes

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