

DECOMMISSIONING AUSTRALIA'S OFFSHORE PETROLEUM ASSETS

OVERVIEW OF CONSULTATION DISCUSSION PAPER AND POTENTIAL
IMPLICATIONS FOR OIL AND GAS M&A



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1

EXECUTIVE SUMMARY

- + The Commonwealth Department of Industry, Innovation and Science (**Department**) has published the discussion paper titled 'Decommissioning Offshore Petroleum Infrastructure in Commonwealth Waters' (**Discussion Paper**) as part of a review into the Commonwealth decommissioning framework. The paper identifies five key areas for regulatory improvement:
 1. scope of decommissioning obligations;
 2. level of information available to government;
 3. allocation of statutory (legal) responsibility and duration of that responsibility;
 4. financial capacity of titleholders to meet their responsibilities; and
 5. regulatory power to enforce compliance against current and former titleholders.
- + This note focuses on the Department's proposed reforms in respect of legal and financial responsibility for decommissioning.
- + Proposed solutions include:
 - introducing an 'alternative liability regime' (i.e. titleholder liability in perpetuity); and
 - dedicated decommissioning financial security requirements for titleholders.
- + These proposed solutions could have implications for oil and gas M&A activity, including impacting the ability to generate a 'clean exit' from a transaction, risk allocation in joint ventures, the ability to attract private equity investment or, in the case of smaller entities, the ability to enter the market in the first place.
- + One of the drivers behind the regulatory review was to assess whether the current regime could adequately meet the needs of a maturing offshore petroleum industry and increasing potential for large-scale decommissioning being required. It remains to be seen if the proposed solutions will be a value-add to the current decommissioning regulatory regime in Australia and represent best practice.
- + Any option for improvement must carefully weigh the risk of increased red tape discouraging economic investment that is otherwise socially and environmentally responsible and consistent with community and Government expectations.
- + Gilbert + Tobin's Oil and Gas team are monitoring this space and working closely with key stakeholders. For further information or assistance please contact our [Oil and Gas team](#).



2 INTRODUCTION

Australia's offshore petroleum industry has continued to play a significant role in the country's economy and energy security since commencing operations in the early 1960s. As an increasing number of offshore petroleum projects move towards the end of their productive lives, key questions arise:

- *What happens to the infrastructure (wells, pipelines, subsea completions etc.) when petroleum production stops?*
- *Who bears the financial and legal responsibility for removing or otherwise dealing with the infrastructure?*
- *How can the process be undertaken in a safe, environmentally responsible and economically efficient way?*

Decommissioning is the process of removing or otherwise satisfactorily dealing with offshore petroleum property at the end of its useful life.¹ The process includes the following activities:

- + plugging and abandoning wells;
- + rehabilitating the project site; and
- + carrying out any necessary monitoring.

In a recent 'Oil and Gas Competitiveness Assessment' published by National Energy Resources Australia (**NERA**), Australia ranked poorly against other producing nations for abandonment, mainly due to the country's substantial future decommissioning liability and lack of experience in the abandonment phase. With an estimated US\$21 billion of decommissioning liability expected to stem from Australia's offshore petroleum industry over the next 50 years, a figure which will undoubtedly grow over time, it is essential that the regulatory regime is equipped to respond to upcoming challenges.³

With this in mind, it is not surprising that the existing decommissioning framework is the subject of review at both the Commonwealth and State level. The Commonwealth Department of Industry, Innovation and Science (**Department**) recently published the discussion paper titled 'Decommissioning Offshore Petroleum Infrastructure in Commonwealth Waters' (**Discussion Paper**). Following the release of the Discussion Paper, the Department's review has now entered a public consultation period. The Department and the National Offshore Petroleum Safety and Environmental Management Authority (**NOPSEMA** or **Regulator**) are seeking feedback from stakeholders on potential avenues for amending the existing regime with a timeline set for possible policy and regulatory change from 2020 onwards.

The Discussion Paper follows the Department's decommissioning guideline released in February 2018 (our review found [here](#)).

3 POTENTIAL IMPROVEMENTS TO THE EXISTING REGIME

Consistent with the terms of reference for the review, the Discussion Paper is an options paper expressed to stimulate consideration of elements within the framework that have the potential to be clarified, rationalised or improved with a focus on environmental and well integrity outcomes and regulatory oversight. The Discussion Paper is therefore far from representing a final policy position and identifies the following areas for potential improvement and amendment to the existing *Offshore Petroleum and Greenhouse Gas Storage Act 2006* (Cth) (**OPGGGS Act**) and associated regulations.

Legal and financial responsibility (as highlighted) are undoubtedly the areas that have generated the greatest level of focus for government, regulators and stakeholders alike. These issues are explored further below.

Area for improvement	Identified regulatory concerns / gaps
Decommissioning obligations	The scope of infrastructure to which the decommissioning obligations apply is unclear. Further, there is a lack of specificity in timeframes for decommissioning and the current framework means a title has to end before the status of the removal obligation is clear.
Information available to government	Titleholders are not required to provide an overarching decommissioning plan or to ensure the government has up-to-date information on infrastructure in the title area including in relation to its use, status or any projected decommissioning.
Legal responsibility	On the basis that statutory responsibility for undertaking decommissioning is not explicitly stated, there is a potential lack of clarity regarding key issues, including: who bears statutory responsibility for ensuring decommissioning is carried out, the extent to which they are responsible and the associated length of time.
Financial responsibility	The titleholder's financial capacity to meet its decommissioning obligations is only considered at the initial grant of title or at the time the title is transferred – this point-in-time assessment does not guarantee a titleholder's future ability to meet removal obligations.
Post-title compliance and enforcement	Remedial direction powers may require a former titleholder to carry out certain activities, but they cannot reinstate duties and obligations that apply to a titleholder under the OPGGS Act (such as a requirement to have and comply with an inforce environment plan before undertaking an activity).

4 LEGAL AND FINANCIAL RESPONSIBILITY

The Government's view on statutory responsibility is that decommissioning is a titleholder's responsibility. Under the current regime, the Government is concerned that it will be required to step in and meet the costs of decommissioning in circumstances where the titleholder fails to carry out its obligations. The Discussion Paper identifies the following contributory factors:

- + the market is becoming characterised by a number of late-life project ownership changes, specifically, transfers from large to smaller oil and gas companies without immediate access to comparable financial resources of global producers and operators; and
- + the acquisition of a parent company with ownership or control of a titleholder does not constitute a change in titleholder under the current law. As a result, a change in titleholder assessment of the ongoing technical and financial capacity to meet decommissioning obligations under new ownership does not apply.

Clarifying legal responsibility for decommissioning and introducing financial security mechanisms presents an opportunity to mitigate this risk.



5 OPTIONS FOR IMPROVEMENT

The Discussion Paper presents the following possible options to address the perceived regulatory gaps concerning legal and financial responsibility for decommissioning.

Options for improvement

Legal responsibility

Clarify responsibility for decommissioning - Amending the OPGGS Act to expressly provide that each member of a titleholder group can be held to account for the total decommissioning obligations and allow the Government to pursue any costs should a titleholder default.

Implement alternative liability arrangements - Amending the OPGGS Act to provide that responsibility for decommissioning survives the transfer of title. Former titleholders would remain responsible for decommissioning infrastructure installed before the time of transfer irrespective of how many times a title changes hands and therefore remain subject to the ongoing risks of regulatory action.

Civil liability rests with the titleholder in perpetuity - Without a statutory 'liability release', the risk of civil liability would continue after operations cease and extend beyond decommissioning and title relinquishment.

Liability release after certain decommissioning activity - Titleholders could be released from accrued liability after undertaking certain decommissioning activities. This would provide certainty to titleholders in clarifying where liability lies after completion of decommissioning (including in circumstances of property being left in a marine environment).

Government assumes infrastructure ownership - This would see the government enter into arrangements with titleholders whereby the government takes ownership of, and therefore assumes liability for, decommissioned infrastructure. This is seen in artificial reefing or similar programmes in international jurisdictions.

Financial Responsibility

Assessment of the titleholder's financial and technical capacity to meet its obligations at any time - A range of compliance and enforcement actions to be made available to the Government if the titleholder fails to demonstrate necessary financial or technical capacity to meet its obligations (including decommissioning obligations).

Extend existing titleholder financial assurance or security obligations to include decommissioning activities - This could be achieved by an express statutory requirement for titleholders to provide financial security (i.e. through bonds, letters of credit or other instruments) attached to the title itself or require financial security for decommissioning on a discretionary basis.

Establish a dedicated decommissioning fund:

- + *Individual fund* - titleholders would be required to contribute periodically throughout the project life-cycle to a fund directly tied to the title; or
- + *Pooled fund* - titleholders to contribute periodically (through levies) to a pooled fund which would be used to cover the costs of decommissioning in the event of individual default.

6 KEY STAKEHOLDER CONCERNS

The options for improvement previously mentioned have been modelled off the well-established abandonment and decommissioning regimes in the US, UK and Norway. The question is, are these options suitable for the Australian oil and gas industry or do they present significant challenges to the market and its participants?

Industry stakeholders have raised a number of concerns at the recent public discussion forums.

Legal responsibility

Introducing alternative liability may constrain investment activity Liability in perpetuity would generate significant risk for titleholders and groups of titleholders. This has the potential to act as a disincentive for investment in the industry and creates significant apportionment of risk considerations for future oil and gas transactions. It has been suggested that policy makers in the UK may consider amending the existing 'liability in perpetuity' arrangement with fears that the regime has been counterproductive in its operation.

Introducing liability in perpetuity may not be an efficient solution It may result in more titleholders opting for complete removal of petroleum infrastructure without adequately assessing alternative options that may present more appropriate economic or environmental outcomes.

Risk of liability beyond title may limit the productive life of projects Without the assurance of a full liability release, titleholders may opt to decommission before a project has reached its full productive capacity resulting in resources becoming economically stranded (particularly late-life or marginal fields). This may ultimately limit the level of resource that is returned to the market or the maximisation of recovery of petroleum from individual fields.

Financial responsibility

Additional point-in-time regulatory reviews may be ineffective Given the cyclical nature of the resources industry, participants have raised concerns around the ability of the Regulator to adequately quantify and assess potential decommissioning costs at various stages of a project. Further, the extensive life-cycle of petroleum projects and the impact of fluctuating oil prices on a company's financial position may mean that any point-in-time assessment of a titleholder's capacity to meet decommissioning obligations may not be appropriate and could lead to unnecessary adverse regulatory outcomes.

Requiring financial security may be add little value over the existing regulatory regime Existing financial assurance mechanisms may be a useful means for ensuring a titleholder can deal with 'extraordinary' costs, but they may not be appropriate for ordinary costs of completing planned activities such as decommissioning. Further, there is a risk that any new requirement for financial security may be an inefficient use of project capital that could otherwise be employed for resource exploitation and present a significant financial burden or obstacle to investment.

Financial security requirements may increase barriers to entry Financial security requirements for significant decommissioning costs may present a barrier to entry for smaller companies in late-life petroleum projects.

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POTENTIAL IMPACT ON
M&A ACTIVITY

Any change to the legal and financial responsibility requirements for decommissioning in Australia may have implications for M&A activity. Potential impacts include:

- + *Clean exit:* The introduction of alternative liability regimes, including the possibility of liability in perpetuity, may impact a party's ability to generate a 'clean exit' from an oil and gas asset. As has been seen in an international context, this may discourage private equity investment or give rise to alternative contractual structures whereby sellers retain ongoing control / operator step-in rights.
- + *Joint venture arrangements:* Joint venture parties will need to consider the issue of ongoing decommissioning liability. This will include liability following the transfer of a participant's percentage interest in the relevant title. Parties may need to consider entering into standalone agreements (such as decommissioning security agreements prevalent in the UK) that deal specifically with the security for decommissioning liability.
- + *Participation by smaller oil and gas companies:* Imposing significant financial security requirements may impact the ability of smaller oil and gas companies to enter the market, as is typically the case in relation to projects and fields entering the later phase of development.
- + *Indemnity and post-transaction rights implications:* Any of the proposed changes to legal and financial responsibility may impact the scope of indemnities given in sale agreements and increase focus on the post-transaction rights of the seller, particularly if an alternative liability regime is adopted. This may impact the time for negotiation and pricing discussions in a sale.
- + *Timing and costs:* Any change to the apportioning of risk and liability will increase the deal timeframes and cost of negotiating. Any strengthening of regulatory oversight or compliance obligations will increase the annual cost to titleholders and have pricing implications for M&A activity.
- + *Opportunities for contractors:* Although the potential reforms may give rise to concerns for oil and gas companies, decommissioning presents opportunities for oil and gas contractors and may provide greater certainty in addressing future project decommissioning risks.⁴



8 WHAT'S NEXT?

The potential impact on the oil and gas market will depend significantly on the final legislative and regulatory position. Internationally, comparable regimes to Australia (such as in the US, Norway and the UK) should be informative. The Department has clearly indicated that any future reform of the decommissioning framework will continue to promote the following pillars of the current regime:

1. Objective-based regulation of the offshore petroleum sector.
2. Environmental, safety and well integrity outcomes are paramount.
3. Decommissioning is the responsibility of titleholders (also applies to titleholders that have acquired assets, from a former titleholder).
4. Decommissioning should be considered early and often through all stages of the petroleum lifecycle.
5. Complete removal of property and the plugging and abandonment of wells is the 'base case'.
6. Decommissioning should take place before block(s) become vacant acreage.

Interested stakeholders are invited to provide comments and submissions on the Discussion Paper by 16 January 2019.

The Department anticipates the release of an Options Paper in late 2019 setting out the government's preferred options with a further period of public consultation. The final government decision on the amended framework is expected to occur in 2020.

For further information or assistance in relation to the Discussion Paper or making submissions please contact the Gilbert + Tobin Oil and Gas team.

ENDNOTES

- ¹ Department of Industry Innovation and Science, 'Discussion Paper – Decommissioning Offshore Petroleum Infrastructure in Commonwealth Waters' (October 2018), 5.
- ² NERA, Australian Resources Research Centre, 'Oil & Gas Industry Competitiveness Assessment - Report on the Framework, Baseline Score, Insights and Opportunities' (September 2016), 13.
- ³ Department, above n 1.
- ⁴ Commentators have made reference to decommissioning as the next 'oil and gas boom'. This includes media release by Deloitte, 'Decommissioning has potential to be Australia's next oil and gas boom' (May 2017) available at < <https://www2.deloitte.com/au/en/pages/media-releases/articles/australias-next-oil-and-gas-boom-160517.html>>.

9 G+T OIL + GAS EXPERIENCE

BEACH ENERGY LIMITED

On its \$1.585 billion acquisition of Lattice Energy, the conventional upstream oil and gas business, from Origin Energy, associated offtake agreements, and related equity capital raising and debt financing

JADESTONE ENERGY

On its acquisition of the Montara oil field from PTTEP for US\$195 million

SCEPTER PARTNERS

On its \$7.1 billion proposal to acquire Santos

AURORA OIL & GAS

On the \$2.6 billion acquisition by Baytex Energy by scheme of arrangement

VITOL

On its \$2.9 billion acquisition of Shell's Australian downstream assets, including the Geelong Refinery and 870 retail sites across Australia

WESFARMERS

On its US\$100 million acquisition of a 13.7% interest in Quadrant Energy Holdings

AGL

On the disposal of its interests in Elgas (\$230 million) and Gas Valpo (US\$90 million)

CNOOC

On its participation in the North West Shelf project

ENGIE

In respect of its gas transportation and supply arrangements in Eastern Australia with Santos and Epic

AWE

On its bid, and the structuring of its related proposed financing arrangements, to acquire a large North Asian oil & gas portfolio

SHELL

On the \$3.3 billion partial sale of its stake in Woodside Petroleum, representing the largest underwritten block trade in Australia's history

ORICA LIMITED

On its Gas Supply Agreements with Exxon Mobil, BHP Billiton and Strike Energy

BEACH ENERGY LIMITED

On its proposed acquisition of Toyota Tsusho Corporation's interests in the Otway Gas Project, BassGas Project and related assets

AGL / ALINTA

On the acquisition of a 27.5% stake in Queensland Gas Company and entry into a 20 year gas supply agreement with QGC

NEPTUNE ENERGY GROUP, THE CARLYLE GROUP AND CVC CAPITAL PARTNERS

On the Australian aspects of Neptune's US\$3.9 billion acquisition of ENGIE E&P International S.A.

GLNG OPERATIONS

On its upstream gas supply and transportation arrangements for the GLNG facility on Curtis Island

MACQUARIE

On its acquisition of a 49% interest in SK Enron (the second largest gas company in Korea) for US\$350 million

HIBISCUS PETROLEUM BHD & PUNCAK OIL & GAS

On their bid to acquire the Malaysia oil & gas assets of Newfield Exploration Co and the structuring of their proposed reserve based financing arrangements relating to the acquisition

BOW ENERGY

On its \$1.2 billion acquisition by scheme of arrangement by Arrow Energy (jointly owned by Shell and PetroChina)

AL-THANI

On its evaluation of and bid to acquire a significant interest in InterOil's upstream and LNG projects in Papua New Guinea

OIL SEARCH

On its upstream, joint venture arrangement in Papua New Guinea

BP AUSTRALIA

Providing strategic advice on native title, Aboriginal heritage and land access issues associated with construction of an onshore LNG gas hub

BRUNEI NATIONAL PETROLEUM COMPANY

On negotiation and drafting of its onshore Production Sharing Agreement and related bidding rounds and negotiations

AURORA OIL & GAS

On the acquisition of producing oil and gas interests in the USA

PURA VIDA ENERGY NL

On its farm-out of a 52% operating participating interest in the Mazagan permit, offshore Morocco to Plains Exploration & Production Company

SOVEREIGN WEALTH FUND

On the evaluation of, and bid to acquire, a significant interest in InterOil Inc's Upstream and LNG projects in Papua New Guinea

FINDER EXPLORATION

On its farm-out and joint operating agreement with Shell and Sasol

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