END OF LIFE CARE: DECOMMISSIONING OFFSHORE INSTALLATIONS

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In a recent judgment, *Apache UK Investment Limited v Esso Exploration and Production UK Limited*[1], the English High Court has provided guidance on decommissioning security obligations of owners and previous owners of oil and gas assets. With the high numbers of mature oil fields in the North Sea, ownership increasingly in the hands of "late life specialists" and many offshore assets reaching the end of their useful life, decommissioning issues are no doubt a sign of things to come. However, for the time being, reported decisions about decommissioning are rare and when they do arise it is useful to put such decisions into context.

BACKGROUND

Decommissioning is the process of removing and disposing of offshore oil and gas installations and pipelines at the end of their field life. Decommissioning on the United Kingdom Continental Shelf is primarily controlled through the Petroleum Act 1998 (the "Act"). The Offshore Petroleum Regulator for Environment and Decommissioning ("OPRED"), a specialist agency of the Department for Business, Energy and Industrial Strategy ("BEIS"), is the UK authority which deals with decommissioning.

Under section 29 of the Act, the Secretary of State for BEIS can give a written notice requiring a wide range of persons connected with offshore installations, including owners, operators, licensees and associated entities, to submit, at a date to be notified in future, a programme setting out proposed measures in connection with the abandonment of an offshore installation or submarine pipeline. Once approved, it is the duty of each person who submitted the abandonment programme to maintain an ability directly or indirectly to carry it out, in accordance with any applicable conditions. Such parties who are liable to submit decommissioning plans may be required to enter into Decommissioning Security Agreements ("DSAs") either with the Secretary of State, with co-participants in the Joint Operating Agreements ("JOAs") and/or (as in this case) between seller and purchaser of the relevant interests.

Although the Secretary of State can release a party from any duties under an approved abandonment programme, they can also pursue previous owners, operators, licensees and associated entities, meaning that such parties may have contingent liability in perpetuity under UK law. Therefore, when selling such assets, it will be important for parties to consider appropriate indemnification and security arrangements in respect of the risk of future decommissioning costs. In *Apache v Esso*, the Commercial Court considered such indemnification and security obligations, as well as the scope of section 29 notices.

FACTS

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Apache UK Investment Limited had, in 2011, acquired from Esso Exploration and Production UK Limited the sole legal and beneficial ownership in a company which held various licences in six hydrocarbon producing fields in the North Sea (the "North Sea Fields"). The Secretary of State had served section 29 notices in respect of the North Sea Fields in 2004 and 2005. Under the sale and purchase agreement ("SPA"), Apache was obliged to indemnify Esso for all decommissioning related expenditures which Esso was or might become liable to incur, whether arising from installations built before or after the effective date of the SPA. Initially, Apache provided security through a guarantee from an affiliate, Apache Corporation, in respect of those obligations pursuant to six Bilateral Decommissioning Security Agreements ("BDSAs"). There was no decommissioning plan in existence at the time of the SPA.

The dispute between the parties concerned the level of security to be provided. The parties adopted short trial procedures to expedite the process. There were two broad issues to consider, which we will now examine.

THE YEAR IN WHICH APACHE WAS REQUIRED TO PRODUCE A DECOMMISSIONING PLAN

In March 2020, the guarantor, Apache Corporation, ceased to be a "Qualifying Surety" under the terms of the BDSAs. By April 2020, Apache was required to provide Esso with alternative interim security in the form of 11 Letters of Credit to the aggregate value of £549,672,792. This sum was calculated by reference to an "Initial Amount" which was set out at the time of the SPA in 2011.

As there was no previous decommissioning plan, the BDSAs obligated Apache to produce a proposed plan for the "Relevant Year". This was defined as the "immediately following year" with "Year" defined as a calendar year. In June 2020 Apache produced two plans, one for 2020 and one for 2021. These plans allowed the most up to date net costs of decommissioning to be assessed. Both indicated that the level of security required should be reduced to £412,045,083. Apache contended that 2020 was the "Relevant Year", Esso was over-secured and therefore had to immediately return some of the Letters of Credit. Esso argued that under the terms of the BDSA the proposed plan could only be for the year 2021 and Apache had to maintain the higher security until then.

The Court held that on a plain reading of the BDSAs, the obligation to submit a proposed plan had to relate to 2021. Even though the term "Relevant Year" was not used consistently in the BDSAs, commercial common sense was also on the side of Esso's construction. One of the reasons was that on Apache's case, the process of submitting a proposed plan would focus not on the security required for the coming year of 2021 but the past year 2020. Depending on when the triggering date occurred under the BDSAs, such plans may not be submitted until early 2021 and probably agreed in mid-2021, which would defeat the purpose of an accurate and up to date security.

SCOPE OF THE NOTICE UNDER THE ACT

Esso challenged the 2021 plan on the basis that it did not include proposals for decommissioning four particular wells (the "Additional Wells"). The second issue was whether Esso could, in principle, be held liable for the decommissioning of these wells which were drilled some years after it had sold its interest to Apache and whether security to cover the Additional Wells should therefore be provided by the latter.

The description of the Field Installations under the section 29 notices was very general/encompassing. Esso contended that these notices were potentially wide enough to cover the Additional Wells, even though they had been drilled after the notices were issued and the fields had been sold. Accordingly, and noting that OPRED had indicated in discussions with Esso that it may be liable for the Additional Wells, it was said that there was a risk that unless provision was made for these wells under the 2021 plan, Esso would be significantly unsecured.

The Court ruled in favour of Apache. In doing so, it observed that it was not correct to treat an entire field or sub-field as an "offshore installation" within the meaning of the Act. Instead the reference to abandonment of offshore installation was more naturally to equipment or structures within the field or sub-field such as a rig. Noting section 44 of the Act that limits the Secretary of State's powers to installations which are or have been maintained, or which are intended to be established, the Court held that the Secretary of State would only have power to apply a section 29 notice to the Additional Wells if, at the time of the relevant notices, those wells were being operated or developed or were "intended to be established". In this case, the section 29 notices predated the drilling of the Additional Wells by many years.

Intention to establish the Additional Wells was a question of fact for which no evidence was produced owing to the nature of the trial. However, there was no suggestion that there was ever an intention at the time of the notices to construct the Additional Wells and, in the Court's view, there was no possible reason to think they could fall within the notices on the basis that they were "intended to be established".

On this basis, it followed that the Secretary of State would have no power to impose a liability on Esso for the decommissioning of the Additional Wells, and no security was therefore required to be provided by Apache in relation to them.

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COMMENT

Reported decommissioning decisions are rare. The decision in *Apache v Esso* confirms principles established by the Act that there is no automatic discharge of liability on disposal of an interest.

This particular dispute arises out of the sale of a company owning licences in North Sea oil fields where no decommissioning plan had been prepared prior to the sale. The BDSAs between seller and purchaser had bespoke terms. Whilst bespoke BDSAs are used in the industry for SPAs or M&A transactions between two parties, it is more often that we see DSAs based on the UK standard form field-wide Model DSAs being agreed between operators and the relevant licensees and attached to a JOA where there are more than one licence holder. These model terms allow for sale of interests with former interest holders to still be party to such agreements as "Second Tier Participants". These agreements reduce the risk of parties having to provide significant amounts of security to different parties covering the same risk.

There are a significant number of installations on the UK Continental Shelf which will require decommissioning over the next few years. It is a costly and time-consuming process that the UK Government has said will see between £40-66bn of investment over the next 40 years[2]. The application of the decommissioning provisions of the Act give rise to tensions between regulators ensuring that relevant parties maintain the wherewithal to decommission offshore assets and encouraging existing interests to continue to operate or new oil field late life specialists to enter this market and invest in mature oil fields.

Decarbonisation and sustainability are also high priorities for the UK Government, which is working with the oil and gas sector through the North Sea Transition Deal to decarbonise North Sea oil and gas production and reduce greenhouse gas emissions from decommissioning activities[3]. Traditionally, decommissioning has been considered the only path to follow when production ends, but this is changing, as re-purposing options become feasible which are supportive of either the transition to a net zero energy system, or reuse for other hydrocarbon-related purposes.

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The decision is likely to give some confidence to sellers that they are not liable for every development that happens to an oil field that they once owed. From the buyer's perspective, onerous security requirements, if imposed, can severely restrict their cash flow and their ability to seek third-party funding. A fine balance needs to be struck to ensure that decommissioning costs and the commensurate level of security can be reduced when appropriate, and at the same time, adequate safeguards are in place to minimise the impact of decommissioning on the environment.

[1] [2021] EWHC 1283 (Comm)
[2] Oil and Gas Authority Decommissioning Strategy, May 2021
[3] BEIS, North Sea Transition Deal, March 2021

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