

**OFFSHORE ENERGY  
INSTALLATIONS  
CONSULTATION RESPONSE**

**Government response to the  
consultation on proposals relating  
to the decommissioning of offshore  
energy installations**

NOVEMBER 2007

## Department for Business Enterprise and Regulatory Reform

### Decommissioning Offshore Energy Installations

#### Government response to the consultation on proposals relating to the decommissioning of offshore energy installations (Oil & Gas and Renewables).

#### Introduction

The consultation related to proposed changes to the statutory decommissioning regimes for offshore Oil & Gas installations and pipelines and offshore Renewable energy installations and related electric lines.

The consultation began on 21 June and closed on 13 September 2007. It discussed five main issues:

- **Safeguarding Decommissioning Funds** – ensuring funds set aside as financial security for decommissioning are safe for that purpose in the event of insolvency (i.e. they do not fall to the insolvency office-holder and creditors)
- **Widening the categories of persons on whom decommissioning obligations can be placed** – replicating the oil and gas installation provisions to enable the Secretary of State to place decommissioning obligations (including financial security) on parent companies or associates for offshore renewable energy installations in specified circumstances and extending the renewable and oil & gas decommissioning regimes to cover associates of Limited Liability Partnerships (LLPs).
- **Earlier issue of notices and provision of security** - at the start of a development or any subsequent stage - for offshore oil and gas installations and pipelines, as is already the case for offshore renewable energy installations.

- **Information** – ensuring the Secretary of State has access to appropriate information to enable him to carry out his functions under the renewable and oil & gas energy decommissioning regimes.
- **Potential for Cross-industry cooperation and collaboration** – the value of cross-industry cooperation and collaboration at the decommissioning stage.

42 responses to the consultation were received from the following organisations and individuals:

Airtricity  
 Association of Electricity Producers  
 Association of Investment Trust Companies (AIC)  
 Bank of Scotland  
 British Wind Energy Association (BWEA)  
 Centre for Environment, Fisheries, Aquaculture and Science  
 Centrica  
 Chamber of Shipping  
 Conoco Phillips (UK) Ltd  
 The Crown Estate  
 DEFRA  
 Dong  
 East of England Energy Group  
 EDF Energy  
 English Heritage  
 E-ON UK  
 Ministry of Defence  
 Oil & Gas Independents' Association  
 Oil & Gas UK  
 Port of London Authority  
 Price Waterhouse Cooper  
 Renewable Energy Association (REA)  
 RWE N.Power  
 Scottish and Southern Energy  
 Scottish Environment Protection Agency (SEPA)  
 Scottish Executive  
 Scottish Fishermans Federation  
 Scottish Power Energy Networks  
 Scottish Power Renewables  
 Shell UK  
 Shell Wind Energy Limited  
 Shepherd & Wedderburn  
 Structured Product Solutions LLP

Talisman Energy  
Total  
Traprain Consultants Ltd  
Tullow Oil  
United Kingdom Hydrographic Office  
Venture Production Plc  
Vinson & Elkins  
Warwick Energy  
Wood Group

## **EXECUTIVE SUMMARY**

The four main issues considered in the consultation were:

- Safeguarding decommissioning funds from insolvency:  
*The consultation showed general agreement for the proposed action*
- Extending the Secretary of State's powers to require information:  
*The consultation showed general agreement for the proposed action*
- Earlier issue of notices and provision of decommissioning security:  
*It was generally accepted that the Secretary of State should be able to ask companies for a bank guarantee or similar security if a project was high risk. But there was concern that the costs and impact on the companies' ability to borrow would discourage investment. We are discussing with the industry ways to mitigate this. Some of the smaller companies said they prefer to provide security than have their projects rejected.*
- Securities:  
*The responses raised several interlinking issues relating to the provision of security to guarantee decommissioning funds for renewables projects:*
  - 1) *Acceptable forms of security – concern was expressed that we might be too restrictive, although we have tried to make it clear that we will accept any security a company wishes, provided it does the job of securing the decommissioning funds*
  - 2) *Clarification of our definition of an associate – there were some concerns that any investor might be held to be potentially liable and therefore investment could be discouraged*
  - 3) *Parent Company Guarantees (PCGs) – our policy of not accepting these was questioned*

*4) The requirement to provide adequate decommissioning funds was described in some responses as a barrier to future growth of the industry because it could burden the balance sheets of the more financially stretched developers*

**The Government response deals with the above issues as follows:**

- 1) We will accept whatever form of security the company judges most suitable for its business circumstances, subject only to being satisfied that it will meet the costs of decommissioning when required.*
- 2) Our intention is to have recourse if necessary only to those with a controlling interest (and the financial resources to meet the decommissioning obligation). We will seek to reflect this in the drafting of the Bill.*
- 3) We do not consider that PCGs offer an adequate form of security as they do not provide the assurance that costs will be fully met when required.*
- 4) Our guiding principle is that the polluter should pay for the costs of dealing with their own pollution. Subject to that we will aim to maximise the scope for participation and competition by being as flexible as possible about the forms of security we approve.*

**SAFEGUARDING DECOMMISSIONING FUNDS IN THE EVENT OF INSOLVENCY**

Respondents agreed with the proposal to safeguard decommissioning funds in the event of insolvency so that they are safe for the purpose of decommissioning and do not fall to the insolvency office-holder and creditors. It is our attention to achieve this by disapplying the Insolvency Act 1986.

**INFORMATION**

The vast majority of respondents agreed with the proposal to give the Secretary of State broader powers to request information necessary to enable him to carry out his functions under the offshore oil & gas and renewable energy decommissioning schemes. This would allow the Secretary of State to request information throughout the process which is necessary when judging if a decommissioning plan is fit for purpose, from a wider range of people, such as parents or associates. It does not provide for any significant broadening of the actual types of information that could be requested.

Some consultees had concerns about submitting detailed financial information which could then be made publicly available to their competitors or which used proprietary software. The Department's practice is **not** to release or publicise financial information received from applicants. However this position is subject to a possible application of the Freedom of Information Act 2000, the Environmental Information Regulations 2004 or the Data Protection Act 1998. Any future request for information covering financial data will have to be judged on its merits at that time and subject to possible exemptions, relating,

for example, to protection of confidential information or of commercially sensitive information, as well as to protection of information subject to statutory restrictions upon such disclosure. It is **likely** that requests for information as outlined above would fall within these three categories.

### **EARLIER ISSUE OF NOTICES AND EARLIER PROVISION OF DECOMMISSIONING SECURITY (Oil and Gas)**

The Petroleum Act enables the Secretary of State to ask companies to put up financial security when he has approved a decommissioning programme, but this does not happen until the end of a field's life. Fields can hit trouble before then (e.g. Emerald in 1995/6 and Ardmore in 2005) pushing the licensees into liquidation and unable to carry out the decommissioning. International and public obligations mean the Government would have to carry out and pay for the work, so the Department needs to be able to serve notices requiring companies at risk to put up security from the start-up of a field when the risk of default is judged to be unacceptable. Most respondents accept this is justified when companies have limited resources, but point out that it may discourage some developments by making them more expensive. There were differences of opinion on the costs of security but for a typical small development with capex of £70m and decommissioning expected to cost £8m, a letter of credit would probably cost about £900,000/yr including bank fees and the cost of cash collateral.

We believe the risks of defaults are increasing with more small developments and a growing number of smaller companies involved. We are testing a financial assessment process to identify the high risk cases where security would be necessary and plan to publish this process, meeting a number of respondents concerns that the provision should only apply to those with insufficient resources and that we should use a clear rating procedure.

Some of the major oil companies and Oil & Gas UK expressed disappointment that we are not adopting their suggestion that sellers of licence interests should get a permanent release from decommissioning liabilities if a suitable security agreement is arranged by the buyer. Under the Act the original owner of an installation can be made to carry out the decommissioning even after disposing of his interest if all the current owners default. The companies wanted to be able to get a clean break from their liabilities when they sell assets and have promoted this proposal in PILOT (a government/industry forum) and in a separate submission to the Secretary of State. A small number of industry respondents did not agree with this proposal, being concerned about the loss of the major companies' expertise and financial strength. The Government has difficulties with the proposal because of the uncertainties involved. The model security deed was launched on 25 September and has not been used yet. We cannot be certain that it will be effective or how the courts would react if it was challenged in a default situation. The deed will use estimates for decommissioning costs which are widely accepted as being subject to significant increases especially for the larger platforms because of the limited industry experience of projects to date. These uncertainties might be addressed by multiplying the security value by a

suitable risk factor but again the lack of experience could require the Department to apply a factor which would be unfeasible.

## **SCOPE AND FORMS OF SECURITY**

### **Widening the categories of persons on whom decommissioning obligations can be placed (Renewables)**

#### **Parent Company Guarantees**

The current guidance notes for industry, *Decommissioning of Offshore Renewable Energy Installations under the Energy Act 2004*<sup>1</sup> state that a number of forms of security may be acceptable. A few exceptions are listed as normally being **unacceptable** with Parent Company Guarantees (PCGs) being one such example. Around 2/3rds of respondents thought it was acceptable for the Secretary of State to be able to impose decommissioning obligations on Parent Companies or associates if adequate arrangements had not already been made by the developer, and on a case by case basis.

Most of the respondents who were unhappy with the Secretary of State being able to impose decommissioning obligations on parents or associates felt it was counterintuitive that the department was not willing to accept Parent Company Guarantees (PCGs) as a suitable means of security, but was looking to extend decommissioning responsibilities to Parent Companies or Associates, if the Secretary of State felt adequate arrangements were not in place from the developer.

We still consider that PCGs do not provide the same degree of assurance as many other forms of security. If the guarantee was not honoured for whatever reason, it may be necessary to litigate (in some cases in jurisdictions overseas) in order to recover the costs of decommissioning. However, where it is required, the imposing of decommissioning responsibilities on a Parent Company or Associate, as a direct statutory obligation upon such a body is a far stronger means of ensuring the decommissioning work is carried out.

#### **Acceptable forms of security**

As outlined under the previous heading we do not consider that PCGs provide the same degree of assurance as many other forms of security. In the responses to the consultation, it appeared that there was a degree of confusion over what forms of security the department currently finds acceptable for renewables decommissioning. We wish to ensure that any form of security which is suitable for any individual business's circumstances will be considered, subject only to the department being assured that it will meet the costs of decommissioning when required.

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<sup>1</sup> Decommissioning of Offshore Renewable Energy Installations under the Energy Act 2004, Guidance Notes for Industry, December 2006 available at

[www.dti.gov.uk/energy/sources/renewables/policy/offshore/page22500.html](http://www.dti.gov.uk/energy/sources/renewables/policy/offshore/page22500.html)

It is our intention to revise the guidance notes for industry to emphasise that our approach is pragmatic, permissive and will continue to be tailored to the circumstances of each case as far as is reasonably practicable. In consultation with industry we will expand the list of examples of acceptable forms of security. This is not intended to be exhaustive. We encourage the industry to think about more novel and wide-ranging types of security, if they deem it useful for their particular business.

### **Definition of an associate**

Some respondents raised concerns about whether the definition of an associate would be too broad and have the effect of discouraging purely financial investors. We recognise these concerns. Our intention is to be able, if necessary, to call on those able to exercise control over the direction of a company to meet the costs of decommissioning. We will aim to reflect this in the drafting of the Energy Bill.

### **Decommissioning securities as a barrier to future industry growth**

Some respondents were concerned that requiring a high degree of security for decommissioning would be a particular burden on companies with weaker balance sheets, and that Government should be prepared to take on a greater degree of risk in order to promote development, particularly in the renewables sector.

The Government is keen to encourage the growth of the renewables sector, minimise the cost to business of essential regulation and maximise the scope for as many businesses as possible to compete. Our guiding principle is that the polluter should pay for the costs of dealing with their pollution, the 'Polluter Pays Principle'. It would not meet our environmental objectives (nor the UK's international treaty obligations under OSPAR and UNCLOS) to encourage businesses into the market who did not have the capacity to provide for decommissioning costs from their own business resources. Subject to that we will aim to maximise the scope for participation and competition by being as flexible about the forms of security we will consider.

### **Limited Liability Partnerships (LLPs)**

The consultation proposed that LLPs should be treated in the same way as limited companies for both Oil & Gas and Renewables which would enable Government to make the corporate parents of an LLP carry a liability if the LLP is, or is likely to be, in default of its decommissioning obligations, whether for financial or other reasons. This proposal was generally accepted by respondents.

## **OTHER ISSUES**

### **Minor Amendments for Oil and Gas**

We proposed a number of technical amendments on Oil & Gas to fill gaps in the existing legislation. Respondents agreed with our proposals to amend the Petroleum Act so that legal obligations (S29 notices can be served on co-licensees at the same time as the operator and on pipeline owners when construction begins. Some expressed concern that we intended to make contractors who manage installations on behalf of operators liable for decommissioning. That is not the intention and we will make clear in our guidance notes that we believe the company managing an installation is the approved operator. We are discussing with the industry how best to amend our guidance on this point.

There was also concern that our proposals to serve liabilities on certain owners of installations when licensees are capable of carrying out the decommissioning might be extended to owners of parts of installations. Owners of installations such as floating production and storage vessels are already within the scope of the Act and our intention is simply to ensure that the Act continues to apply if the owner sells the installation to another company.

Some respondents objected that the proposal to serve obligations for pipeline decommissioning on licensees and parties to joint operating agreements would apply to various users of pipelines: we recognise the difficulties in arriving at a workable definition which does not catch pipeline users and will withdraw this proposal.

### **Potential for cross-industry cooperation and collaboration**

Several respondents thought there was scope for cross-industry cooperation and collaboration, both in a forum/working group that could look at cross-cutting issues, and in practical collaboration at the decommissioning stage of installations, which would be likely to yield financial benefits due to economies of scale. It was also suggested a potential short-term deferment of decommissioning could be useful so that decommissioning could then take place in a number of decommissioning rounds, for example, every 2-3 years. We are keen to minimise the costs of decommissioning and will take these suggestions forward in discussions with both industries outside of the legislative process.