Apache UK Investment Ltd v Esso Exploration and Production Ltd

[2021] EWHC 1283 (Comm):

Offshore Decommissioning Risk Transfer Considerations

A judgment handed down by the Commercial Court concerning the decommissioning of offshore installations under the Petroleum Act 1998 highlights certain risks that require careful consideration when oil & gas companies are assessing their risk transfer options.

Introduction

In 1987 the UK government enacted a Petroleum Act that contained provisions relating to the removal and disposal of offshore structures, within territorial waters, upon field abandonment. The Secretary of State being empowered to approve or reject abandonment programmes relating to the removal and disposal of such offshore structures.

A further Petroleum Act, enacted by the UK government in 1998, contained additional definitions relating to the powers of the Secretary of State and the parties responsible for complying with obligations regarding the removal and disposal of offshore structures.

In the UK, the Operator is required to provide an acceptable form of security. The objective of the security being to ensure that the licence holders have the financial capability to meet their obligations at the time of abandonment. In accordance with the provisions of Joint Operating Agreements, each field Partner will provide the Operator with security for their respective shares.

Furthermore, in the event that the interests in production assets are sold, the Petroleum Act 1998 can be used to make the seller responsible to the government for decommissioning costs should the purchaser ultimately default on meeting such costs.

Accordingly, interested parties, selling offshore assets, will seek security from buyers in relation to the seller's ongoing exposure to decommissioning costs. It is in this respect that that the dispute between Apache UK Investment Ltd ("Apache") and Esso Exploration and Production Ltd ("Esso") arose.

Apache acquired from Esso the latter's sole legal and beneficial ownership in certain hydrocarbon producing fields in the North Sea. Apache and Esso entered into six Bilateral Decommissioning Security

Agreements (BDSAs) providing security in respect of Apache's obligation under the sale and purchase agreement to indemnify Esso for decommissioning related expenditures which Esso was or might become liable to incur whether such expenditures arose before, at or after the effective date of the sale and purchase agreement.

Apache's obligation to indemnify was supported by a parent company guarantee provided by Apache Corporation, the ultimate parent company of Apache. Latterly, in accordance with the provisions of the BDSAs, Apache were required to provide further security in the form of Letters of Credit. The BDSAs provided a contractual process to determine the amount of such further security and it is in this respect that the dispute arose.

Inter alia, the dispute involved a disagreement as to whether or not the Secretary of State, in accordance with the Petroleum Act 1998, could impose a decommissioning cost responsibility on Esso in relation to wells which were drilled for the first time after Apache had acquired ownership of the company holding the licences in the fields. Specifically, if Esso were faced with such an additional exposure then same should be reflected in the level of further security Apache were obliged to provide in the form of Letters of Credit. In this respect, the Court found in favour of Apache, deciding that the Secretary of State had no power to impose a liability on Esso for the decommissioning of additional wells that had not been in existence, or intended to be established, at the time earlier existing notices had been served (on Esso's associated group company) to submit to the Secretary of State an abandonment programme. Therefore, Apache were not required to provide security to Esso in relation to such additional wells.

The case serves to highlight the importance of security mechanisms in relation to decommissioning risks and also the exposures relating to wells. So far as the insurance market's response to decommissioning risks is concerned, these are two issues which benefit from further analysis.

Insurance Contracts & Guarantee Contracts

It will be seen, from the *Introduction* section, that Operators and Partners, including buyers of assets, can be faced with instances when they are required to provide a form of security to demonstrate their ability to meet their responsibilities in relation to field decommissioning costs. In this respect, such parties may be offered a solution via the insurance industry. If so, it is important that such parties establish the nature of the solution being offered. Specifically, reference is made to the distinction between an insurance contract and a guarantee contract.

A guarantee is a specific type of indemnity whereby the guarantor "A" promises "C" to answer for the debt or default of another person, "B". Certain elements distinguish an insurance contract from a guarantee contract. In particular, in respect of an insurance contract, an insurer will pay a claimant without then having any recourse against the policyholder. Whereas a surety, who pays a claimant under a guarantee, *is* entitled to seek reimbursement from the client.

Accordingly, unlike a guarantee contract, a key principle of insurance is the transfer of risk. Therefore, when considering decommissioning security solutions, offered via the insurance industry, it is essential that clients seek clarity as to the nature of the contract.

Wells: Project Risks

Whilst Apache were held not to be responsible for providing security to Esso in relation to the *additional* wells under consideration, the case serves as a reminder that offshore installation abandonment programmes, within the provisions of the Petroleum Act 1998, can encompass wells.

Operational Control of Well Insurance (Operators' Extra Expense) would provide coverage in respect of control of well and seepage, pollution, clean up and contamination losses during the plugging and abandonment of declared wells. However, would a standard Control of Well insurance contract realistically be expected to respond to such losses in the event that a plugged and abandoned well was damaged during the removal of physical assets such as an entire platform or subsea infrastructure? If Operators and Partners considered such a risk to exist then clearly such coverage would require express negotiations with the Operational Control of Well underwriters.

Alternatively, Operators and Partners may wish to ensure that any stand-alone insurance policy, addressing decommissioning project risks, contains appropriate terminology affording control of well and seepage, pollution, clean up and contamination coverage during the dismantling and removal phase of the project. Historically, Offshore Dismantling & Removal policy wordings affording such coverage have been placed in underwriting markets committed to this risk category.

Wells: Post-Project Risks

Based upon their ongoing perception of the frequency and severity of potential incidents, Operators and Partners may determine there to be a sufficient degree of uncertainty of loss so as to merit maintaining insurance coverage, in respect of plugged and abandoned wells, after all field abandonment dismantling and removal activity has ceased.

In such instances, Operators and Partners can achieve ongoing coverage in respect of plugged and abandoned wells by continuing to declare same to their Control of Well (Operators' Extra Expense) insurers. Such insurers providing the aforementioned control of well and seepage, pollution, clean up and contamination cover.

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