

**The California Oil and Gas Report**

# Fracking and Allocation of Risk

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##### Part 3 of a 4-part series

Numerous parties are involved in the drilling and completion of a shale gas well. First and foremost, there is the owner/operator of the site. The operator will have others working at the site, including contractors building out infrastructure, such as roads, pads, and ponds, and drilling contractors who supply the rig and crew to drill the well.

There likely will also be wireline operators and equipment suppliers. Fracking operators provide the chemicals, blend the fluid, and supply the pumps to frack the wells. Another contractor may drill water wells on the site.

In addition to the operator and contractors, “nonoperating” owners who own a portion of the well through a “joint operating agreement” may be involved in the site.

So, how is risk allocated among all of these entities? Every agreement and arrangement is unique, but the on-shore exploration and production industry is relatively uniform in how the risks are allocated.

Based on many years of contracting history, most of the parties are familiar with how risks are apportioned. Operating agreements generally allocate the risk to the operator and the “nonoperating” ownership in accordance with their ownership interest.

Contractors on the site generally are responsible for their workers and their equipment regardless of fault. Under this form of contract, referred to as “knock for knock,” each party indemnifies the other for damage to their personnel and their property. Each party thus insures only the risks associated with their personnel and equipment. They don’t have insure the personnel or property of others in the event that their acts lead to damage to the others.

In addition, contractors generally will not be responsible for downhole or “resource” damages. For instance, the owner/operator cannot hold the driller responsible for failure to recover gas by alleging that the fracturing or drilling resulted in damage to the formation, making recovery impossible.

There are several different types of contracts used for drillers, including day rates, footage rates, or turnkey. Turn-key contracts are the only contracts where the drillers accept liabilities from the operations.

However, the majority of the drilling contracts are written as day rate or footage contracts. Under these contracts, the operator essentially assumes control of the drilling rig (i.e., they are instructing the driller.) The operator assumes the risk and provides the liability and “control of well” insurances for the site.

The driller will be responsible for certain insurances for their equipment and, of course, workers compensation for their employees. Some larger drillers may also choose to purchase their own “control of well” programs (discussed below) in the event that they are working for smaller operators. But, generally speaking, the owner/operator assumes liability for operations at a fracking site.

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