

Chair
Cabinet Economic Growth and Infrastructure Committee

CONSULTING ON AMENDMENTS TO THE FINANCIAL SECURITY REGIME FOR OFFSHORE INSTALLATIONS

Proposal

1. This paper seeks Cabinet's approval to undertake consultation on amendments to improve the financial security regime for offshore oil and gas installations.

Executive summary

2. The financial security regime for offshore installations aims to ensure operators are able to meet the costs of their proposed activities, meet their legal obligations and cover their potential liabilities in the event of unplanned events.
3. Officials from the Ministry of Transport and Ministry of Business Innovation and Employment (officials) have reviewed the financial security regime and concluded that most of the regime is working well.
4. However, there are areas where greater protection can be given to the government and the public by better ensuring that operators have the financial means to pay all response costs and compensation should an adverse event occur.
5. I propose releasing the attached consultation document, which seeks views on options to improve the effectiveness and efficiency of the regime. The options will place tougher requirements on offshore operators, but these broadly align with requirements in Australia and the United Kingdom.
6. My intention is to report back to Cabinet on final recommendations following consultation.

Current financial security regime for offshore installations

7. New Zealand uses the prevention-control-response-recovery framework for regulating offshore petroleum exploration and production. The primary focus is preventing spills and minimising harm by ensuring that operators have the capability, plans and resources necessary to minimise the likelihood, and reduce the effect, of any adverse event.
8. The regulatory framework for offshore installations includes a financial security regime that aims to ensure operators are financially capable of meeting the costs of their proposed activities, meeting their legal obligations, and covering their potential liabilities.
9. Under Part 26A of the Maritime Transport Act 1994 (MTA), owners and operators of offshore installations are liable, in the event of a spill from their operations, for the full

costs related to pollution damage to other parties, and costs incurred by public agencies in preventing and cleaning up a spill.

10. In broad terms, there are four aspects to the financial security regime:
 - 10.1. under the Crown Minerals Act 1991, New Zealand Petroleum & Minerals (NZP&M) assesses an operator's financial capability to carry out proposed exploration or production activities
 - 10.2. under the Exclusive Economic Zone and Continental Shelf Act 2012 (EEZ Act) or the Resource Management Act 1991 (RMA), owners are required to obtain a marine consent from the Environmental Protection Authority (EPA), or a resource consent from the relevant local authority. The EPA or regional councils may impose conditions to ensure operators appropriately deal with adverse effects of the activity authorised by the consent on the environment or existing interests. Conditions may include a requirement that consent holders:
 - a) provide a bond for the performance of any one or more conditions of the consent;
 - b) obtain and maintain public liability insurance of a specified value.

A bond requirement can continue after the expiry of the marine consent to secure the ongoing performance of conditions relating to long-term effects
 - 10.3. under Marine Protection Rule Part 131 (Part 131), Maritime New Zealand undertakes financial assessment of whether an operator has the financial means to implement its emergency response plans and procedures in the event of an oil spill resulting from all potential types of well control failure, and
 - 10.4. under Marine Protection Rule Part 102 (Part 102) operators are required to obtain a Certificate of Insurance from Maritime New Zealand by providing evidence of external financial assurance to pay compensation to affected parties who incur response costs, clean up costs and pollution damages associated with a oil spill incident.
11. The proposed consultation relates entirely to Part 102.

Previous decisions

12. In 2009 the Government's Petroleum Action Plan was launched with the aim of ensuring New Zealand is able to maximise the benefit of the responsible development of its oil and gas resources.¹
13. As part of the Petroleum Action Plan, an independent review of the adequacy of New Zealand's health, safety and environmental legislation for offshore petroleum operations was completed in December 2010. It concluded that New Zealand's health, safety, and environmental arrangements for offshore petroleum operations already incorporated a number of key characteristics of international best practice. However,

¹ <http://www.med.govt.nz/sectors-industries/natural-resources/oil-and-gas/petroleum-action-plan>

the review made eight prioritised recommendations for strengthening the regime. The majority of these have been implemented.

14. As part of its response to the Petroleum Action Plan, the Government asked the Ministry of Transport (the Ministry) to explore increasing the current minimum financial assurance requirement for offshore installations [EGI(11)165 refers].
15. In May 2014, Cabinet agreed [EGI Min (14) 9/3 refers] to:
 - 15.1. undertake a review of the financial security regime for offshore installations, and as part of that review, consider a regime that would allow the minimum level of financial assurance to be scaled depending on the likely economic damage and prevention and clean up costs from each installation, and
 - 15.2. seek public feedback on a proposal to, in the interim, increase the minimum financial assurance requirement from approximately NZ\$26 million to NZ\$300 million.
16. Submitters agreed that the current level of financial assurance was inadequate and should be increased. However, some submitters also stated there was a lack of suitable insurance policies available to cover liabilities required under the MTA.
17. In response to issues raised by submitters, I instructed officials not to progress with the interim increase financial assurance requirement, and instead focus on the issues as part of the broader financial security regime.

Improving New Zealand's financial security regime

18. Officials have reviewed all aspects of the financial security regime for offshore operators to determine its relevance, effectiveness and suitability.
19. Following discussions with offshore operators and relevant agencies and regulators, three main issues have been identified:
 - a) lack of an explicit financial assurance requirement for the cost to contain an out of control well,
 - b) an insufficient level of financial assurance required to ensure operators have the financial means to pay the potential costs of clean up and compensation to other parties, and their damage resulting from a spill from their installation, and
 - c) incompatibility of conventional insurance policies with financial assurance requirements.
20. The attached consultation document outlines options to address these issues. The main alternatives are outlined in further detail below.

Financial assurance for well containment

21. Under the current financial security regime, there is no explicit requirement for operators to provide financial assurance for well containment.
22. If an operator does not, or can not, fulfil its legal obligations to respond to an incident, the Crown would respond to resolve an incident. Without adequate financial assurance for cost containment, there is no guarantee that the Crown, or any contracted parties, can recoup costs incurred. Affected parties could be required to take their claim through the courts at their own expense.
23. Without explicit financial assurance for well containment, there is a risk that an operator's insurance is insufficient to cover compensation and damages. As insurance policies typically pay out the costs of controlling the well and re-drilling first, less money will be available for subsequent payments to affected parties.
24. The alternative option presented in the consultation document is to introduce a calculation to estimate the financial assurance needed and use an external source, such as insurance, to provide a guarantee. Operators already typically hold insurance that specifically includes well containment costs. This approach mirrors that of Australia and the United Kingdom.
25. A draft approach, representing New Zealand conditions, is presented in the consultation document. The calculation would reflect the cost of containing a well blow out, such as the cost of drilling a relief well and using a capping stack. Operators with more complex well activities would need to show a higher level of financial capability. Estimates of NZ\$120 million to NZ\$360 million indicate the range of possible requirements under this option.
26. Consultation seeks feedback on the preferred option, proposed formula and to establish the cost impacts to operators.

Level of financial assurance

27. Part 102 imposes a minimum financial assurance requirement for all offshore installations, which is currently set at 14 million International Monetary Fund Units of Account or approximately NZ\$27.0 million.² Operators are not required to hold more than the minimum, which applies to all offshore installations, irrespective of the potential impact of a spill.
28. Operators currently do not provide financial assurance commensurate with the potential costs of clean up and compensation. In the event of a major incident, the current level exposes the Crown and other parties to a risk of non-recovery for clean up costs and pollution damage.
29. Modelling has been undertaken to estimate the likely cost of oil spills from different offshore locations in New Zealand. The range of estimated costs for exploration wells varied from NZ\$12 million for a well off the coast of Canterbury to NZ\$926 million for a

² As at 30 September 2016, 1 International Monetary Fund Unit of Account is equal to NZ\$1.93. Based on this rate, 14 million units of account equates to NZ\$27.02 million.

deepwater Taranaki well. Any significant incident is likely to exceed the current minimum level of NZ\$27 million.

30. As it will be of public interest, I intend to make this modelling publicly available during the consultation period.
31. Two options are provided in the consultation documents:
 - a) Increase the minimum level of financial assurance to better reflect the potential costs of an event, and
 - b) Introduce a scaled requirement reflecting the potential impacts from each installation.
32. The first option would provide a greater assurance that operators can meet their costs following an oil spill event. A minimum requirement of \$300 million is above the estimated potential cost from a spill in the Pegasus and Canterbury Basin, but below that for a spill from the Deepwater Taranaki. It would place New Zealand near the midpoint of requirements in Canada, the United Kingdom and Australia.
33. The second option adopts a scaled framework for requiring financial assurance in the offshore drilling environment, similar to that applied in Australia and the United Kingdom. This option would subject each individual installation to a financial requirement that is more appropriate, based on the potential impact of a spill from that installation.
34. The proposed framework would use operators' spill trajectory modelling to estimate the possible financial impacts of an oil spill from each installation. Installations would be allocated into one of eight bands, which range from NZ\$25 million to NZ\$800 million. The highest band sits between those set in the United Kingdom and Australia, reflecting differences in the drilling environment and the time required to mobilise equipment from overseas to regain control of the well.
35. While both options represent a significant increase, the cost impact may not be large as many New Zealand operators are included within their parent company's global insurance policy. Consultation seeks feedback on the two options and the potential cost impacts for operators.

Compatibility of conventional insurance policies

36. Part 102 allows operators to use insurance or other financial security products to meet the financial assurance requirements. The assurance must be provided by an external source to ensure affected parties have a clear avenue to claim damages in the event that an operator does not have the financial ability to meet their liabilities resulting from a spill event.
37. As part of their normal business operations, operators already hold insurance at a level well above the current minimum financial assurance requirement. However, the insurance market faces difficulties in providing policies that meet the strict requirements under Part 102. While some current policies provide a breadth of cover

that addresses all of an owner's potential types of liability, these are unlikely to be available if the level of financial assurance is increased.

38. In the absence of acceptable insurance policies, operators would need to use another form of financial guarantee to meet the requirements of Part 102 and be issued a Certificate of Insurance. For example, some operators currently use a parent company guarantee. However, for a higher level of financial assurance, companies are unlikely to have the ability to provide a parent company guarantee or other form of guarantee.
39. Two options are provided in the consultation documents:
 - a) Refine the scope of financial assurance required, or
 - b) Introduce separate financial assurance requirements for different aspects of liability.
40. The first option would limit the type of liabilities that the financial assurance must cover. The purpose would be to address the mismatch between the liability for which financial assurance is required under Part 102 and the coverage of available insurance products. This would effectively result in conventional insurance policies being accepted as meeting their financial assurance obligation. Operators would still be liable for all costs and damages resulting from an oil spill event, regardless of whether it was covered by the financial assurance.
41. Although there are differences between jurisdictions, this option is similar to the United Kingdom and Australia, where third-party losses of profit are not incorporated into financial assurance tests, but operators remain liable for losses of profit.
42. The second option is to maintain the current level of financial assurance for third party loss of profits at the current level of NZ\$27 million, but introduced a scaled level of financial assurance for other costs, including remediation, compensation for expenses incurred and physical damage. Issues of insurability still arise here.

Public consultation

43. Engagement with key stakeholders has been undertaken at key parts of the policy development process.
44. The consultation process will be open to the public, with the consultation document available on the Ministry's website. Consultation will last for four weeks.
45. As it may be of public interest, I seek Cabinet's agreement to make this Cabinet paper publicly available on the Ministry's website at the start of the consultation period.
46. I also intend to make the modelling used to inform the analysis to be available publicly.
47. The secondary legislation change necessary to implement any alternative options would be subject to further consultation.

Risks

48. There could be heightened public and media interest in the potential cost of an oil spill outlined in the consultation document and scenario modelling. To address these comments, I plan to highlight that these scenarios represent a worst case where the probability of occurrence is extremely low. I will also reiterate that New Zealand's regulatory framework for offshore exploration and production is robust, and focuses on preventing spills by ensuring operators have plans and resources in place to minimise the likelihood, and reduce the effect, of any adverse event.
49. Stakeholders may also perceive the consultation on the incompatibility of conventional insurance policies as an attempt to loosen regulation. I plan to highlight that:
 - a) a significantly higher financial assurance level is proposed
 - b) higher financial assurance may not be possible without narrowing its scope
 - c) operators are still liable for all costs and damages
 - d) the proposed scope of financial assurance is similar to that of Australia and the United Kingdom, and
 - e) consultation seeks views on the assumptions and information contained within the consultation document.

Consultation

50. In the development of this paper, the Ministry of Transport and the Ministry of Business, Innovation and Employment have consulted with and received feedback from Ministry for the Environment and Treasury.
51. In addition, the following agencies have been consulted on this paper: Department of Prime Minister and Cabinet, Department of Conservation, Maritime New Zealand and the Environmental Protection Authority.

Financial implications

52. There are no immediate financial implications with the release of the consultation document.

Human rights implications

53. There are no human rights implications with the release of the consultation document.

Legislative implications

54. There are no immediate legislative implications with the release of the consultation document.

Gender implications

55. There are no gender implications with the release of the consultation document.

Disability perspective

56. There are no disability implications with the release of the consultation document.

Regulatory Impact Analysis

57. A Regulatory Impact Statement is not required for this Cabinet paper. However, the Ministry of Transport and the Ministry of Business, Innovation and Employment have taken into account the Regulatory Impact Statement requirements for a consultation paper and the principles of the Code of Good Regulatory Practice.

58. Following consultation, a Regulatory Impact Statement will be prepared and submitted as part of the Cabinet Paper seeking final decisions.

Publicity

59. Should Cabinet agree, the attached consultation paper will be formatted for publication and released on the Ministry's website.

Recommendations

60. The Minister of Transport recommends that the Committee:

1. **note** that officials have undertaken a review of the financial security regime for offshore installations
2. **note** that the review concluded that most of the regime is working well, however, there are areas where greater protection can be given to the government and the public
3. **note** that the attached consultation document outlines options to strengthen the financial security regime for offshore installations
4. **agree** to release the attached consultation document, subject to editorial changes, which seeks the public views on the options
5. **agree** to make this Cabinet paper publicly available on the Ministry's website at the start of the consultation period
6. **note** my intention to report back to Cabinet on final recommendations following consultation

Hon Simon Bridges
Minister of Transport