2 August 2017

Ministry of Transport
PO Box 3175
Wellington

info@transport.govt.nz

PEPANZ submission on proposed changes to Marine Protection Rules Part 102: Certificates of Insurance

This document constitutes the Petroleum Exploration and Production Association of New Zealand's (PEPANZ) submission in respect of *Rule amendments to give effect to changes to the financial security regime in Marine Protection Rules Part 102: Certificates of Insurance – Invitation to Comment* ("Invitation to Comment"), which was released by the Ministry of Transport on 11 July 2017.

PEPANZ represents private sector companies holding petroleum exploration and mining permits, service companies and individuals working in the industry. Our members include the permit operators of all offshore petroleum exploration and mining permits in New Zealand and most of the commercial participants in those permits.

Summary

- PEPANZ's support for increased assurance requirements under *Marine Protection Rules Part 102: Certificates of Insurance* ("Part 102") is predicated on these being able to be met using relevant insurance products issued on market standard terms. Changes are proposed to Part 102 in this submission and specific direction to the regulator to this effect is required to ensure this is achieved. An explicit reference in rule 102.8 to the acceptability of an insurance policy that is on terms that are market standard for these types of coverage is proposed.

- PEPANZ supports the policy of significantly increasing assurance requirements by introducing a financial assurance requirement sufficient to cover the costs of well control and introducing a scaled framework for the level of financial assurance required for pollution damage.

- It is not possible to fully understand the effects of the proposed revised Part 102 when key elements of its application will be covered in yet to be developed guidance material. We are concerned detailed work has yet to be undertaken on how the revised Part 102 will be implemented and that significant reliance is being placed on yet to be developed guidance material to ensure the workability of the amended rule.

It is appropriate for matters of detail to be covered in guidance but guidance can't make up for gaps or deficiencies in Part 102 itself. PEPANZ nonetheless supports the development of comprehensive guidance material and will welcome the opportunity to be involved in its development.

- A transition period with the following features needs to be provided to avoid imposing potentially significant compliance costs on industry participants. We propose that:
    - the revised Part 102 does not come into effect until at least three months after the guidance material is finalised; and
    - existing installations are grandfathered for up to 12 months after the rule comes into effect to allow for the annual renewal cycle of insurance policies to take place.

Introduction

This submission is in three sections:

- 1. Policy changes to financial assurance requirements
- 2. Specific comments on Draft Rule Amendments to Part 102
- 3. Implementation issues that need to be addressed

1. Policy changes to financial assurance requirements

Government has been working on changes to financial assurance requirements for offshore installations for a number of years. This involved the release of discussion documents outlining specific proposals in mid-2014 and again in late 2016. PEPANZ has consistently supported substantial increases in levels of required assurance under Part 102 but has continued to express concerns with the implementation of a revised Part 102, particularly the necessity of being able to meet the requirements using international market standard insurance policies of the relevant types.

The Invitation to Comment summarizes the Government's decisions made following consideration of submissions made on a discussion paper released by the Ministry of Transport in December 2016.[1] The Invitation to Comment outlines the following three changes to the financial assurance requirements that Government is now intending to introduce:

- a financial assurance requirement sufficient to cover the costs of well control;
- a scaled framework for the level of financial assurance required for pollution damage; and

[1] *Improving the Financial Security Regime for Offshore Oil and Gas Installations*, Ministry of Transport, December 2016.

- refining the scope of liabilities under Part 26A of the *Maritime Transport Act 1994* (MTA) that the financial assurance must cover.

PEPANZ is supportive of the policy changes proposed and we make specific comments on each element in the following subsections of this submission. We are however of the view that changes are required to the detail of Part 102 to ensure the policy can be practically implemented.

The proposed **transition period** for the amended Part 102 outlined in the Invitation to Comment is insufficient given that the guidance material underpinning the revised rule is yet to be developed and the annual renewal cycle of insurance arrangements. The details of this and a recommended approach are discussed further below in Section 2 of this submission.

Introducing a financial assurance requirement sufficient to cover the costs of well control

PEPANZ continues to support financial assurance requirements specifically encompassing the potential costs of well control and containment, where these are relevant. We were broadly comfortable with the methodologies for this outlined in the 2016 discussion paper and welcomed the certainty and predictability such methodologies provide.

The Invitation to Comment states that a permit holder's Oil Spill Contingency Plan, required under *Maritime Protection Rules Part 131*, will be referenced in the rule as a factor to be considered by Maritime New Zealand ("the regulator") when considering the level of financial assurance required by the permit holder under Part 102, and that officials intend to finalise the required cost calculation after the Rule amendment is finalised, with the requirements to be detailed in supporting guidance.

As noted above PEPANZ is broadly comfortable with the proposed methodologies outlined for calculating well containment costs outlined on page 13 of the Invitation to Comment but the lack of confirmation as to exactly what they are, compounded by the fact that there are two separate formula and a reference to Part 131 creates uncertainty as to what the required assurance levels may be. There should be more certainty within the amended Rule. We have made comments below in Section 2 of this submission relating to how a financial assurance requirement for the potential costs of well control can be better provided for in the drafting of Part 102.

There is a specific point that needs to be addressed with the description of the formula outlined on page 13 of the Invitation to Comment. A capping stack should only be included in the calculation of well containment costs where it is a valid response option. It is potentially not a relevant response option for some wells, including some at existing producing facilities.

The Invitation to Comment outlines that the draft Rule amendment would require permit holders to hold a level of financial assurance sufficient to cover the costs of well containment, however, it notes the draft Rule amendment does not explicitly refer to "well containment" and states:

> "Part 26A of the MTA addresses third party liability and does not require financial assurance to be held for well containment carried out by an offshore permit holder. Instead, the draft rule amendment implicitly includes well containment as part of a permit holder's liability to the Crown or marine agencies for costs incurred in "dealing with" a harmful substance, under section 385B."

This appears to be an example of how the MTA is not designed to fit with the realities of, and wider regulatory design applying to, the offshore petroleum sector.

Introducing a scaled framework for the level of financial assurance required for pollution damage

The Invitation to Comment states the intended approach is to apply a scaled framework for the level of financial assurance required for pollution damage. The intended approach will provide certainty whilst also ensuring that assurance levels are better associated with the risks of a particular activity.

This is very similar to the framework consulted on in the 2016 discussion paper but with the top two bands (Bands 6 and 7) merged into one and a maximum level of NZ$600 million. For Bands 0 to 5 the required financial assurance is the same as proposed in the discussion paper. We note the change has brought this framework closer to the equivalent Australian regime, which has a highest prescribed band of A$500 million.

Refining the scope of liabilities under Part 26A of the MTA that the financial assurance must cover

PEPANZ has consistently raised concerns with the workability of the Part 102 in terms of using insurance to meet the assurance requirements. The uncertainty and openness associated with the scope of liabilities under the MTA means it does not align with relevant insurance products, for example conventional policies for managing well blowouts, and while insurance policies will cover third party claims for damage to property they generally don't cover pure economic loss claims.

It is of fundamental importance the offshore financial assurance/security requirements in Part 102 can be satisfied through the use of conventional international insurance policies, such as operators extra expense (OEE) in the case of risks associated with wells. As such we support the scope of relevant liabilities for assurance being refined so as to align with what is conventionally insurable. We also note the scope of potential liabilities under the MTA remain unchanged.

PEPANZ's support for increased assurance requirements under Part 102 is predicated on these being able to be met using relevant insurance products issued on market standard terms. We provide specific comments in Section 2 of this submission below regarding changes to Part 102 to support this. Specific direction to the regulator and the content of guidance will further contribute to achieving clarity and certainty on this aspect.

2. Specific comments on Draft Rule Amendments to Part 102

We note the amendments to Part 102 provide a framework for the intended policy outcomes but leave some of the key elements of the policy (i.e. the types of acceptable insurance and the mechanics of the scaled framework) to the proposed supporting guidance. Given their materiality it would have been preferable if the key elements of the guidance were available to be considered at the same time as the draft Part 102 itself.

For the assurance levels to be increased as planned with the introduction of the scaled framework and a requirement for well control costs it is critical that Part 102's requirements can be met using conventional insurance policies issued to the offshore oil and gas industry around the world by the specialist insurance markets providing these sorts of coverage. It must also be clear that each joint venture participant in a relevant exploration/mining permit only needs to maintain (and demonstrate) financial assurance for its percentage interest share of the required assurance level for the activities under the permit.

We are mindful that as well as the scope of liability issue the regulator has identified other aspects of insurance policies that might not be considered acceptable, such as:

- partial interest clauses;
- discovery and reporting requirements;
- whether policies respond to slow seepage as well as sudden events;
- the nature of single combined limits for an event on policies covering multiple potential liabilities (e.g. well control and pollution and clean-up);
- aggregate annual loss limits;
- acceptable levels of excess; and
- treatment of captive insurers.

We recognise some of these matters are noted in Appendix 2 as potentially being covered by guidance, although the substance of this is yet to be developed.

It is fundamental to remember that the relevant insurance policies applying to the upstream petroleum sector are, like other types of insurance, subject to a set of terms and conditions that represent conventions developed over many years of practical and legal experience around the world. The global insurance and re-insurance market in turn is based on adherence with standard approaches. These market standards can evolve

over time but this evolution is driven, and constrained, by the ongoing need to meet the different and interests of insurers, insured parties and regulators in key jurisdictions.

It is not practical for domestic regulators in small markets to require changes to these industry standard terms because the provision of insurance to the assurance levels being proposed for Part 102 (potentially up to and perhaps beyond $800 million depending on well control costs) relies on adherence to international norms. Refining the scope of liabilities under Part 26A of the MTA is important but not of itself sufficient to make Part 102 insurable if the regulator is unable or unwilling to accept conventional insurance policies for other reasons.

Providing an explicit reference in Part 102 to the acceptability of an insurance policy that is on terms that are market standard for these types of coverage or otherwise acceptable to the regulator, would make the acceptability of such polices clear and certain for both the regulator and industry participants. We consider this is consistent with the policy intent outlined in the Invitation to Comment and the Cabinet paper[2] that released it. PEPANZ's support for the proposed policy changes to financial assurance is predicated on this level of clarity existing in the Rule itself.

The below table outlines our full comments on the drafting of Part 102 but for the avoidance of doubt the most critical issues we raise are the following and these are **bolded** in the table:

- adding an explicit reference in Part 102 to the acceptability to the regulator of an insurance policy that is on terms that are market standard for these types of coverage [refer to below comments in relation to 102.8(2)(b)]; and
- the importance of requiring a single combined level of assurance based on the appropriate application of the two requirements in 102.8(2)(b).

Table: Comments on draft rule amendments to Part 102 outlined in Appendix 1 of the Invitation to Comment

Clause of Part 102	Comments/issues	Proposed change to drafting
102.8(1)(c)(i)	Use of the term "planned work programme" inappropriately links to terminology under the *Crown Minerals Act 1991* where permit "work programmes" could include matters of no relevance to Part 102 (e.g. seismic surveys, data processing or desktop geological studies). Alternative terminology that captures the relevant matters (e.g. drilling wells and/or operating	Replace "planned work programme during the period…" with wording along the lines of "ongoing or planned activities to be undertaken at the installation during the period that have the

[2] *Amendments to the Financial Security Regime for Offshore Installations*, Minister of Transport Chair, Cabinet Economic Growth and Infrastructure Committee.

	producing facilities) to be undertaken by the offshore installation should be included in 102.8(1)(c)(i).	potential to result in a release of hydrocarbons….".
102.8(1)(c) & 102.8(2a)(2)	The term "spill" is used in these two clauses but not elsewhere in Part 102. We note *Maritime Rule Part 131: Offshore Installations – Oil Spill Contingency Plans and Oil Pollution Prevention Certification* uses the term "oil spill" and alignment between these two rules appears desirable.	Consider replacing references to "a spill" with "an oil spill" in 102.8(1)(c) & 102.8(2a)(2)
102.8(2)(b)	**As outlined above it is critical to the workability of the revised Part 102, and its associated increased assurance levels, that conventional insurance policies are acceptable to the regulator.** **Providing an explicit reference in Part 102 to the acceptability of an insurance policy that is on terms that are market standard for these types of coverage, or on terms that are otherwise acceptable to the regulator, would make the acceptability of such polices clear and certain for both the regulator and industry participants.**	**Add a new sub-clause to rule 102.8(2) that provides that a contract of insurance will be accepted where it is on terms that are market standard for that type of coverage. This could be by way of for example a new clause [e.g. 102.8(2)(f)] providing one of the following or similar:** **"the contract or contracts of insurance are on terms that are consistent with market standards for that type of coverage or are otherwise appropriate"** **or** **"the contract or contracts of insurance are on terms of a type ordinarily available in the market or is otherwise appropriate"**
	Given that most offshore exploration and mining permits are held by joint ventures it is likely that multiple insurance policies will be used to meet the overall financial assurance obligation. Clause 102.8(2)(b) could be reworked to anticipate this more clearly be referring to "contract or contracts".	Consider replacing "contract" with "contract or contracts" in 102.8(2)(b).
	Use of "determined by the Director" raises question of whether the applicant or the Director is required to calculate the approved level. We had assumed in practice it would be that the applicant determines this and then the Director approves, or not, what has been applied for based on the requirements provided in Part	Change "determined by the Director" to "required" or similar.

	102 as supported by relevant guidance to be developed.	
	We question the value of including a reference to "Part 26A of the Act" given that relevant sections within that Part (385B and 385C) are specifically referenced. Referencing both risks ambiguity and possible confusion as to scope.	Remove reference to "Part 26A".
102.8(2)(b)(i)	This clause uses the term "pollution" when the relevant section of the Act (385B) contains no use of that term (except for in the chapeau) instead using "harmful substances". This clause should be aligned with section 385B of the Act to avoid any ambiguity.	Replace "dealing with pollution" with "dealing with harmful substances".
102.8(1)(c)	Query whether reference to "Part" should be to "subpart" or "rule".	Consider whether reference to "Part" should be to "subpart" or "rule".
102.8(1)(c)(iii)	Reference to "prospected" is redundant as prospecting cannot involve any drilling or petroleum production and the definition of "offshore installation" in the Act only refers to "exploration for, or the exploitation or associated processing of, any mineral". Reference to "exploiting and mining" is sufficient to cover all possible situations where there is a risk of hydrocarbons being released from an offshore installation.	Remove reference to "prospected for".
102.8(2A)(1)	**This clause needs revision to make clear that the "scaled framework" only applies to clean-up costs under rule 102.8(2)(b)(ii) and not to "dealing with" matters under section 385B as per 102.8(2)(b)(i).** **At present it is also unclear how the well containment costs envisaged to be covered under the reference to section 385B of the Act in 102.8(2)(b)(i) will be calculated, other than an oblique reference to "information provided by the applicant in accordance with rule 102.8(1)(c)".** **102.8(2A)(1) must also provide that the assurance level required is a single number and not two separate numbers. This is critical as relevant insurance policies will generally have a single combined limit, which enables the whole limit to be available to any of the limbs of coverage. So long as the combined limit is greater than the total of the costs under both limbs under 102.8(2)(b) then this**	**One way to resolve this through the drafting would be to:** • **Remove the reference to "scaled framework" in 102.8(2A)(1) and replace with references to applying the current (2A)(2) and a new clause.** • **Insert a new clause that outlines the w ell containment requirements covered by rule 102.8(2)(b)(i). This new clause would logically be located before the current (2A)(2) to align with the ordering of related clauses in 102.8(2)(b).** • **Replace "sums" with "sum" in 102.8(2A)(1).**

	must be acceptable to the regulator. Replacing "sums" with "sum" helps to achieve this and avoid any ambiguity in this respect.	
102.8(2A)(2)	Two drafting comments: • Reference to "NZ" is redundant as legislation is in New Zealand dollars unless specified otherwise. • Numbering style for 102.8(2A)(2) is incorrect and inconsistent with the rest of Part 102, should be (a), (b), (c) etc. rather than (i), (ii), (iii) etc.	Remove "NZ". Re-number (i), (ii), (iii) as (a), (b), (c) etc.
102.8(3)(e)(i)	Consideration needs to be given to whether the existing clause 102.8(3)(e)(i) needs to be modified to reduce unnecessary administrative complexity. As noted elsewhere in this submission most exploration/mining permits will have multiple permit participants each utilising their own insurance policies, which will have different renewal dates. This means that when one participant's policy is renewed others will likely only have a portion of the year remaining, potentially in turn requiring a certificate of insurance for a single installation to be issued by the Director multiple times per year for a matter of months at a time, even though the underlying insurance policies may remain the same over time.	Consider changes to 102.8(3)(e)(i) to address this issue.

Transition period for commencement of the revised Part 102

As noted above a transition period of an appropriate duration needs to be provided for from the commencement of the revised Part 102 to make compliance practical and avoid imposing potentially significant compliance costs on industry participants. The proposal outlined in the Invitation to Comment "The rule is expected to come into force 12 months after signing" is insufficient given both the guidance material underpinning the revised rule is yet to be developed and the natural annual cycle of insurance arrangements.

Two separate aspects need to be provided for to make the transition to the revised Part 102 workable:

- the normal renewal cycle of insurance policies (this is particularly relevant to the to the operation of existing permanent offshore installations at producing fields); and
- the time required from when the details of the new regime are finalised through the guidance, at which point a new or renewing applicant can first reasonably be expected to be able to comply given various work may need to be undertaken (spill modelling) to determine the level of assurance and potentially whether existing insurance policy/policies will be acceptable.

We recommend that for transition the following is required as a minimum:

- the revised Part 102 does not come into effect for new applications until at least three months after the guidance material is finalised and publicly issued; and
- for all existing installations to be required to be compliant 12 months later than the above date, which allows for the annual renewal cycle of insurance policies to take place.

The practical risk of grandfathering existing installations is lower than it might seem on the surface given that industry participants have in place much higher levels of assurance (through insurance) for producing fields than is currently required. Many already have in place insurance policies to levels that would be compliant with the increased assurance levels proposed.

3. Implementation issues that need to be addressed

Because Part 26A of the MTA has shipping industry based origins and has not been designed to align with the realities, commercial practices and terminology of the upstream petroleum sector, or integrated with other sector relevant legislation, it is critical that Part 102 is applied in practical way that allows it to fit sensibly within this wider context.

For industry to be able to meet the proposed increases in required assurance levels and without imposing significant unproductive compliance costs it is necessary for the implementation of the regime to align with industry practices that are standard in New Zealand and around the world and with wider regulatory framework in New Zealand, particularly the *Crown Minerals Act 1991*. Key elements of this that are relevant to implementation include:

- Offshore exploration and mining permits are generally held by joint ventures of multiple oil and gas companies with differing shares of the permit. It is these parties (permit participants) that are responsible for the costs of activities associated with permit.
- Permit participants hold insurance for relevant liabilities for their share of the permit. An application for a Certificate of Insurance made under Rule 102.8 will therefore generally be made on behalf of an joint venture with multiple participants, each of which will have a different insurance policy covering their interest (percentage share) of that permit.
- Permit participants hold insurance policies that are provided from specialist international markets and which generally have market standard terms and conditions for these types of coverage. Deviating from these standard terms and conditions to accommodate the specific requirements of a very small market such

as New Zealand is generally problematic and depending on what is required may be impossible.

- Industry participants hold insurance policies for control of well in particular (e.g. OEE) that often apply to wells of different kinds (exploration, production etc.) located in multiple permits in New Zealand and potentially to wells in licenses/permits in countries around the world. This means that the renewal of a single policy may be relevant to multiple permits across New Zealand.
- Insurance policies are renewed annually and with renewal on different dates for different parties. The coverage held by a company generally doesn't change much, if at all, in substance year to year. Standard insurance industry practice is for policy renewals to be confirmed only a short time (e.g. a week or two) before the current one expires. Whilst each policy would be extended for a year this will likely mean that across the joint venture at any one point in time one or more of the polices will have only a modest fraction of the year left remaining before annual renewal.

To be workable the design of Part 102 and its implementation needs to recognise, be compatible with, and find ways to most efficiently operate given the above features. For Part 102 to be practically and efficiently implemented the regulator will need to rely on insurance certificates issued by brokers/insurers each year to confirm the establishment or extension of coverage for another year for a permit participant.

PEPANZ considers that providing comprehensive guidance to underpin the implementation of the amended Part 102 is important and supports this being developed. There are a range of areas where guidance can sensibly provide detail (e.g. the parameters of spill modeling) or expand on the interpretation of the revised Part 102. There is extensive supporting guidance in place for the equivalent requirements applying in the United Kingdom and that should be considered in the development of guidance here.[3]

As outlined above it is critical that Part 102 can be satisfied using conventional insurance policies used by the upstream oil and gas industry around the world and the guidance should therefore support this. Guidance can provide certainty and transparency in terms of what forms of assurance, for example insurance, are acceptable to meet the requirements of Part 102. However this must build on what is in the Rule and it is not appropriate to expect it to make up for gaps in it. This is why we consider a specific reference should be included in Part 102 to policies on standard terms and conditions being acceptable.

[3] "Guidelines to assist licensees in demonstrating Financial Responsibility to DECC for the Consent of Exploration and Appraisal Wells in the UKCS", Issue 1 November 2012, UK Oil and Gas Association.

The list of matters outlined in Appendix 2 for inclusion in the guidance look broadly comprehensive and generally appropriate. It is for example important to outline how FPSOs will be provided for, particularly as the bulk of the policy work has been focused on well related issues. Appropriately providing for process issues (application timelines and processes for applications from joint ventures etc.) are also very important.

It will be important to involve relevant subject matter experts (e.g. insurance or spill modelling etc.) and the affected industry in the development of the supporting guidance. PEPANZ would welcome the opportunity to engage in the development of guidance and to facilitate the participation of its relevant industry members.

Cameron Madgwick
Chief Executive