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Decommissioning: Legal Issues and Business Opportunities

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Decommissioning: Legal Background

– S.29 and 34 Petroleum Act 1998 - DECC can serve notice on various parties requiring them to submit a decommissioning programme.

– s29 parties jointly and severally liable to carry out programme.

Previous Licensee

S.34 Petroleum Act 1998

→

New Licensee

S.29 and S.34 Petroleum Act 1998

– S.34 clawback: DECC can claw back into liability net anyone on whom a s29 notice could have been served at any time after first s29 notice served.

– S.34 never used in practice but has significant impact on asset trades.

Decommissioning: Legal Background

- JOA will usually outline responsibilities between co-venturers for decommissioning and production of decommissioning plan.

- Party agrees to provide security for its share of decommissioning liabilities for an interest:
  - To Vendor - as part of sale and purchase
  - To partners/co-venturers - fieldwide **DSA**
  - To DECC (relatively rare)

- In 2013 Government and Industry developed a contract in which Government would guarantee to make up shortfall if tax rules changed from status quo (Decommissioning Relief Deeds).

- Finance Act 2013 provides the statutory framework for the execution of DRDs and made technical amendments to tax legislation to ensure effective tax relief.

Problems: Decommissioning Liability

- Concerns about decommissioning liability and tax uncertainty slowed trade in UKCS licences and assets. Inevitably, this had a negative impact on UKCS related businesses.
- Decommissioning and liability is often the key commercial concern in sale and purchase agreements (shares and assets).
- Security for decommissioning liabilities under DSAs is very expensive (particularly for smaller participants). Difficult to obtain L/Cs from AA- banks.
- Now rectified by Decommissioning Relief Deeds: security provided on a “net” of tax basis. DRDs increase decommissioning certainty.

UKCS Decommissioning Relief

- Tax relief for decommissioning is available when expenditure is incurred.

- Where expenditure qualifies as decommissioning expenditure, tax relief is available in the form of a deduction for tax purposes equal to the full value of expenditure.

- This can reduce the profits of the person incurring the expenditure for the purposes of **RFCT**, **SC**, **CT** and **PRT** (now abolished since 2016 Budget).

- When decommissioning expenditure is incurred the field in question will no longer be producing significant income.

- Deduction available to a company on decommissioning is therefore likely to be greater than its income receipts for the period = **<u>significant losses for tax purposes</u>**.

UKCS Decommissioning Relief

- These losses are offset against the profits of previous periods, reducing the amount on which tax is payable and triggering a repayment of tax already paid in respect of those periods.

- Amount of relief available depends on the amount of tax paid historically, and varies with the tax rates and profits of previous periods.

RFCT, SC and CT (company specific taxes)

- Losses can be used by the entity incurring the decommissioning expenditure against:
    - its taxable profits for RFCT, SC and CT purposes in the period in which the loss occurs and the three previous periods; and
    - its taxable profits for RFCT and SC purposes for earlier periods beginning on or after 17 April 2002 onwards.

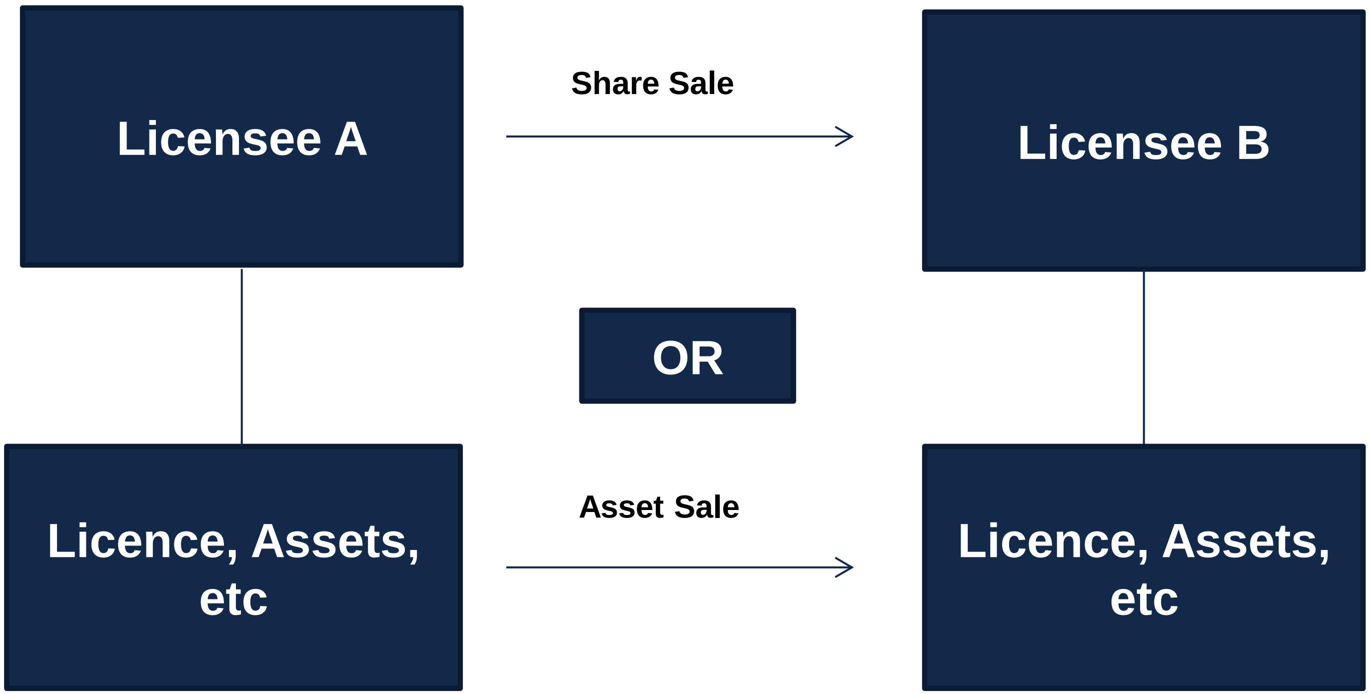
PRT (field specific tax)

- Availability of reliefs affected by the tax history of that specific field.

- Losses can be carried back indefinitely and can be used to reduce the taxable profits of the person incurring the decommissioning expenditure, but can in certain circumstances be set against the profits of previous participators (repayment will then paid to the previous participator).

Business Opportunities: Acquiring End of Life Licences

<u>Share sale or asset sale</u>



Business Opportunities: Acquiring End of Life Licences

Share Sale

Tax history accessible therefore availability of profits/losses very important.

Seller passes on savings/funds.

Purchaser takes all licence risks (e.g. litigation, etc)

Asset Sale

Tax history of Seller inaccessible for set offs. Allowable in future?

Terms of SPA very important. These may detail that the Seller will retain decommissioning liability or require the Seller to pass on any repayments received as a result of decommissioning (PRT).

Business Opportunities: Example of Acquiring End of Life Licences

Licensees: S.29 Liability = $ Estimated Decommissioning Cost (**A**)

Licensees pay: Contractor $**X** and Project Manager $**Y**

Therefore: A must be ≥ X+ Y

Licensee: If only 1 asset – low reward/relatively high risk

Licensee: If multiple(**N**) assets – scale, timing, technology, lower overheads (Discount (**Z**)) mean that **A x N > X + Y x N / Discount (Z)**

ESTIMATED COST – ACTUAL COST = PROFIT

Business Opportunities: Specialist Decommissioning Companies/Businesses

- Drilling companies for P & A.
- Contractors completing decommissioning for licence owners (Engineering Procure Remove Dispose (EPRD) contracts).
- Heavy lift.
- Waste disposal/recycling.
- Insurance.
- HSE.

Business Opportunities: Specialist Decommissioning Companies

Legal Risks

- Most claims will be under EPRDs or similar (unlikely under SPAs). Claims likely to relate to pollution, HS&E, performance of contract and delay/cost.
- Subcontractor/counterparty solvency risks.
- Relatively new industry therefore many unknowns. Possible damage to reputation linked to inevitable risk of decommissioning activities.
- Increased competition from others as industry develops.
- Availability of insurance?
- Legislation may change and contracts relatively undeveloped.

BUT possibility of high returns for early entrants.

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