20 ESSEX STREET

BULLETIN

END OF SHELF LIFE:

The regulatory framework and legal issues involved when decommissioning oil and gas platforms

Introduction

The oil and gas industry worldwide is facing the daunting prospect of decommissioning its infrastructure. This is a global issue, affecting installations in Indonesia, the Gulf of Mexico and Europe. In respect of Europe this is especially so in the North Sea, where depressed prices, high maintenance costs and depleted natural reserves on the continental shelf signal the end of life for many ageing platforms. The United Kingdom, owing to the position of current sites on its side of the continental shelf, is set to dominate the necessary expenditure in this area. Present estimates suggest that costs could exceed US $43 to 50 billion, depending on the method of removal. The source of these costs include the approximately 146 oil platforms predicted to be removed between 2019 and 2026, accounting for just over half of the total platforms in UK waters.

Decommissioning each item of oil and gas infrastructure is a significant commercial and industrial project that requires substantial planning and expenditure. Industry players will need to be aware of the complex regulatory and legal path to decommissioning in the United Kingdom. However, beyond establishing and approving the plan itself, other legal questions will be relevant, from funding the decommissioning costs and liability under joint operating agreements to asset transfers, litigation risk with contractors, and the need to comply with international, EU, and domestic regulations on the environment.

In this bulletin, we flag the principal legal issues that players in the oil and gas industry should consider when planning to decommission their infrastructure, when contracting with companies to implement the plan, and when limiting their exposure to relevant costs.

Who is responsible for decommissioning?

The first step is to understand the international and EU legal framework on which the UK legislative regime is based. The key foundational instruments include:

i. The UN Convention on the Law of the Sea 1982 (UNCLOS) and the IMO's related 1989 Guidelines
ii. The Convention for the Protection of the Marine Environment of the North East Atlantic 1992 (the OSPAR Convention) and the related OSPAR Decision 98/3

KEY ISSUES

1. Who is responsible for decommissioning oil and gas infrastructure and when must they do it?
2. How is a platform decommissioned and permission for the same obtained?
3. How can actors spread the costs amongst other interested parties and reduce their own exposure?
4. How should actors approach attempts (by themselves or others) to shift decommissioning responsibility to third parties?
5. How can parties manage the risks inherent in decommissioning and take action when it goes wrong?

If you are interested in further information addressing the issues above, 20 Essex Street offers short seminars and talks on decommissioning, which can be tailored as appropriate to your organisation. Please contact our Head of Practice Support, Rachel Foxton, to make arrangements rfoxton@20essexst.com

iii. The Convention on the Prevention of Marine Pollution by Dumping of Wastes and Other Matter 1972 (the London Convention) and its 2006 protocol (the London Protocol).

Industry players will wish to turn their minds to the following questions:

- Which State is obliged to undertake decommissioning and what are the territorial limitations?
- When is an obligation to decommission triggered?
- In what circumstances may decommissioning be avoided and what are the other internationally accepted alternatives?
- How have these international instruments been implemented in UK law (in the Petroleum Act 1998, the Energy Act 2004 and 2008, and associated regulations) and to what extent do international obligations remain relevant to industry players (including in any negotiations or disputes with the UK)?

How is a platform decommissioned?

Once decommissioning is on the horizon for a site on the UK continental shelf, players must consult the specific regulatory framework and the consultation and approval process in the UK. From the basics of what decommissioning means and what UK law requires and permits to be done by way of closing down aged sites, to the steps needed to create a realistic plan that can be approved and efficiently implemented, companies and stakeholders are faced with a number of issues. Key topics to consider are:

> "PLAYERS WILL NEED TO ADDRESS WHEN A FUND IS LIKELY TO EXIST, WHAT ITS PRINCIPAL FEATURES AND BENEFITS ARE, HOW IT WORKS, AND WHAT YOU CAN DO IF THERE IS NOT ONE ALREADY IN PLACE.

- The regulatory environment: Industry players will wish to understand the current and future status of the UK Oil and Gas Authority (OGA) as an Executive Agency within the Department for the Environment and Climate Change (DECC), including its powers and responsibilities, as well as the framework of the Petroleum Act 1998 and the status of DECC's Guidance Notes.
- Liability for costs: The rule that industry players are liable to pay the costs of decommissioning the relevant infrastructure(s), its reach and its effects. In particular, actors will need to consider the possibility that liability for costs may be shifted through chains of indemnities in previous agreements concluded for the transfer of relevant rights and/or infrastructure.
- Service of "section 29 notices": This is a notice that the Secretary of State is empowered to serve on a wide range of actors which requires the addressee to submit a decommissioning programme. This gives rise to several questions, including: can you be served a notice if you are a former owner of infrastructure, or if you intend to acquire infrastructure as a late-stage extractor? When can a parent or subsidiary of a relevant company under the rules be served a section 29 notice? Can a notice be withdrawn? When can you mount a challenge in the English courts (by way of judicial review) to the Secretary of State's decision to serve you a notice and is that step worthwhile?

Perhaps the most significant step for industry players to take, once they have considered the above, is to prepare the "Decommissioning Programme". Bearing the regulatory framework firmly in mind, players need to address the feasibility of a number of different options, which can include:

- Piecemeal removal by reverse installation
- Removal of entire top-structures with single lift vessels (SLVs) such as The Pioneering Spirit
- Leaving bottom-structures in place, either as navigable obstacles or to be repurposed
- Removal of infrastructure (particularly the cumbersome concrete platform legs) off-shore to create artificial marine reefs – this has been successfully practised in the Gulf of Mexico
- Deep water dumping

In any event, the Programme should follow a detailed consultation process with the Oil and Gas Authority and any interested parties before being submitted for regulatory approval. Once approved, the Programme will be published and players will have to turn their minds to the practicalities of how the approved Programme is to be implemented.

How are the costs spread?

Oil and gas players face different exposure to the cost of

decommissioning depending on their historic role in the particular site and the contractual arrangements that they have made with other players to pool costs of the ultimate expenditure over time. Key questions under this heading for players to consider include:

- Costs:
  What are the principal expenditures required to decommission infrastructure, and are there any fees charged by the DECC to cover its decommissioning functions?

- JVs:
  What are the company's financial obligations in relation to decommissioning costs under any joint venture agreement?

- JOAs:
  What 'cash calls' can a company make or might a company have to meet under any joint operating agreement? What if one party to the JOA defaults on its obligations? Industry players will want to consider the nature of the AIPN 2012 Model International JOA and how older JOAs that may already be in place may differ from that agreement.

- Decommissioning Trust Funds:
  Many (especially modern) JOAs establish funds to ensure that costs are pooled by the relevant infrastructure owners over time. Players will need to address when a fund is likely to exist, what its principal features and benefits are, how it works, and what you can do if there is not one already in place. Answers to these questions may be fundamental to ensure that if a company is the current owner of infrastructure it is not left "last man standing" to pay for the costs of the decommissioning programme.

- The effect of insolvency:
  When are decommissioning liabilities ring-fenced from creditors in the event that a relevant player enters into an insolvency process in the UK or abroad?

Selling it on

When reserves diminish and large-scale commercial extraction becomes uneconomical, many oil and gas majors may want to transfer the site to specialist late-stage extractors who can work the site for residual economic benefit. Under this heading, important legal topics to consider include:

- Possible transfer arrangements, from assignment and novation of licence rights to sale and purchase agreements for physical infrastructure. Actors will also want to consider the possible rights to access infrastructure that they or other participants may have under the Petroleum Act 1998.

- Whether a transferor of licence rights can obtain withdrawal of an existing section 29 notice, whether consent is required to transfer license rights, and whether a section 29 notice could be served on such a transferor at some stage in the future.

- The power to re-serve a licence under section 34 and the use of clauses in sale and purchase agreements requiring the seller to co-operate on the buyer's release from a section 29 notice.

- The statutory power to require transferors of licence rights to put up security for decommissioning costs as a condition of consent or release from a section 29 notice, and what to do if there is already a fund or other security in place between the relevant players.

- The extent to which co-venturers are able to prevent a transfer, in circumstances where they are concerned about an incoming licensee's financial ability to

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pay decommissioning costs.

How best to get the job done?

As with any large scale industrial project, there are considerable litigation risks in decommissioning a site. The size and complexity of removing, adapting, or dumping an off-shore oil or gas structure is substantial and may give rise to disputes with contractors engaged to carry out the work. Important areas to consider in relation to decommissioning agreements are:

- Contractual co-operation obligations:
  The effect and consequences of the implied obligation of co-operation (or "*Mackay v Dick clause*") in the unusual context of decommissioning programmes, particularly bearing in mind recent English case law.

- Possible delays:
  The provision of realistic timelines for completion, including staged completion dates. Delays in decommissioning projects are reasonably likely and parties should provide for (i) those delays that are either at the employer's or the contractor's risk and (ii) those delays that qualify as *force majeure* events. In addition, notification provisions in respect of delay and completion should be carefully drafted. By way of example, substantial delay has already arisen in the first major decommissioning project in the modern regulatory framework – the Yme Platform in Norway has had its decommissioning put back owing to delays in the completion of *The Pioneering Spirit.*

- Liquidated damages clauses:
  Where appropriate, consideration should be given to using liquidated damages clauses for delay. Parties will need to ensure, following the recent decision in *Cavendish Square Holding BV v Talal El Makdessi* [2015] UKSC 67, that damages are set at a level that do not *"impose a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation"*, or they may be struck down as penal.

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- The possibility of terminating the agreement for frustration:
  In particular, given the unique character of many fields and the infrastructure required to decommission them, parties may want to consider whether to make provision if machinery or SLVs are damaged, lost, or otherwise unavailable to carry out the work required.

- Assessing damages in the decommissioning industry:
  What are the sort of losses that might be incurred for breach of decommissioning agreements and how might parties try to reduce their exposure or expand their recoverability (as to both the kinds and quanta of loss recoverable)? Further, parties will need to give thought to the provision of indemnities in their decommissioning agreements arising from loss or damage caused by or to contractors during the project.

- Environmental harm:
  Parties will wish to consider their obligations to minimise environmental harm, which have their genesis in the UK's obligations under UNCLOS, the OSPAR Convention, OSPAR Decision 98/3 and the London Protocol 2006 (many of which variously define decommissioning as 'dumping'). They will also wish to consider the potential application of EU directives on waste management (in particular EC Regulation 259/93 and EC Directive 91/689), protected habitats and environmental impact assessment in their decommissioning operations.

- Safety of decommissioning operations:
  Parties will also wish to understand and ensure their compliance with EU Directive 2013/30/EU on the safety of offshore oil and gas operations, which has recently been implemented in the UK through domestic regulations.

- Resolving disputes:
  What are the advantages and disadvantages of arbitration and litigation, and how should parties draft an appropriate dispute resolution clause in their relevant contracts?

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About 20 Essex Street

20 Essex Street are international barristers based in London and Singapore who are experts in on- and offshore infrastructure. This includes work on decommissioning in the UK, which covers the international, EU and regulatory aspects of the decommissioning process as well as the commercial litigation risks in implementing any decommissioning plan. We advise and represent clients in the myriad issues that arise, including, where necessary, appearing for them as advocates in domestic and international arbitrations and before the specialist courts in the UK.

Barristers at 20 Essex Street also have niche expertise in decommissioning oil, gas and other energy structures worldwide. They are often able to advise on the similar issues and challenges facing industry players in regions in Asia, Africa and the Middle East.

Seminar

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