



BEN W. HEINEMAN, JR.

Ben Heineman has held senior positions in business, law, and government, is a senior fellow at Harvard's Law and Kennedy Schools, and is author of [High Performance With High Integrity](#) (Harvard Business Press, 2008).



A Cautionary Tale for Regulated Industries

By: Ben W. Heineman, Jr.

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The lessons from BP's gulf explosion in 2010 took a dramatic turn for many regulated industries. Alleging a "culture of corporate recklessness," the Department of Justice recently said that [BP was guilty of "gross negligence" and "willful misconduct"](#) in the Deepwater Horizon explosion. The company strongly disputed the allegations.

This new government charge has significance for BP because it could lead to triple damages under the [Clean Water Act](#) for each barrel of oil spilled. The penalties on this issue alone could total \$21 billion, assuming, as the government does, 4.9 million barrels escaped from the Macondo Well (BP says 2.7 million barrels). But the charge has broader significance for companies facing gross negligence or willful misconduct allegations under a number of regulatory statutes that impose triple damages for such conduct.

[The Justice Department's arguments](#) for such behavior — and how the issues will be resolved — are thus issues of great moment, not just for BP but also for many regulated industries. Such companies should pay close attention to the different ways in which the Justice Department claims egregious BP behavior and prevent such actions in their own operations.

[In March, BP settled civil claims by private plaintiffs for \\$7.8 billion](#), but this did not resolve claims against the oil company by federal and state governments under various statutes and theories. The Justice Department charges of gross negligence were filed before the judge considering whether to approve this private party settlement in order to ensure the issues were preserved for the BP-Department of Justice (DoJ) trial scheduled for January, 2013.

The harsh wording was, in part, a negotiating tactic (and probably a tough-on-business election year initiative). BP and the government are reported to be \$10 billion apart on a final resolution of all government claims, not just those arising from the Clean Water Act (BP=\$15M, DoJ=\$25B).

But, on the substance, the Justice Department court filing is a road map for such charges against companies operating under regulatory regimes with triple damages provisions. DoJ sketched out at least four different ways in which BP might, in a civil case, be found grossly negligent (egregious conduct beyond reasonable care with foreseeable adverse consequences) or to have engaged in willful misconduct (intentional acts with adverse consequences). (No criminal charges have been filed against the company.)

- Because it failed to remedy safety process and safety management failures detailed in reports following BP's 2005 plant explosion at Texas City, **senior BP management off the rig — from the board of directors down — acted improperly**. I have argued for two years that both BP's accident report and the numerous government reports have failed to look at the broader questions of [leadership](#), [management](#), and accountability in the company. DoJ now says this is a highly relevant consideration.
- Gross negligence may be inferred from the fact that **eight different failures — rather than a single act — combined to allow gas to escape up the well and to explode on the rig**: e.g. failure to cement the well-head, failure to detect gas in the well, problems with the blow-out preventer, and failure to deal with gas on the rig. Under leading case law, Justice says, such a chain of failures can demonstrate egregious conduct rising to gross negligence.
- Gross negligence may also be proven by a single critical event, in this case **BP's failure to resolve a red flag conflict**: ignoring a warning signal of gas in the well and crediting a different measure showing no gas. Proceeding without further testing and a much greater degree of certainty is, DoJ says, an egregious act by itself.
- Finally, gross negligence may be inferred from BP's failure to make sure its contractors, most importantly Transocean (who owned and operated the rig) and Haliburton (responsible for closing the well on the ocean floor with cement) acted prudently and safely — and to refrain from asking those contractors to take extra risks (as alleged in this instance). This question of **BP's responsibility for overseeing contractors** is critical because so many risky, high technology projects involve use of specialized vendors upon whom safety and quality depend. And BP, in its own report, acknowledged that one of the operational

imperatives in the future was to do a better job in overseeing contractors' key processes and developing "audit-able" contractor safety practices which BP can review. (See [implicit BP admissions in its recommendations.](#))

To be sure, these different theories — top management failure, multiple connected causes, a single critical failure, and improper oversight of key contractors — have not been laid out in detail by DoJ nor rebutted in detail by BP. That is what will happen in the January trial, unless the case settles. But, they are vital issues to address now for all companies who operate potentially catastrophic technologies with the risk of triple damages for events which can cause damages in the billions.

Given the public and corporate interest in understanding as much as possible about higher degrees of fault — if such are found — the government settlement should seek to clarify this set of issues. To avoid additional government cases, that is why an agreement to end the disputes could well be global — involving both federal and state governments, and involving not just liability for past acts but payments for future restoration of the environment (called Natural Resource Damages) as well as resolution of criminal charges (if any) against the company (as opposed to individuals). That way, any admissions would have limited future legal effect (though reputational harm might persist unless and until BP convinces various constituencies of changed safety systems and processes).

Thus, more than two years after the Gulf explosion, significant legal proceedings still must be watched with great care by companies operating with great risk to the environment and the economy. These proceedings still cast a long shadow over BP's financial exposure; its stock price (still down more than 30 percent since the event and under performing its peers); its assets (drilling rights sold to help pay damages); its relations with key contractors (suits against Transocean and Haliburton) and, ultimately, its past management. The cautionary tales for companies in high-risk global business continue to offer dramatic lessons as the out-of-pocket cost for BP heads north of \$40 billion amidst serious government charges.

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http://blogs.hbr.org/cs/2012/09/new_bp_charges_a_continuing_ca.html