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Arbitration and the Decommissioning of Oil and Gas Assets: An Australian Perspective

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As the oil and gas industry continues to mature, the number of mid-to-late life assets grows. A key challenge for the energy sector is how to effectively manage the decommissioning of these assets, especially those situated offshore. In Australia:

- decommissioning work is expected to be required for up to 65 offshore platforms by 2026, and
- the cost of decommissioning over the next 30 years is predicted to be in the order of $60 billion.

The challenge is not one for engineers and operators alone. Decommissioning presents legal issues that implicate oil and gas companies, investors, contractors, and the government. As with the original construction projects, decommissioning is a minefield for disputes; in particular, disputes in relation to the mechanisms used to mitigate the risks associated with the newly implemented trail liability provisions set out below, and the estimation of decommissioning costs, their impact on the value of assets and who will be responsible for those costs. Arbitration remains the preferred method of dispute resolution for these types of energy projects, particularly due to confidentially and ease of enforcement.

Nor is the challenge one for Australia alone. While the current buoyancy of energy commodity prices is likely to push out some decommissioning work, a wave of decommissioning is expected over the next decade, with a significant number of assets around the world reaching the end of their economic life phase.

Context

At the macro level, the timing of decommissioning of oil and gas assets depends in large part on government policy as well as the market for energy commodities.

Even as Covid-19 disruption eases globally (with the notable exception of China), the war in Ukraine and redoubled sanctions against Russia, compounded by Russia itself cutting supply of natural gas to a number of European countries, threaten to push prices even higher.

While disruptions in the short to medium term look set to continue, the transition towards renewable energy in the mid to longer term continues to press forward. In Australia, the newly

elected Labour-led government has committed to reducing emissions by 43% by 2030 (a more ambitious target than the previous Government's goal of 26-28%).

Though, for example, hydrocarbon prices are likely to sustain their current highs for the foreseeable future, prolonging decommissioning for some oil and gas fields in the short to medium term, the long-term outlook in the coming years and decades remains unchanged.

Decommissioning in Australia

Decommissioning of oil and gas assets is not a simple "pack-up" exercise. It involves a range of activities necessary to safely dispose of the various installations of piping and platforms, and restoration of the site to an "agreed" status (as determined by contract, typically a joint operating agreement, and any legislation). However, decommissioning is more than a technical engineering challenge. Prior to any work being undertaken, pre-abandonment surveys will be carried out, and a decommissioning plan must be prepared for regulatory approval.

Though decommissioning is gathering pace globally, Australia faces a particular challenge in this regard. A Wood Mackenzie study on the subject noted:

> "Unlike in the Gulf of Mexico and the North Sea, decommissioning is still in its infancy in Australia, and all involved (i.e., regulators, operators, and the service sector) need to be prepared for the coming wave as assets approach the end of their producing lives."

The legislative landscape

Offshore oil and gas decommissioning is currently regulated by the *Offshore Petroleum and Greenhouse Gas Storage Act 2006* (Cth).

Until recently, the registered titleholder was responsible for decommissioning, with no financial assurance required to ensure liquidity to cover associated costs. Things changed following an incident in 2019, when the Northern Oil and Gas Australia group of companies went into liquidation, leaving the Australian government responsible for extensive decommissioning costs in the Timor Sea. A review was established (the Walker Review) to investigate the liquidation, and make recommendations to improve practices, policies and legislation. The key recommendations were adopted in the *Offshore Petroleum and Greenhouse Gas Storage Amendment (Titles Administration and Other Measures) Act 2021* (Cth) (the **Act**).

One of the key changes introduced by the Act was the "trailing liability" provisions, whereby earlier titleholders would not be absolved of responsibility for remediation and decommissioning. The National Offshore Petroleum Safety and Environmental Management Authority has the power to "call back" not just former titleholders but (1) any person that has significantly benefited from the operations, (2) anyone who was in a position to influence the extent of another person's compliance with their obligations under the Act, or (3) has acted jointly with a titleholder in their

operations. The sweeping provision encompasses employees, advisers, financiers and royalty holders.

The provisions, which came into effect on 2 March 2022, are intended to be used as a "last resort". Residual issues that could involve calling back a former titleholder include where a previously plugged and abandoned well has a leak or impacts arise from a previously decommissioned activity.

Along with the trail liability provisions, other key changes in the Act add yet further transactional and regulatory complexity.

Disputes avoidance – navigating the labyrinth

The trailing liability provisions pose a significant risk factor for investors in oil and gas assets, as well as those wishing to divest. As many of the larger companies look to sell-down their Australian portfolios to smaller, later-life-stage operators, these provisions contribute an added layer of complexity to any transaction.

In other countries where trail liability can be imposed by regulators on a wide range of parties (such as the UK), the response has been to implement decommissioning security agreements (**DSAs**), whereby buyers and sellers, as well as other joint venture parties, contribute funds (in tiered amounts, according to their stake and involvement) into a trust set aside for decommissioning costs.

Disputes may arise in relation to the mechanisms and structures used to mitigate the risks associated with trail liability. For example, disputes can arise between parties to a DSA, in connection with the estimate of sufficient security to cover the costs of decommissioning, and the respective contributions of different parties to the agreement.

DSAs also rest on intrinsic assumptions as to when decommissioning will occur, which is a key input into the expected net cost of decommissioning and how that should be split over time. Disputes can then ensue when oil or gas prices rise or fall, altering the optimal decommissioning date, and thereby thwarting parties' expectations as to the extent or duration of their contributions. In the UK, the decision in *Apache v Esso* provided that a former titleholder would not be liable for decommissioning of wells drilled after the titleholder ceased to be the owner of the relevant oil and gas assets.[1)] By contrast, the regulatory guidance note in Australia acknowledges that the trail liability provisions do not differentiate between property that was:

- *in the title area at the time that person was involved and*
- *brought in subsequent to that person's involvement*".[2)]

Disputes can also arise as to the scope of decommissioning required, the execution, and environmental remediation (which is not always straightforward) and interpretation of the relevant legislation.

The potential for disputes increases with the time taken for approval of decommissioning plans and execution of the works, particularly if any delays accrue (for example, because of weather

conditions), or the actual scope of required decommissioning changes (for example, if a site or rig deteriorates and becomes more hazardous to work on).

For older agreements, it is not uncommon for the contract *not* to include precise mechanisms for dealing with abandonment (which may not have been considered or thought out at the time the contract was signed). This can give rise to issues of unexpected liability, where it must be decided who is to bear the cost of regulatory compliance. Parties in this position should be aware of the applicable regulatory framework and what that may require of them and proactively engage with stakeholders and regulators to front foot and minimise their risk.

Offshore oil and gas facilities are often developed by joint ventures that operate under Joint Operating Agreements (**JOAs**). JOAs typically include a provision for the creation of a decommissioning fund. The trigger date for decommissioning is usually a point at which the net value of the remaining reserves reaches a percentage of the costs. However, estimating the value of both decommissioning and reserves involves assumptions, which are difficult to make during periods of market volatility and can give rise to disputes when the expectations underlying those assumptions are unfulfilled.

Other issues to keep an eye on include:

- Records for older assets may not provide a complete picture, particularly where the construction was decades ago, and records were not kept or converted to digital. In such instances, the inherent uncertainties involved in decommissioning are exacerbated by incomplete information.
- Delay issues can also arise where sub-contractors are mobilised to remote locations but are required to wait on standby due to delays. Where various sub-contractors provide mutually dependent services to a tight schedule, one delay can cause cascading issues for successive decommissioning steps.

To avoid disputes escalating, parties should be mindful of maintaining robust contract management practices, including, on the employer's part, providing clear instructions, and on the contractor's part, issuing unambiguous notices of claim, and submitting timely and detailed variation requests where a claim is intended.

References

?1 *Apache UK Investment Limited v Esso Exploration and Production UK Limited* [2021] EWHC 1283 (Comm).

?2 Department of Industry, Science, Energy and Resources, *Guideline: Trailing liability for decommissioning of offshore petroleum property* (2 March 2022), at 3.9, available here. However, in issuing a remedial direction, the regulator will give consideration to whether a person was responsible for a specific installation or well.

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