

## Introduction

In recent years, the UK oil & gas industry has come under significant pressure. As Malcolm Webb, Chief Executive of Oil & Gas UK, said, "If the challenge facing our industry was significant when oil was at \$110 per barrel, the scale of the issue has greatly escalated with the oil price collapse." In 2014 production revenues amounted only to £24.4 billion, the lowest since 1998. This level is expected to fall to little more than £17 billion in 2015.

With Brent prices falling from USD110/bbl to below USD55/bbl in January 2015, issues have only been exacerbated. Oil & Gas UK's 2015 Activity Survey clarifies that in 2014, the industry experienced a negative cash flow of £5.3 billion. Additionally, the cost of operating in the UK Continental Shelf (UKCS) rose by £0.7 billion.

Given the estimated production revenue – subdued oil prices and increasing costs – the cash flow picture for 2015 is looking bleak. The competitive pressures on the UK oil & gas industry have increased to such an extent that the Chief Executive of Oil & Gas UK confirmed that to effectively secure a sustainable future for the UK basin, cost reductions of up to 40% per barrel of oil equivalent must be achieved.

With over £1 billion (4% of total expenditure) being spent on decommissioning activity in 2014, decommissioning activity in the UKCS is looking to accelerate. Without fully factoring recent oil prices, Oil & Gas UK expect that spending on decommissioning will increase to £1.8- £2.0 billion per year between 2015 and 2020.

Although a zero-sum game, decommissioning does provide British companies with significant economic opportunities. As Sir Ian Wood's 2014 Report states: *"if the UK can develop its expertise in this area, it will have a competitive advantage which can be exported to other oil provinces as they mature."*

## Decommissioning

Decommissioning, in the offshore context, means "the abandonment and making safe of offshore oil and gas installations" that are no longer economically viable. The process is a complex one and involves assessing the options, obtaining governmental approval and subsequently: executing plans to shut down operations at the end of a field's life, closing the wells, cleaning up, making the installation safe, removing some or all of the facilities and reusing or disposing of them as appropriate.

The primary requirements for decommissioning in UK waters are set out in the Petroleum Act 1998, as amended by the Energy Act 2008. This statutory regime implements the UK's international obligations arising under the 1982 UN Convention on the Law of the Seas and 1992 Convention for the Protection of the Marine Environment of the North East Atlantic. Currently, jurisdiction for ensuring compliance with the Act lies with the Department for Energy & Climate Change.

## Decommissioning Liability

To ensure that British taxpayers do not bear the costs of decommissioning offshore structures, the obligations and liabilities created under the Act are extensive. Under Section 29 of the Act, the Secretary of State may, by written notice, require almost any party connected with an offshore installation to submit a decommissioning programme.

Once a party is served with a Section 29 Notice, it will become liable for all decommissioning costs related to the particular installation. The class of persons on whom the Secretary of State can serve a Section 29 Notice on is extremely wide and theoretically even includes the owner – and their parent or sister company – of a floating production storage and offtake system or drilling rig used as a production platform. This may be the case even where the owner has little or no beneficial interest in the field.

## Decommissioning Agreements

To date, no industry standard form contract for decommissioning project activities exists. As such, until industry standards are established, decommissioning projects are likely to be based on other offshore contracts. Particularly likely sources are drilling and offshore construction contracts. Others include onshore construction contracts, shipbuilding contracts and nuclear decommissioning agreements.

Until industry standard terms do emerge, the commercial, practical and legal uncertainties associated with decommissioning offshore oil & gas installations are likely to make it an area beset with disputes. From a decommissioning project perspective, the most substantial disputes are likely to arise out of delays in the decommissioning process.

## Delay Disputes

Decommissioning an offshore platform is a complex undertaking composed of a number of time consuming and technically challenging phases. It requires coordination between numerous parties, including operators, head contractors and subcontractors.

Planning each phase of the decommissioning process and estimating its respective costs is particularly difficult. In previous instances, such estimations have been far from perfect. For example, in the North West Hutton Decommissioning Programme, there were underestimations in decommissioning costs by over 50%. This miscalculation was linked to significant delays in dredging, trenching and cutting activities.

How delays are treated will depend on the exact wording provided in the applicable decommissioning contract. It is likely, however, that decommissioning contracts will provide:

- A set completion date (or a number of days for completion);
- certain permissible delays that permit the extension of the completion date; and
- a requirement that the contractor notify the employer of those delays.

Under English law, if the decommissioning contract is silent as to the completion date, it is likely to be implied that the project must be completed within a reasonable time. What a 'reasonable time' is will depend on the facts of the particular project.

As there is no standard form of decommissioning agreement, the commercial terms that parties agree may differ widely in each instance. Accordingly, with costs amounting to hundreds of thousands or more per week, the allocation of risk for losses that arise from delays will need to be carefully considered.

Project contracts usually provide express wording entitling the contractor to an extension of time for:

- (i) delays agreed as the employers' risk; and
- (ii) delays agreed as force majeure events (events outside the control of the parties).

Difficulties arise, however, where parties do not allocate the risk for other breaches of contract by the employer that cause delays (including acts which prevent the contractor from carrying out the contract, and are a breach of the implied duty of cooperation).

As an example, delays caused by an employer's work on nearby installations may not fall into the wording provided in either clause above. If such a delay arises, an employer may argue that the contractor should only be entitled to an extension of time where the delay falls into one of the clauses. The contractor, however, would argue that the employer should not be entitled to benefit from its own breach of contract and therefore an extension of time should be permitted. Ultimately, the outcome will depend on the contractual wording and facts of each case.

Particular difficulties in the decommissioning context can also arise from 'force majeure' clauses. Decommissioning requires specialised offshore machinery and vessels. Specialist vessels are, however, very limited. There is therefore a real possibility that they may be unavailable at the contractual start date. For example, the decommissioning process of the YME Platform off Norway was delayed as a result of completion delays in constructing the specialized heavy lift vessel, *Pioneering Spirit*. Whether the non-availability of such vessels should be a force majeure event under the contract will need to be set out as part of the contracted risk allocation.

Where there is delay, the question normally arises as to what the appropriate remedy should be. In shipbuilding contracts, the contractor is usually required to pay liquidated damages at a daily rate until the project is complete.

Whether a liquidated damages provision is enforceable under English law is subject to a number of principles including the need that the provision reflects a genuine pre-estimate of loss. If the provision does not provide a genuine pre-estimate, it is likely to be struck down as a penalty and be unenforceable. Given the infancy of the industry, providing a genuine pre-estimate of loss is likely to be a difficult task. Moreover, as there is no end product in decommissioning projects, an employer's loss is likely to be more limited. Accordingly, stipulating a cap on the contractor's fees may be a more effective remedy.

Termination for excessive delay is another typical remedy in project contracts. This can be a risky remedy to exercise. If the employer wrongly terminates, the contractor is likely to argue that the termination was a breach of contract entitling them to substantial compensation.

## Conclusion

Decommissioning is a developing industry and the number of decommissioning programmes submitted for consideration continues to grow. Careful legal consideration by in-house and external legal advisors and project managers, all with knowledge of the industry and its potential pitfalls is essential in the drafting of decommissioning contracts so as to save parties millions from protracted litigation.

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