West End roundtable series

Discussing decommissioning: Investment opportunities and regulatory concerns

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The UK's oil and gas authorities have adopted a pragmatic approach to the issues concerning liability for the decommissioning of offshore installations.

Here are some of the factors that investors in the sector should be aware of:

- The oil price collapse has led to a fundamental change in the oil and gas markets, and as the UK Continental Shelf (UKCS) increasingly matures, decommissioning is becoming a larger part of the discussion.
- Nevertheless, significant development opportunities on the UKCS remain—with an estimated 20 billion barrels of remaining potential and up to 300 unsanctioned discoveries with 3 billion barrels' potential; the need to balance development opportunities and decommissioning liability is a key consideration for the regulators.
- The UK government has ultimate liability for decommissioning on the UKCS and has developed a legislative regime that ensures the decommissioning bill is assigned to those parties deriving, or who have derived, financial benefit from the asset, rather than the UK taxpayer. For offshore installations, these parties will include, in the first instance, current licence holders, owners and parties to the joint operating agreement, but may also extend to 'associated' companies of license holders and then former licence holders.
- The main governmental departments and companies responsible for framing and implementing policy on the UKCS and liaising with owners/operators/investors in the sector are the Department for Business, Energy and Industrial Strategy (BEIS) and the Oil and Gas Authority (OGA).
- Although the general rule under the OSPAR Decision 98/3 requires the full removal and reuse/disposal of an installation, there are opportunities to apply for a derogation in certain cases to determine that certain infrastructure may remain on the ocean floor under OSPAR. BEIS will consider options for leaving pipelines and related materials in situ if it is demonstrated to be the best solution through a comparative assessment of options for decommissioning.
- Despite the hierarchy of decommissioning liability from current owners to past owners and 'associated' companies, BEIS and the OGA consider commercial factors and will look to adopt a reasonable and proportionate approach across the basin, regardless of the commercial arrangements in place and will not just look to the party with the deepest pockets.
- BEIS has stated that until decommissioning liabilities exceed 50 per cent of the net worth of the existing participants, it will not tend to look up the ownership structure to cover the liability or retain or reassign liability to former owners.
- Decommissioning obligations for participants actually arise when the UK Secretary of State (acting through BEIS) issues a notice under Section 29 of the Petroleum Act (1998)—a Section 29 Notice—on those parties, requiring the submission of a decommissioning programme by a specific date. This decommissioning programme will then be scrutinised by both the OGA and BEIS prior to being approved by BEIS.

- To mitigate decommissioning exposure or when required by BEIS, Section 29 Notice holders enter into a Decommissioning Security Agreement (DSA). The DSA uses a trust structure to ensure that if a licensee fails to meet its decommissioning obligations, the other beneficiaries can access the defaulting licensee's share of the trust.
- While an industry standard form DSA exists, these contracts are becoming increasingly negotiated and complex in the current market. New entrants to the sector look to novel methods to apportion decommissioning liability, with many DSAs signed over the past year having the seller (often an oil major) retain liability for part of the decommissioning process—to make the purchase of the ageing asset more palatable to the new owner.
- The UKCS ownership landscape is evolving as smaller players with an ability to operate at lower profit margins take over from the supermajors. Although this is helping to support the overall objective of maximising economic recovery from the basin, the ability of these smaller players to cover decommissioning liability must be managed both through the legislative regime and the DSA structure.
- To further promote the development of opportunities on the UKCS and ensure economic recovery from the basin is maximised, the OGA has developed a number of Asset Stewardship Expectations and has encouraged licence holders to operate on an Area Plan basis rather than as individual blocks to help protect critical infrastructure, increase production efficiencies and encourage cost reduction for both the development and decommissioning of an asset.
- The OGA will review Cessation of Production requests to assess whether they adhere to the principles and objectives of the MER UK strategy.
- The OGA and BEIS are working closely with both oil majors and smaller/new entrants to assist in cases where there are concerns about the financial stability of any of the parties involved. In certain circumstances, the Secretary of State may seek to become a party to a DSA.
- Significant tax incentives to reduce the burden of decommissioning an asset are offered, including decommissioning relief deeds and the ability to post decommissioning security on a post-tax basis. HM Treasury is also undergoing a consultation on the barriers to late-life investment in the sector and ways in which further investment can be encouraged.
- The UK policy and approach to decommissioning continues to evolve. Revised BEIS decommissioning guidelines are expected to be released in 2017. Improvements in technology and enhanced collaboration between participants are expected to further reduce the cost of decommissioning in coming years.

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