TWENTY ESSEX

Offshore decommissioning: Zeroing in on trends and challenges

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Decommissioning of offshore assets has been high on the energy industry's agenda for some years. This high-tech, high-cost challenge raises a host of difficult legal and policy issues. We last examined the legal framework in our 2016 bulletin, *End of Shelf Life*.

Since then, sustained low oil prices and ever-increasing policy emphasis on climate change have made this an ever more complex area for owners and operators of assets, specialist contractors, governments and regulators globally.

This bulletin is the first in a series of publications and events from Twenty Essex focusing on developments in this area, aimed at helping players in the sector and their advisers navigate the constantly shifting legal terrain.

In this bulletin, we cover:

- The major recent trends affecting decommissioning.
- The evolving regulatory framework for decommissioning on the UK Continental Shelf (UKCS) as it sets itself the awkward objective of both maximising economic recovery of petroleum and furthering the UK government's decarbonisation aims.
- How the 'Net Zero' target impacts decommissioning.
- Potential legal challenges arising out of the newly updated Oil & Gas Authority (OGA) Strategy.

What has changed?

In recent years, the oil and gas industry has undergone significant changes, impacting on the cost, risk and timing of decommissioning.

The United Kingdom

At least six key developments have affected UK-based players:

1. Major to minor

The majors have continued to sell assets to smaller, independent players with an appetite for lower margins and higher risks. The ten largest operators on the UKCS now account for just over half of the North Sea's output, down from around two-thirds a decade ago. The parties have had to consider how to address decommissioning liability, choosing between 'clean break' and shared liability options, and factoring the impact of future regulatory action into their acquisition structure.

2. Climate change

The Paris Agreement, ratified in November 2016, imparts a binding obligation to limit global warming to below 2°C. The UK government has committed to achieving net zero greenhouse gas (GHG) emissions by 2050 ("Net Zero"). As a result, the activities of fossil fuel companies have come under greater scrutiny. Tightened regulation of petroleum production and consumption has been accompanied by rapid growth in climate change litigation globally. For UK-based international operators, the dispute risk is amplified by the English courts' willingness to accept jurisdiction over environmental claims relating to overseas operations and subsidiaries. In *The Maran (UK)*[1], the Court of Appeal found that an English shipping company selling a vessel for dismantling in South Asia could owe a duty of care to workers in Bangladesh even where multiple third parties were involved in the transactions – a decision with clear implications for decommissioning.

1 *Hamida Begum (on behalf of Md. Khalil Mollah) v Maran (UK) Limited* [2021] EWCA Civ 326.

3. Reduced demand and falling prices

The past year has seen a significant fall in petroleum prices. In April 2020, West Texas Intermediate crude futures dropped below US$0 per barrel for the first time in history. Brent crude fell below US$20 per barrel – the lowest price since the aftermath of 9/11. This dip in prices is linked with the decrease in demand caused by COVID-19. Low oil prices are set to play "a pivotal role" in boosting UKCS decommissioning spend as assets cease to be economically productive. Meanwhile mainstream lenders' commitments to decarbonise their portfolios mean constraints on funding and costlier borrowing for petroleum extraction.

4. Decommissioning costs fall

The cost of decommissioning is steadily declining. In 2020 the OGA announced that costs fell by a further 2% on a like-for-like basis in 2019. Unsurprisingly, this has coincided with an increase in projected decommissioning spend: in 2020, Oil & Gas UK estimated the decommissioning spend for the next ten years at up to £15.1 billion.

5. Brexit

The UK-EU Trade and Cooperation Agreement (TCA) took effect from the end of the Brexit transition period on 31

December 2020. This is likely to have multiple effects on decommissioning, including for employers in the industry who will have to grapple with the UK's immigration regime. Key EU legislation, such as the Waste Framework Directive 2008/98/EU and the Waste Shipments Regulation 1013/2006, no longer applies directly, but as 'retained EU law' pursuant to the EU (Withdrawal) Act 2018. The UK may in future amend such laws, but Article 7.2(2) of the TCA provides that it shall not "weaken or reduce, in a manner affecting trade or investment between the Parties, its environmental levels of protection or its climate level of protection below the levels that are in place at the end of the transition period." Nevertheless, the industry will be keeping a close eye on future legislative change.

6. Constraints on the offshore workforce

Brexit and COVID-19 have combined to reduce the UKCS workforce. Offshore personnel on board (POB) fell from just over 11,000 in early March 2020 to just over 7,000 in mid-April. Numbers partially recovered to c. 9,000 POB in August, but the focus has largely been on operational continuity and safety-critical maintenance.

Asia

In Asia regulatory change driven largely by environmental concerns has continued apace, notably with the ASEAN Council on Petroleum (ASCOPE) issuing decommissioning guidelines for oil & gas facilities. Industry sources estimate that some 800 offshore platforms in the Asia Pacific region will enter decommissioning by 2027, at a predicted cost of some US$100 billion.

While English law remains a popular choice to govern Asia Pacific decommissioning contracts, it faces stiff competition from other systems. The dispute resolution clause of BIMCO's DISMANTLECON form of contract envisages a choice between English, Singapore and US maritime (or New York) law. Historically, English and Singapore law have followed each other closely. However, the common law of penalties is the latest area in which divergence has emerged, with the Singapore Court of Appeal declining to follow the UK Supreme Court's *Cavendish Square* decision when examining liquidated damages and forfeiture clauses in oil & gas contracts.[2] Choice of law has real consequences for businesses engaged in decommissioning.

Climate change, Net Zero and the regulatory framework

In *End of Shelf Life*, we outlined the main international instruments governing decommissioning operations and their implementation in the legislation regulating the UKCS. The regime under the UK Petroleum Act 1998 (PA 1998) is shaped at a global level by the UN Convention on the Law of the Sea 1982, the IMO's 1989 Guidelines, the 1972 London Convention on Marine Pollution and its 2006 Protocol. The 1992 OSPAR Convention and OSPAR Decision 98/3 enshrine the "clean seabed" principle for removal of marine assets in the North East Atlantic. PA 1998 implements the principle by requiring operators and others to submit and agree a decommissioning and abandonment programme, and ensure that the approved programme is carried out. The process is triggered by a notice under section 29 of PA 1998, which may be served on a range of parties with a current or former interest in licensed assets.

Petroleum licensing functions under PA 1998 rest with the OGA, an arm's length regulator. Meanwhile decommissioning functions rest with the Offshore Petroleum Regulator for Environment and Decommissioning (OPRED), an executive agency of the Department for Business, Energy & Industrial Strategy.

Since 2015, Part 1A of PA 1998 has incorporated the UK government's objective of Maximising Economic Recovery (MER). This was originally implemented through the OGA's statutory MER UK Strategy, binding on all "relevant persons" including holders of offshore petroleum licences, and owners and operators of offshore installations. The OGA's December 2016 Framework Document expressed its preference for "[e]ncouraging, catalysing, facilitating and supporting collaboration across industry to act in a way that will maximise the recovery of offshore oil and gas", but also emphasised its power to take "appropriate action if industry acts in a way that is contrary or inconsistent with MER UK".

MER considerations tend to prolong the life of assets beyond the point at which commercial considerations would lead to the end of their production. However, this is increasingly in tension with UK climate change policy. The UK Climate Change Act 2008 established a long-term target for reduced carbon emissions, overseen by an advisory Climate Change Committee (CCC). The government's Net Zero target followed advice from the CCC. In its 2020 progress report, the CCC recommended the introduction of "policies to significantly reduce the emissions intensity of fossil fuel production". This stopped short of directly recommending acceleration of the wind-down of UKCS petroleum recovery. However, other recommendations (e.g. those on decarbonising the power system and displacing fossil fuel use in transport and buildings) make plain that the CCC envisaged a government-driven programme of irreversible reduction in demand for fossil fuels, including those derived from UKCS production.

The government's 2020 Energy White Paper attempts to resolve that tension. Its "Net Zero Basin" section insists on

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2 *Denka Advantech Private Limited v Seraya Energy Pte Ltd* [2020] SGCA 119, declining to follow *Cavendish Square Holding BV v Talal El Makdessi* [2015] UKSC 67.

sharp cuts in emissions arising directly from the petroleum production process ("Scope 1" emissions, in the language of the GHG Protocol Corporate Standard[3]), such as those from flaring and venting. It also commits the government to "challenging the sector" to reduce indirect and embedded emissions from consumption of extracted fuel ("Scope 2" and "Scope 3" emissions). The Paper discusses incentivising the switch to clean energy, including bringing the UKCS regulators' "roles, powers and priorities" into line with government decarbonisation policy, though "without imposing significant additional regulatory burdens".

This provides the setting for the new strategy. Following consultation, the updated and re-named "OGA Strategy" was laid before Parliament in December 2020 and introduced on 11 February 2021. Its centrepiece is a revised Central Obligation (**emphasis** shows new text):

> "Relevant persons must, in the exercise of their relevant functions activities, take the steps necessary to:
>
> *a. secure that the maximum value of economically recoverable petroleum is recovered from the strata beneath relevant UK waters;* ***and, in doing so,***
>
> ***b. take appropriate steps to assist the Secretary of State in meeting the net zero target, including by reducing as far as reasonable in the circumstances greenhouse gas emissions from sources such as flaring and venting and power generation, and supporting carbon capture and storage projects."***[4]

On 15 March 2021, the OGA published its new "Stewardship Expectation 11 – Net Zero", aimed at assisting the industry in understanding how it expects implementation of Net Zero obligations to be approached. These include:

- Creating a culture of GHG emissions reduction on the UKCS.
- Ensuring that GHG emissions reduction is considered throughout industry lifecycle activities.
- Collaboration between all relevant parties (including the renewables sector) to support and progress potential energy integration developments, such as electrification, carbon capture and storage and hydrogen.

How does Net Zero impact decommissioning?

Despite the Strategy's change of name, the MER objective remains in place. This is no "keep it in the ground" strategy. What has altered is the *way assets are managed* in the context of recovery of oil and gas. The updated OGA Strategy is unlikely in itself to accelerate the pace at which assets come forward for decommissioning, beyond the consequences of falling demand (and perhaps prices) flowing from the government's overall policy of reducing fossil fuel dependence in the downstream economy. Rather, elements of the OGA Strategy may slow the pace of decommissioning.

The Central Obligation is supplemented by a number of detailed provisions on re-use of assets not only for CCS projects but also, "where appropriate", for "projects relating to hydrogen supply". §§15 to 17 of the OGA Strategy, headed "Decommissioning", require relevant persons to demonstrate, before planning decommissioning of infrastructure, that "all viable options" for its continued use, "including for reuse or re-purposing for [CCS]" have been "suitably explored". Note the word "including": potential re-use is not confined to CCS but could also include hydrogen and other clean energy uses such as offshore wind. So, even where an asset cannot continue in economic petroleum use, OPRED may reject a decommissioning programme where the whole or part of the structure may viably support clean energy development. The OGA may also use its licensing powers to ensure cooperation between asset owners and others, including parties seeking to invest in alternative uses (§21 of the OGA Strategy).

Postponement of decommissioning will sometimes, but not always, be welcome news to asset owners. UKCS M&A transactions and other contracts will typically be priced on assumptions about the useful life of an asset and the timeframe within which the costly process of decommissioning is expected to take place. Insistence by OGA or OPRED on prolonging the life of an asset with a view to reuse may result in parties discovering they have overpaid into a security arrangement, or finding themselves compelled to negotiate elaborate cost apportionments with incoming investors. Unravelling or altering already complex contractual arrangements to accommodate these changes may prove legally and financially problematic.

Legal challenges

Several NGO respondents to the 2020 consultation regarded the MER objective as simply incompatible with the Paris Agreement. Others proposed that the OGA Strategy should at least give the Net Zero target precedence over MER. So far, courts in the UK have been reluctant to assess the legality of regulatory policies and decisions against even those climate obligations the UK government accepts as binding: see the *Heathrow* and *Drax* cases.[5] In *R (Finch) v Surrey County Council*,[6] the High Court specifically rejected an attempt to

3 https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf

4 https://www.ogauthority.co.uk/news-publications/publications/2020/the-oga-strategy/

5 *R (Friends of the Earth and others) v Heathrow Airport Ltd* [2020] UKSC 52, reversing the Court of Appeal [2020] EWCA Civ 214; *R (ClientEarth) v SSBEIS, Drax Power Ltd Interested Party* [2020] EWHC 1303 (Admin).

6 [2020] EWHC 3566 (Admin).

treat embedded emissions in extracted petroleum as part of the emissions attributable to the extraction operation itself. There will be great interest in the forthcoming appeal.

On the industry side, several respondents objected to the lack of definition in key concepts appearing in the draft. It is entirely possible that an aggrieved owner or operator whose decommissioning or divestment plans are upset could challenge an individual decision by OGA or OPRED. For example, there may be arguments as to whether particular assets are capable of viable re-use for alternative energy-related purposes, fuelling disputes about the content of a decommissioning programme (especially timing and costing). The use of regulatory powers to force an asset owner into unplanned collaboration with a stakeholder from another sector may also be a source of controversy.

The forum for resolving such disagreements is ultimately the statutory review procedure under section 42 of PA 1998. However, that procedure has a number of important constraints. An application to the court must be initiated very quickly (within 42 days of the decision). This restricts opportunities to resolve the matter through negotiation before launching proceedings. More importantly, the process is not an appeal on the merits but a challenge to the *lawfulness* of OPRED's decision, with the onus on the aggrieved party to establish a basis for challenge corresponding to the traditional grounds of judicial review: irrationality, illegality or procedural impropriety. As to the first two:

- "**Irrationality**" has a high threshold. In an area involving competing expert views about highly technical issues, the court will be especially reluctant to second-guess the decision-maker's assessment unless there is a demonstrable absence of evidence or an obvious flaw in the reasoning process (for example, if OPRED has failed to recognise and examine a possible alternative use proposed by an asset owner).[7]
- "**Illegality**" includes misinterpreting applicable policy documents, since their meaning is a question of law for the court.[8] However, the kind of open-textured language that characterises the OGA Strategy ("appropriate steps", "as far as reasonable", "fair market value") tends to blur the distinction between questions of ascertaining meaning and exercising regulatory judgement.

OPRED's application of the policy to individual decommissioning decisions has yet to be tested in the courts. However, despite the high bar to a successful section 42 challenge, the value of the economic interests involved, coupled with the inexorable trend in bringing climate change-related issues before the courts, means that the effect of Net Zero is likely to be litigated before too long.

7 *R (Lasham Gliding Society Ltd) v Civil Aviation Authority* [2019] EWHC 2118 (Admin), esp. Thornton J at [43].
8 *R (Manchester Ship Canal Co) v Environment Agency* [2013] JPL 1406, CA.

Key takeaways

- The legal framework for decommissioning activity is fast-moving. On a global level, environment and climate change concerns have grown in significance as drivers of regulatory policy, and are increasingly understood as sources of litigation risk. UKCS operators face additional changes arising from Brexit.
- As far as the UKCS is concerned, the MER duty (in what is now the OGA Strategy) has been tempered by a Net Zero objective. Although focused on management of assets rather than diminution in production, this is likely to be accompanied by progressive reduction in demand over the coming period.
- The OGA Strategy directly affects decisions about which assets come forward for decommissioning, and when, because of its provisions on re-use of assets to facilitate transition from fossil fuels. Asset owners and operators may find themselves obliged to collaborate with stakeholders who have a contrasting agenda for future management of the asset.
- Any challenge to individual OPRED decisions must be brought on the limited grounds available under section 42 of PA 1998. Despite the heavy burden of establishing a ground for review, future challenges are expected given the high value economic interests at stake and the growing trend of bringing climate change issues before the courts.

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Gordon specialises in international litigation and arbitration. He has a particular focus on claims by and against state bodies, especially in the areas of energy, infrastructure and utilities. He has acted in disputes involving UKCS petroleum assets, and advised on decommissioning liabilities and energy transition issues.

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Read his online bio ›

Maria Kennedy

Maria has a broad practice, with experience in arbitration, energy, civil fraud, insolvency, shipping, insurance, general commercial disputes and public law.

Before coming to the Bar, Maria was a qualified solicitor-advocate. She spent five years working at a top international law firm, where she specialised in commercial litigation, arbitration and regulatory investigations.

Read her online bio ›

Over the coming months we will be producing a series of publications and events on the energy transition agenda, including further updates on decommissioning.

We will be picking up some of the themes and developments mentioned in this bulletin as well as a range of other contract issues, regulatory and funding developments, and risk management challenges.

The editorial and writing teams for the series include:

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