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Consultation on financial assurance requirements for offshore installations
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PEPANZ Submission: Consultation on financial assurance requirements for offshore installations

This document constitutes the Petroleum Exploration and Production Association of New Zealand's (PEPANZ) submission on the consultation document, *Increasing the minimum financial assurance requirement for offshore installations* ("consultation document"), which was released by the Ministry of Transport ("the Ministry") on 29 May 2014.

PEPANZ represents private sector companies holding petroleum prospecting, exploration and mining permits, service companies and individuals working in the industry. PEPANZ members include the operators of offshore producing fields and exploration permits.

This submission is in two parts:

- Part 1 – Overarching comments
- Part 2 – Responses to individual questions in the consultation document

Part 1 – Overarching comments

International context

Regulatory approaches to liability for oil pollution from shipping are generally consistent and subject to international conventions and arrangements (e.g. P&I clubs). In contrast regulatory approaches relating to liability for oil pollution from offshore petroleum activities (both exploration and production) are varied, reflecting domestic considerations and regulatory frameworks.

There are no international conventions in place and whilst the underlying rationale for the regimes in relevant countries is similar the detail of the regimes vary substantially. These include how liability for pollution is framed, the scope of that liability (particularly how liability to third parties is provided for) the existence and size of any limits on liability, and how and at what level assurance is provided to regulators concerning the ability of a company, or companies involve in a joint venture, to meet potential liabilities.

Whilst similar in general terms to, for example, the liability regime applying offshore in the United Kingdom, the requirements in Part 26A of the *Maritime Transport Act 1994* ("the Act") and Maritime Rules Part 102 – Certificates of Insurance ("Part 102) differ from requirements in other key jurisdictions. This is a material issue as the insurance options available to the offshore industry and centred on the major offshore jurisdictions globally such as the United Kingdom, Norway and the United States of America. Effective and

efficient insurance markets requires premium pools to match the exposures taken and so global insurers predominate. Differing obligations complicate this and the relatively small scale of the New Zealand offshore industry means a local approach would not be practical.

The ability to meet the financial insurance obligations using insurance is fundamental. A regulatory approach which potentially excludes global insurance products as satisfactory could mean precluding smaller companies from effectively participating in the New Zealand petroleum environment, where they have traditionally been, and remain, an important component.

The proposed comprehensive review of the financial assurance regime

Given the issues identified in the consultation paper including the insufficient minimum value in Part 102 currently, the differences between the New Zealand regime and key international regimes, and international developments in this area, we consider it appropriate to undertake a comprehensive review of the financial security regime for offshore installations.

We support consideration being given to a customised regime that reflects the specific risks and profile of each activity, or at least some sort of scaling of minimum requirements. As the risk profile of different activities varies substantially based on their nature and scale it is inefficient to impose a single minimum value for all operations regardless of their specific features. Given the substantial costs of insurance in this area it is likely the allocative efficiency benefits of more accurately linking the minimum requirement to specific risks will outweigh any additional administrative costs.

This review must include reviewing the way liability is provided for in Part 26A of the Act to ensure it takes account of international developments and is as certain in its application as possible. At present it is very broadly framed making its application open to interpretation and therefore uncertain.

Concerns with the interim regime proposed in the consultation document

Whilst there is a need to review the current regime and to increase the current minimum requirement it is not necessary to rush into place an interim regime. Industry already holds substantial oil spill related insurance cover and activity offshore in the short to medium term is actually decreasing (see answer to question 4 in Part 2 of this submission). The primary problem is not the proposed headline minimum of NZ$300 million[1] but the apparent partial mismatch between currently available and utilised insurance policies and the requirements emanating from Part 26A of the Act and Part 102 as applied by Maritime New Zealand (MNZ).

PEPANZ considers it is imperative to explore and preferably reconcile this apparent mismatch before increasing the minimum requirement as proposed. If as appears the mismatch means there is a gap we consider it is fundamental to understand the scope of this gap and how it is addressed in similar jurisdictions such as Australia. The ability to meet the financial assurance obligations using insurance is a fundamental part of the regime and is reflected in the name of Part 102 itself. Smaller companies won't necessarily have the balance sheet and/or credit rating to issue guarantees of the scale that could be required.

This further policy work must happen before the minimum requirement is increased by as large amount as is proposed. Part 102 currently, and the proposal for an interim regime, are silent on how such a gap would be

[1] We recognise the value would be expressed in IMF units but have referred to the proposal as $NZ300 million for convenience and easier comparison.

met. The implementing agency (MNZ) would thus have no policy guidance on how to approach this, creating uncertainty for both it and industry in the application of the requirements.

If a mix of financial assurance measures were to be required then it would appear necessary to amongst other things consider the extent to which the different elements of “pollution damage” in Part 26 of the Act might be met separately rather than through a single insurance policy or guarantee to a total value such as NZ$300 million. If non-insurance measures are required these should not be expected to unnecessarily overlap insurance and should not diminish the strength of an insurance approach.

We don’t consider a mixed approach to be an ideal or preferable approach but if any mismatch or gap cannot be resolved then it is a necessary one, for any interim regime at least, as otherwise substantial duplication may arise. Companies could for instance be required to have company guarantees covering what was largely already covered by insurance. This duplication would likely at the minimum level proposed result in substantial, and largely unnecessary, costs on industry.

There are also technical matters with the application of the financial assurance regime that need to be developed before any substantial increase in minimum value is progressed. Matters that have not been issues at the current low level (as for example they can be met solely by the permit operator) will arise with a higher minimum level and the regulatory regime has to recognise this. Joint ventures are common in the petroleum industry here and internationally. These are therefore not requirements solely for the company that operates the permit, usually on behalf of a joint venture of permit participants. It is important that all companies participating in a permit are accountable for their proportional share of the financial assurance. Administering this may prove more complex in relation to parent company guarantees than it does with insurance should this form part of the mix used to meet the obligations.

Part 2 – Responses to individual questions in the consultation document

In Part 2 of this submission we provide responses to the specific questions posed in the consultation document.

QUESTION 1: Do you agree the current minimum of approximately NZ$26 million is unlikely to provide adequate cover for the related clean-up costs or pollution damage? Please give reasons for your answer.

PEPANZ agrees that based on overseas events, the currently prescribed minimum insurance requirement of approximately NZ$26 million is unlikely to provide adequate should a major spill or blowout occur.

We note however that those companies undertaking offshore production or drilling operations in New Zealand carry insurance for oil spills at a level that is substantially higher than the current minimum requirement of NZ$26 million. As such the minimum value requirement in Part 102 is not driving the levels found in insurance arrangements held by the industry presently.

QUESTION 2: Do you agree with increasing the minimum level of financial assurance required to approximately $300 million? Please give reasons for your answer.

As outlined in the consultation document the proposed figure of NZ$300 million for an interim regime is broadly in line with global norms and the minimums found in many industry insurance policies. We note however the logic for this level is based on research and modelling done in the North Sea and so from a New

Zealand perspective can be considered arbitrary. As outlined briefly above we consider that whilst permit holders carry substantial insurance the current minimum in Part 102 is insufficient to cover the potential costs of a major spill event and that a substantially higher minimum value would align better with global norms and existing industry practice.

However, as outlined above in Part 1 of this submission we consider such an increase should only take place once either, it is clear the requirement to have a certificate of insurance can be met through available insurance policies, or at least it is identified and determined how the requirements could be met efficiently through a mix of insurance and other approaches. We don't support simply increasing the minimum level in Part 102 from $NZ26 million to NZ$300 million at this stage without these other necessary matters being first resolved.

QUESTION 3 – Current arrangements:

3a) How do you currently meet the requirement to hold approximately NZ$26 million in financial assurance?

3b) What, if any, issues have you encountered in meeting the current requirement in the past?

As noted above permit holders currently hold insurance policies substantially above the ~NZ$26 million minimum requirement, generally above NZ$200 million. Traditionally these insurance policies were used to meet the obligations in Part 102 but MNZ revised its approach in the second half of 2013. This new approach highlighted the differences between the New Zealand requirements and the insurance policies widely utilised by the offshore petroleum industry globally.

A consequence of this change and these differences was that companies have recently began using parent company guarantees as a means for complying with Part 102 based in the current NZ$26 million minimum. Given this recent change in approach and the consequent adoption of parent company guarantees it is presently unclear whether the terms and conditions of available insurance policies would meet the domestic requirements.

This utilisation of parent company guarantees in recent times represented a major change in practice that moved New Zealand away from global norms. It also imposes costs on industry as permit holders are required to put in place alternative financial assurance through a parent company guarantee even though they already have in place substantial insurance policies focussed on the same issues. The implication and costs of this inefficient duplication obviously would become much greater if the financial requirement is increased by 11.5 times as proposed.

QUESTION 3 continued – Impact of proposed changes:

3c) If the minimum requirement is increased to NZ$300 million, how do you expect to meet this new requirement?

3d) What would be the likely compliance costs in meeting the new requirement?

3e) What would be the expected impact on your operation in meeting the new requirement?

PEPANZ considers the only practical and efficient way to meet the financial assurance requirement in Part 102 is through insurance. Parent company guarantees of as much as NZ$300 million can be costly and are a problematic way of meeting this requirement for any company. Relying on this approach would take New Zealand away from international practice and could prevent the involvement of smaller companies. Furthermore, as companies have in place substantial insurance policies in any case, guarantees or other types of financial assurance would involve considerable duplication of coverage unless

The consultation document notes a potential cost of $NZ3 million per annum for insurance to meet the proposed minimum level of $NZ300 million. The basis of this estimation is not outlined. Given that it has not yet been established whether insurers will offer insurance that meets regulators expectations, and the fact premiums inevitably vary based on circumstances (i.e. exploration drilling or production, oil or gas/condensate) it is unfortunately premature to estimate the potential cost impact of the proposed interim regime.

We note also that NZ$300 million (based on 162 IMF units of account) is effectively a 'moving target' as generally these types of insurance policies are in US$, reflecting their international nature. As an example, depending on the exchange rate of the day insurance cover for US$250 million, which is common internationally, may or may not be sufficient. Permit holders may be required to incur some additional costs in order to ensure policy limits allow for market movements. The fact that Part 102 is currently based on IMF Units has not mattered for permit holders to this point given the relatively low level compared with the much higher policy limits in place. A change from a limit based on IMF Units of Account to US$ (or perhaps a fixed equivalent) would remove these risks and have few disadvantages in the context of any interim regime at least.

QUESTION 4: Will operators be able to meet the proposed new requirement within a 28 day timeframe? If not, what timeframe would be appropriate and why?

We query the rationale for such a swift introduction (simply the "28 day rule" after the amended Part 102 is approved). The Cabinet paper (para 53) refers to bringing the interim regime into effect by September 2014 in time for the next "drilling season".

We note however that no further mobile offshore drilling units (MODU) is expected to arrive in New Zealand within the next year to eighteen months and one of the two MODU's currently here is scheduled to leave later this year. The remaining MODU will remain in New Zealand's jurisdiction into 2015, drilling in shallow water. Offshore drilling activity and the overall risk profile for New Zealand's activity has already peaked and there will not be a 2014/15 "drilling season" as such. We don't expect any new offshore activities to commence in Q4 2014 or Q1 2015. There could be an increase in offshore drilling activity from late 2015 or early 2016.

We note the 28-day timeframe for introduction of any increased minimum requirement is, due to the proposed grandfathering arrangements outlined in the amendments to Part 102[2], only relevant to new operations. Grandfathering of existing accepted certificates of insurance to the end of their duration however provides little additional transitional period if a certificate of insurance expires soon after the new rule comes into effect. The transitional arrangements need to provide for the transitional situation of where an existing certificate of insurance expires after a new application has been made but before it has been accepted. Amongst other things this could avoid any unnecessary time pressure being placed on industry and MNZ.

Given the uncertainty concerning whether available insurance can meet the requirements any implementation period would need to be sufficient to recognise this and give industry the time to put in place potentially different arrangements. Unfortunately we don't have sufficient information to form a clear view on how long would be appropriate as to a substantial extent it will rely on the response of the international insurance industry. Given the complexity of insurance and other financial assurance arrangements it would seem appropriate to provide more than 28 days should the proposed interim regime be brought into place. As explained above however we consider more policy needs to be done before this occurs.

Andrew Saunders
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[2] Maritime Protection Rule Part 102 Certificates of Insurance Amendment 2014