

Chair  
Cabinet Economic Growth and Infrastructure Committee

## **IMPROVING THE FINANCIAL SECURITY REGIME FOR OFFSHORE INSTALLATIONS**

### **Proposal**

1. This paper seeks Cabinet's approval to undertake a review of the financial security regime for offshore oil and gas installations. As part of this review, consideration will be given to a regime that allows the required level of financial assurance to be scaled depending on an assessment of the likely costs and damages of an incident from each installation.
2. Given the time required to complete and implement the review, this paper also seeks Cabinet's agreement to release a consultation document *Increasing the minimum financial assurance requirement for offshore installations*. The consultation document proposes that in the interim, the current minimum requirement for financial assurance should increase from 14 million International Monetary Fund Units of Account (approximately NZ\$26 million) to 162 million International Monetary Fund Units of Account (approximately NZ\$300 million).

### **Executive summary**

3. New Zealand's regulatory framework for offshore exploration and production 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. Intertwined within the separate stages of the regulatory regime, multiple agencies oversee a financial security regime that aims to ensure operators are able to financially meet their proposed activities and subsequent legal obligations. Due to the emphasis on prevention, the likelihood of a significant oil or gas incident in the maritime environment is very low.
4. Should an incident occur, owners and operators of offshore installations are liable for the full costs of pollution damage to other parties, and costs incurred by public agencies in preventing and cleaning up a spill.
5. To support this requirement, and as part of the financial security regime, operators are required under Marine Protection Rule Part 102 (Part 102) to provide evidence of financial assurance, such as insurance or alternative financial security, which covers the operator's potential liability to at least the minimum amount specified. Part 102 currently sets the minimum requirement at 14 million International Monetary Fund Units of Account, or approximately NZ\$26 million, and is irrespective of the operation's type, possible risk or the potential impact of a spill. Part 102 ensures funds are available for affected parties to make a claim to the third party guarantor named in the Certificate of Insurance.

6. The financial assurance aspect of New Zealand's current financial security regime does not reflect international best practice and provides insufficient flexibility to set a requirement that reflects the likely costs and damages of an incident from each operation. Based on previous international incidents, and requirements in other jurisdictions, any significant incident is also likely to exceed the current minimum fixed requirement of NZ\$26 million.
7. To settle a compensation dispute beyond the amount secured, proceedings may need to be brought against the owner/operators through a foreign or domestic court process at the cost of those bringing the proceedings. Should operators not have the financial capability to pay all response costs and compensation in the event of a spill, the current regime exposes the government to the risk of bearing the clean up costs incurred by public agencies. The government may also face pressure to provide compensation to the public if the owner or operator is unable to meet damages awarded against them.
8. To improve its effectiveness and efficiency, I propose that officials undertake a review of the financial security regime for offshore installations. As part of this review, consideration will be given to a regime that would allow the level of financial assurance to be scaled depending on an assessment of the likely costs and damages of an incident from each installation. I propose that the Minister of Transport and Minister of Energy and Resources report back to Cabinet by the end of 2014 on options for an improved financial security regime. In a best case scenario, and with appropriate legislation prioritisation if required, a new regime could be in place before the beginning of the 2015/16 drilling season in September 2015.
9. To provide greater protection for the government and other parties until the wider review is completed and implemented, I am seeking Cabinet's agreement to release a consultation document that proposes an increase in the current undifferentiated minimum requirement. The consultation document proposes increasing the minimum requirement from 14 million International Monetary Fund Units of Account (approximately NZ\$26 million) to 162 million International Monetary Fund Units of Account (approximately NZ\$300 million).<sup>1</sup>
10. Some operators may face difficulty in securing additional security to meet the increase to NZ\$300 million. As part of the consultation process, operators will be asked whether they would be able to, and how they plan to, meet the increased minimum requirement. The outcome of consultation will inform how the Rule is finalised. However, officials cannot guarantee that no operators will choose to surrender their permit or be deterred from exploration as a consequence of the new requirement.
11. If no significant issues are raised, I intend to sign a Rule Amendment to Part 102 to implement the increase. The new rule could be signed by 21 July 2014 and in force once the gazettal notice period of at least 28 days lapses.

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<sup>1</sup> As at 28 February 2014, 1 International Monetary Fund Unit of Account is equal to NZ\$1.847 million. Based on this rate, 162 million units of account equates to NZ\$299.214 million.

## Background

12. Crude oil is New Zealand's fourth-largest commodity export, worth around NZ\$2 billion a year. The government collects NZ\$380 million annually in royalties from the oil and gas industry. At a minimum, the industry provides 3,730 full time equivalent jobs and supports a further 3,970 full time equivalent jobs in other parts of the economy (total full time equivalent staff nationwide 7,700).<sup>2</sup>
13. In 2009 the government's Petroleum Action Plan was launched with the aim of ensuring New Zealand is able to maximise the gains from the responsible development of its oil and gas resources.<sup>3</sup>
14. 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, the review made eight prioritised recommendations for strengthening the regime. As part of the seventh recommendation, the government was urged to investigate whether current levels of financial assurance required from offshore installations are sufficient.
15. 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 security requirement for offshore installations [EGI(11)165 refers]. This work follows the actions to address the recommendations given highest priority, reflecting the importance of improving the prevention regime in the first instance.

## Current regulatory framework for offshore installations

16. New Zealand uses the prevention-control-response-recovery framework for regulating offshore exploration and production. The primary focus is on preventing hazards and discharges from occurring and ensuring that operators have plans and resources in place to minimise the likelihood, and reduce the effect, of any adverse event.
17. To reflect the government's intention to ensure a robust regime for offshore petroleum activity, and the lessons learned from Pike River, the Deepwater Horizon incident in the Gulf of Mexico, and the *MV Rena*, the prevention regime for offshore exploration has been strengthened.
18. Although it is difficult to provide precise figures for the risk of a significant oil or gas incident, the likelihood of a significant incident in the maritime environment is very low. An event would require the confluence of circumstances that are unlikely and would require the failure of sophisticated multi-stage systems and planning. A recent study of historical blow-outs of exploration wells in the North Sea estimates the risk of a

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<sup>2</sup> <http://www.pepanz.com/news-and-issues/issues/economic-contribution-to-nz/>

<sup>3</sup> <http://www.med.govt.nz/sectors-industries/natural-resources/oil-and-gas/petroleum-action-plan>

blow-out at 1 in 8,130 wells drilled, however this does not include the risk of other types of incidents occurring.<sup>4</sup>

### **Financial security regime for offshore installations**

19. Intertwined within the regulatory framework for offshore installations is a financial security regime that aims to ensure operators are able to financially meet their proposed activities and subsequent legal obligations. In particular the financial security regime includes:
- under the Crown Minerals Act 2013 an assessment of an operator's financial capability to carry out their proposed exploration or production activities
  - under Marine Protection Rule Part 200 (Part 200) financial checks are made to demonstrate that operators have the financial means to undertake their emergency response plans and procedures in the event of an oil spill resulting from all potential types of well control failure<sup>5</sup>
  - under Marine Protection Rule Part 102 (Part 102) operators are required to provide evidence of external financial assurance, such as insurance or other financial security, to meet the full costs related to pollution damage to other parties, and costs incurred by public agencies in preventing, controlling, and cleaning up a spill from their installation

### **Liability requirements in a spill incident from offshore installations**

20. Under Part 26A of the Maritime Transport Act 1994, 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.
21. This is supported by a requirement under the Maritime Transport Act 1994 that operators hold a Certificate of Insurance issued by Maritime New Zealand. The requirements for a Certificate of Insurance are set out in Marine Protection Rule Part 102 (Part 102), and require operators to provide evidence of insurance or other financial security to meet potential liabilities up to a minimum amount specified. Part 102 ensures that affected parties may make a compensation claim to the third party guarantor named in the financial assurance to cover the prevention costs, clean up costs, and damages associated with a pollution incident.

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<sup>4</sup> Acona Flow Technology. 2012. Report: Blowout Risk Evaluation – Labrador Sea south-west of Greenland

<sup>5</sup> Amendments made in 2013 to the Exclusive Economic Zone and Continental Shelf (Environmental Effects) Act and the Maritime Transport Act transferred responsibility for regulating discharges from offshore installations from Maritime New Zealand to the Environmental Protection Authority (EPA). Maritime New Zealand will remain responsible for approving marine oil spill contingency plans including well control contingency plans, which are currently part of Part 200. Maritime New Zealand functions will be specified in a new rule, Rule Part 131 – Offshore Installations – Marine Oil Spill Contingency Plans and Oil Pollution Prevention Certification. Part 131 will not include rules relating to the discharge of chemicals used in drilling and production processes, the oil content of production water, displacement water, offshore processing drainage, oil and oily mixtures from machinery spaces and garbage, which are all waste streams to be regulated as a result of the transfer of functions to the EPA.

22. The requirement under Part 102 does not lessen the probability of an incident occurring. Instead this is provided by the prevention regime outlined above.
23. As there is no limitation of liability in respect of offshore installations, the owner/operator will still be liable for any clean-up costs or pollution damage above the minimum amount of financial assurance or other related insurance coverage they may hold. Proceedings could be brought against the owner/operators through a foreign or domestic court process to establish liability and seek claims beyond the amount secured. In a worst case scenario where an operator goes into receivership following a major incident, the requirements under Part 102 limit the Crown's exposure to costs and damages.
24. Currently Part 102 applies a single minimum requirement for all offshore installations, irrespective of the operation's type, possible risk, or the potential impact of a spill. The requirement and criteria under Part 102 originated from similar requirements for ships under the International Convention on Civil Liability for Oil Pollution Damage 1969. However, unlike for ships, there are no international conventions that either impose or limit liability for installations, or provide funding mechanisms for ensuring the payment of compensation for oil pollution damage over and above the limited liability level.
25. The minimum is currently set at 14 million International Monetary Fund Units of Account, or approximately NZ\$26 million.<sup>6</sup> The level has remained at this rate since Part 102 was first introduced in 1998, and is linked to the original figure for ships when the Protocol to the International Convention on Civil Liability for Oil Pollution Damage was developed in 1976.

### **Cost of recent incidents**

26. The potential cost of damage and clean up associated with pollution from offshore installations is highly variable and is dependent on a range of factors, including the:
  - type of installation
  - type and quantity of hydrocarbon released
  - weather conditions and ocean currents at the time of the release
  - location and proximity to other-party interests
  - length and type of the shoreline affected
  - area affected and the economic impact
  - effectiveness of response effort
27. Highlighting this variability are three recent incidents. The clean-up costs for the 2010 Deepwater Horizon well blowout in the Gulf of Mexico are in excess of NZ\$16 billion, with at least an additional NZ\$9 billion paid to local residents for compensation. The

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<sup>6</sup> As at 28 February 2014, 1 International Monetary Fund Unit of Account is equal to NZ\$1.847 million. Based on this rate, 14 million units of account equates to NZ\$25.8 million.

cost of the 2009 Montara well blowout in Australia was approximately NZ\$250 million. However, it did not involve any shoreline impact and there were limited at-sea interests in terms of fishing in the vicinity of the incident. The clean-up of the 350 tonnes of fuel oil spilt during the 2011 *Rena* incident cost \$47 million, but does not include compensation for other party damage and losses. Although the *Rena* is not an offshore installation, the cost of clean up is more than the current minimum financial assurance requirement for offshore installations.

## Comparisons to other jurisdictions

28. While regulatory frameworks for offshore installations are not completely comparable between countries, other countries within their financial security regime require financial assurance from operators that they are able to meet their liability in the event of an incident. These generally include a mix of requirements to cover the operator's ability to respond to a well blow out, any clean-up cost incurred by a public authority and liabilities to third parties for economic damages.
29. Other countries tend to set a requirement appropriate for possible costs associated with each operation, whereas New Zealand's requirement in relation to clean up costs and pollution damage is a fixed sum in legislation. New Zealand's fixed requirement for all operators is also significantly below other jurisdictions. A summary of the requirements in these countries is provided below, with more detail provided in Appendix 1.

Owner/operator liability	Minimum financial assurance requirement	Other points
Australia		
Unlimited liability	Currently moving toward an assessment for financial assurance based on possible costs and damages. Level required has not yet been established.	Previous regime only required to hold insurance for expenses and liabilities when directed. Insurance between NZ\$121 million and NZ\$362 million was common practice.
United Kingdom		
Unlimited liability	Graduated figure determined by categorisation of activity ranging between NZ\$300m and NZ\$880m based on possible costs and damages.	Operates in tandem with the Offshore Pollution Liability Agreement (OPOL), an industry liability agreement for costs and damages.
United States		
NZ\$87m limited liability for pollution damage. Unlimited liability for clean-up costs.	NZ\$12m or NZ\$35m depending on operation. Can be increased to maximum of NZ\$175m if justified based on risk of operation.	Works alongside Oil Spill Liability Trust Fund (OSTLF) that provides up to NZ\$1.2b of compensation per incident. Funded primarily through a levy on oil.
New Zealand		
Unlimited liability	Single fixed figure of NZ\$26m	

## Improving New Zealand's financial security regime

30. Despite differences existing between the two industries, New Zealand's current liability and financial security regime for offshore installations is based on a framework designed for ships. If the costs and damages related to a pollution incident from an offshore installation exceed the amount secured by the Certificate of Insurance, there

is no international funding mechanism, such as those available for ship incidents, to ensure payment of compensation to those affected.

31. The fixed minimum required for financial assurance also provides insufficient flexibility to set a requirement that reflects the likely costs and damages of an incident from each individual oil and gas operation. A fixed minimum requirement creates a tension between setting a level that reflects the costs and damage in most pollution incidents, and minimising the compliance costs for operators whose potential costs and damage are lower.
32. While based on previous international incidents, and requirements in other jurisdictions, any significant incident is likely to exceed the current minimum fixed level of NZ\$26 million.
33. The financial assurance aspects of New Zealand's current financial security regime is inappropriate for offshore installations, too rigid, insufficient, and therefore fail to adequately reflect current and future production and exploration activity. Operators are not required to, and currently do not, provide financial assurance that is appropriate to the potential costs of clean-up and other parties' damage from their installation. Should operators not have the financial capability to pay all response costs and compensation, the current regime exposes the government and the public to the risk of bearing the costs of an incident.
34. To improve the effectiveness, I recommend New Zealand should undertake a review of the financial security regime for offshore installations. An alternative financial security regime should:
  - ensure the financial assurance requirement is appropriate to offshore installations
  - ensure there is effective, prompt and adequate compensation for clean-up costs incurred by public agencies and to other parties which suffer economic damage
  - increase protection to the government from the risk of bearing any clean up costs, and the public from bearing the damage from oil pollution
  - minimise compliance costs
  - future proof legislation from an evolving offshore exploration and drilling environment
  - provide flexibility to adapt to changing operating environments such as technological developments, improved modelling of impacts, and changing costs of clean up and damages
35. As part of this review, consideration will be given to a regime that would allow the minimum level of financial assurance to be scaled depending on an assessment of the likely costs of clean-up incurred by public agencies, and other party damages, associated with a major pollution incident from each offshore installation.
36. Further work on developing an alternative financial security regime is required. This potentially includes consideration of:

- where in the regulatory regime financial security assessments would fit
- how each financial security requirement would interact
- how offshore operations are assessed
- what levels of financial assurance are appropriate in New Zealand conditions
- what type of financial assurance should be acceptable
- whether an industry fund is appropriate and necessary
- what regulatory changes would be necessary
- the government agencies that would be responsible for implementing the new regime

37. I am therefore seeking Cabinet agreement to undertake a review of the financial security regime for assessing the ability of operators of offshore installations to financially meet the likely preventative costs, clean-up costs and pollution damage of an incident from their operation. As part of this review, consideration will be given to a regime that would allow the minimum level of financial assurance to be scaled depending on an assessment of the likely costs of each operation.
38. Officials inform me that changes to secondary legislation would be required, with changes to primary legislation also likely. This work would not be able to be completed before the commencement of the 2014/15 drill season. While there is currently no new exploration drilling activity planned for the 2014/15 season, development drilling will continue near existing installations.
39. In a best case scenario, and with appropriate legislation prioritisation if required, a new regime could be in place before the beginning of the 2015/16 drilling season in September 2015. Officials from the Ministry of Business, Innovation and Employment expect there to be further exploratory drilling during the 2015/16 season and, based on current information, may include up to seven wells.
40. I propose that the Minister of Transport and Minister of Energy and Resources report back to Cabinet by the end of 2014 with options for improving the financial security regime for offshore installations.

### **Increasing the current minimum financial assurance requirement**

41. Until the review is completed and implemented, I believe there is an interim need to increase the minimum rate of financial assurance required to ensure adequate financial compensation is readily available. In the unlikely event of a significant spill from an offshore installation, the current minimum of approximately NZ\$26 million does not provide adequate assurances that an operator can meet its legal liability for the related clean-up costs or pollution damage.
42. Given the number of relevant factors, estimating the expected cost of pollution damage and clean up from an incident is complex and may change over time. Setting

the requirement at a level that is too high may limit the exploration of oil extraction opportunities in New Zealand. However this must be balanced by increasing the assurance that the Crown and other parties have recourse to recover the costs of a major incident should an operator be unwilling or unable to meet their liability.

43. Appendix 1 outlines the factors considered in determining a reasonable interim minimum level of financial assurance.

#### *Proposed changes*

44. I propose that operators should be required to provide evidence of financial assurance of at least 162 million International Monetary Fund Units of Account (approximately NZ\$300 million) to cover their liability related to pollution damage.<sup>7</sup>
45. This proposed increase is not based on scientific modelling, but instead positions New Zealand closer to requirements in other jurisdictions in the interim. The proposed level of NZ\$300 million is at the United Kingdom's lower range for clean up costs and damages. Although based on local modelling and conditions, I note that in updating their regime, the United Kingdom found that the majority of spill scenarios would fall within this level, with only certain limited cases requiring a higher assurance.
46. I consider that until the wider review of the financial security regime is completed and implemented, the proposed interim minimum requirement strikes an appropriate balance between providing greater public protection and minimising unnecessary compliance cost for low risk operators.
47. Officials considered the possibility of not increasing the minimum requirement in the interim, and instead, retain the current requirements until a wider review is completed. Officials did not recommend this given the likely time required to develop, assess, and implement the findings of the review, and the need to provide greater protection in the interim to the Crown and possible affected third parties.

#### *Possible impacts on operators*

48. Most operators with a current certificate of insurance have relied on alternative financial security, and in particular a Parent Company Guarantee, where the liability of a subsidiary company is guaranteed by its parent company.<sup>8 9</sup> Operators, particularly smaller operators, which utilise alternative financial security to meet their requirements, may face difficulty in acquiring additional security to meet the increase to NZ\$300 million.
49. Although operators hold insurance as part of their normal business operations, current insurance products on the market appear to prevent operators from meeting their

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<sup>7</sup> As at 28 February 2014, 1 International Monetary Fund Unit of Account is equal to NZ\$1.847 million. Based on this rate, 162 million units of account equates to NZ\$299.214 million.

<sup>8</sup> Parent Company Guarantees provide a basis to bring a claim directly against the party providing the guarantee under the Maritime Transport Act 1994. However, this is only up to the minimum amount prescribed by the rules and could still require enforcement proceedings in a foreign jurisdiction.

<sup>9</sup> The exception is the floating, production, storage and offloading (FPSO) Raroa. The Raroa is a converted oil tanker that has been permanently moored over the Maari oilfield since 2008. The operators hold protection and indemnity insurance, which is appropriate for their operation.

legal requirements under Part 102 solely through insurance. It is unclear whether operators have sought tailored insurance as a means to meet their Part 102 requirements. In practice operators have instead simply relied on alternative financial security. Should tailored insurance be made available to operators, an increase to NZ\$300 million would increase costs for current and future operators. Initial consultation with insurance brokers suggest that, depending on the operator, premiums for a NZ\$300 million insurance policy could be approximately NZ\$3 million per annum.

50. Initial discussions with industry indicate an acceptance that the minimum level of public liability assurance needs to increase. It is likely that industry's response to the proposal to increase the minimum requirement to \$300 million will be to raise concerns about the lack of available insurance products and restrictions on the acceptable types of alternative financial security. These issues are likely to be more significant for the smaller, New Zealand based operators. While the insurance industry may respond over time to provide insurance products, in the near term there is risk that some operators may be unable to satisfy requirements.
51. To establish the extent of these impacts, operators will be asked as part of the consultation process, whether and how they would meet the increased minimum requirement. The outcome of consultation will inform how the Rule is finalised.
52. Officials cannot guarantee that no operators will choose to surrender their permit or be deterred from exploration as a consequence of the increase.

### **Public consultation**

53. To ensure the new requirements are in place before the commencement of the next drilling season in September 2014, and to satisfy consultation requirements, I propose that a public consultation process be undertaken.
54. The consultation process will be open to the public with the discussion document available on the Ministry's website and notification of the consultation will be made via the *Gazette*.<sup>10</sup> As it may be of public interest, I seek Cabinet's agreement to make this Cabinet paper publicly available on the Ministry of Transport's website during the consultation period.
55. Consultation will be undertaken over a four week period.
56. It is possible that following consultation, some operators state they are unable to acquire insurance or alternative security, and therefore can not meet their Part 102 requirements. The outcome of consultation will inform how the Rule is finalised.
57. If no significant issues are raised, I intend to sign a Rule Amendment to implement the increase. The new rule could be signed by 21 July 2014 and in force once the gazettal notice period of at least 28 days lapses

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<sup>10</sup> Section 446 of the Maritime Transport Act requires the Minister to publish a notice of his intention to make a rule in the *Gazette*.

### *Next steps*

58. If agreed by Cabinet, I will instruct my officials to jointly begin work on developing an improved financial security regime with officials from the Ministry of Business, Innovation and Employment and other government agencies. I propose that the Minister of Transport and Minister of Energy and Resources report back to Cabinet by the end of 2014 on options for an improved financial security regime.
59. I am also seeking Cabinet's agreement to release a consultation document, and draft Rule, that seeks feedback on the proposed change. The proposal to amend Part 102 is part of the Transport Rules Programme for 2013/14 that was noted by Cabinet [EGI Min (13) 20/2 refers].
60. I propose a four week consultation period, commencing in May 2014. This coincides with the end of the 2013/14 summer drill season, although it should be noted that some activity is scheduled to continue throughout the winter.
61. If no significant issues are raised, I intend to sign a Rule Amendment to implement the increase. The new rule could be in signed by 21 July 2014 and in force once gazettal notice period of at least 28 days lapses. This is prior to the next drilling season commencing approximately in September.
62. In a separate Cabinet paper, I am also seeking Cabinet's agreement to undertake consultation on a proposal that New Zealand accedes to the Supplementary Fund Protocol. The Supplementary Fund Protocol relates to compensation for oil spills from oil tanker ships. Should Cabinet agree to this, I propose that consultation on the Supplementary Fund Protocol and the minimum financial assurance requirement be undertaken concurrently.

### **Department consultation**

63. In the development of this paper, the Ministry of Transport has consulted with and received feedback from the Ministry of Business, Innovation and Employment, the Ministry for the Environment, the Environmental Protection Authority, and Maritime New Zealand. The Department of Prime Minister and Cabinet has also provided feedback.
64. In addition, the Ministry of Transport has consulted with the following agencies on this paper: Te Puni Kōkiri, the Ministry for Primary Industries, the Treasury, and the Department of Conservation.

### **Financial implications**

65. There are no immediate financial implications or decisions arising from this paper.

### **Human rights implications**

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

## Gender implications

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

## Disability perspective

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

## Legislative implications

69. Should no significant issues be raised during consultation, a change to Part 102 will be necessary to enable the increase to the minimum required level of financial assurance.

## Regulatory Impact Analysis

70. The regulatory impact analysis requirements apply to this proposal. A Regulatory Impact Statement has been prepared by the Ministry of Transport and is attached to this paper. Two members of the Ministry of Transport's Regulatory Impact Statement evaluation panel have reviewed the Regulatory Impact Statement. The reviewers consider that the information and analysis summarised meets the quality assurance criteria.

71. I have considered the analysis and the advice of my officials, as summarised in the attached Regulatory Impact Statement, and I am satisfied that the regulatory proposals recommended in this paper:

- are required in the public interest
- will deliver the highest net benefit of the options available
- are consistent with our commitments in the Government Statement "Better Regulation, Less Regulation".

## Recommendations

72. The Minister of Transport recommends that the Committee:

1. **note** aspects of the financial security regime for offshore installations have evolved from similar requirements for ships and fails to adequately reflect current and future production and exploration activity
2. **note** that, as part of New Zealand's financial security regime, operators are required to hold at least 14 million International Monetary Fund Units of Account (around NZ\$26 million) of financial assurance, however this level is unlikely to ensure there is adequate, effective, and prompt compensation for clean-up costs and to persons who suffer economic damage as a result of a pollution incident
3. **agree** to 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

4. **direct** the Minister of Transport and Minister of Energy and Resources to report to Cabinet by the end of 2014 on options for an improved financial security regime
5. **note** that until the review is implemented, there is an interim need to increase the current minimum amount to ensure adequate compensation is readily available
6. **agree** to release the attached consultation document, subject to editorial changes, which seeks views on the proposal to increase the level of financial assurance to 162 million International Monetary Fund Units of Account (approximately NZ\$300 million)
7. **note** operators may face difficulty in meeting the increase and consultation will be used to establish the likely impact to operators
8. **agree** this Cabinet paper will be made publicly available on the Ministry of Transport's website from the start of the consultation period
9. **note** in a separate Cabinet paper, the Minister of Transport seeks to undertake concurrent consultation on New Zealand's proposed accession to the Supplementary Fund Protocol relating to compensation for spills from oil tankers

Hon Gerry Brownlee  
**Minister of Transport**

Dated: \_\_\_\_\_

## Appendix 1 - Determination of financial assurance requirement

### New Zealand's operating environment

1. The cost of damage and clean up required from oil spills can be highly variable, and depend on a complex range of factors, including the:
  - type of installation
  - type and quantity of hydrocarbon released, which depends on the characteristics of a particular oil well, for example, possible spill quantity will be affected by the well's flow characteristics and capacity
  - weather conditions and ocean currents at the time of the spill
  - location and proximity to other-party interests
  - length and type of the shoreline affected, for example, whether the shoreline is rocky, sandy, or contains an estuary
  - area affected and the sensitive resources affected, for example, economic impacts on tourism, fishing, or aquaculture
  - effectiveness of response effort
2. New Zealand has a range of offshore installations producing both waxy crude oils and light condensates. The effects associated with spills of these different oils vary. Lighter oils have a greater short term toxicity and lower persistence. The waxy crudes have components likely to cause chronic, longer term effects on sensitive biology, and would require a greater clean-up effort due to their relative persistence.
3. Well pressures in existing New Zealand installations vary. The wells supplying one of the producing facilities have sufficiently low well pressures that they have to be pumped. However, wells in the remaining fields all flow under pressure. Recent potential worst case scenarios in some Discharge Management Plans for exploration wells have listed very high flow rates during a well blowout.
4. New Zealand's geographical isolation also has implications if an oil spill occurred. Maritime New Zealand advises that should an operator lose control of their well, appropriate capping vessels and equipment would have to be sourced from overseas. The delay in capping the well is likely to result in a larger impact zone, and subsequently higher clean up costs and damage.
5. Impacts would be felt on the fishing stock, and those impacts may go beyond the actual duration of the spill. The timing of any event could affect its impact on the ability of the sensitive resource to sustain its previous activity. If a spill occurs at a spawning or breeding time it may cause substantially greater impacts due to the potential to affect breeding stock.

## **Oil spill incidents**

6. Recent examples demonstrate the wide variation of costs and impacts from oil spills, depending on their characteristics. The clean-up costs for the Deepwater Horizon well blowout in the Gulf of Mexico are in excess of NZ\$16 billion, with at least an additional NZ\$9 billion paid to local residents for compensation. The cost of Montara well blowout in Australia was approximately NZ\$250 million, however it did not involve any shoreline impact and there were limited at-sea interests in terms of fishing in the vicinity of the incident.
7. The clean-up of the 350 tonnes of oil spilt during the Rena incident cost \$47 million. This is more than the current minimum financial assurance requirement for offshore installations, and does not include compensation for damages.

## **Requirements in other jurisdictions**

8. In determining what could be a reasonable fixed minimum financial assurance requirement, the Ministry has reviewed requirements in Australia, the United Kingdom and the United States. A summary of the requirements in these countries is provided below.

### *Australia*

9. Amendments in 2013 clarified an operator's requirement to maintain sufficient financial assurance to ensure it can deal with all costs, including extraordinary costs, expenses or liabilities arising in connection with the carrying out of a petroleum activity undertaken under the title, including expenses relating to the clean-up or other remediation of the effects of an escape of petroleum. The level of financial assurance required will reflect the possible costs associated with the specific activity.
10. Prior to those amendments, there was ambiguity regarding the scope of liability that operators faced. Operators were also only required to hold insurance for expenses and liabilities when directed to do so by the responsible Minister. While not a good comparator with New Zealand, based on the previous regime holding insurance between NZ\$121 million and NZ\$362 million was standard practice. However the direction power has not been used since the regulator was centralised in January 2012.
11. Minimum requirements for the current regime are unavailable. Work is currently underway to implement the amendments and establish the most appropriate way to set cost-based financial assurances. The work is expected to be completed by the end of 2014.

### *United States*

12. Under the Oil Pollution Act of 1990, the owner or operator of an offshore installation is liable for the costs associated with the containment or cleanup of the spill and any damages resulting from the spill. United States operators must provide evidence of financial responsibility to cover clean up and pollution damage resulting from an incident. Offshore operators have limited liability for pollution damage up to NZ\$87 million, but unlimited liability for clean up costs. Offshore facilities are required to

maintain evidence of financial responsibility of either at least NZ\$12 million or NZ\$35 million. This can be increased to a maximum of NZ\$175 million under regulations if justified based on the relative risk of the operation.

13. The United States has also established the Oil Spill Liability Trust Fund (OSLTF), which is used for costs not directly paid by the operator responsible for a spill up to NZ\$1.2 billion. The OSLTF is available to pay for the removal costs incurred by federal or state governments; the costs for the government in assessing natural resource damages; developing and implementing restoration plans; uncompensated removal costs and uncompensated damages; and administrative costs
14. The primary source of revenue for the fund is a NZ\$0.06 per barrel fee on imported and domestic oil. Other revenue sources for the fund include interest on the fund, cost recovery from the parties responsible for the spills, and any fines or civil penalties collected.

#### *United Kingdom*

15. United Kingdom's cost based financial responsibility assessment has four categories, NZ\$300 million, NZ\$440 million, NZ\$590 million, and NZ\$880 million, to address pollution damages and clean up costs from exploration. Further security is required for well control and is set according to the expected costs of relief well drilling and capping.
16. The regime operates in tandem with the Offshore Pollution Liability Agreement (OPOL), an industry agreement covering certain European countries. The United Kingdom requires all offshore operators to accept liability under OPOL for pollution damage and clean up costs, up to a maximum of NZ\$300 million per incident. OPOL requires operators to provide evidence of NZ\$300 million worth of financial assurance, such as insurance, financial guarantees, or self insurance.
17. Should an operator be unable to meet their requirement under OPOL, then other members agree to meet the claim up to the NZ\$300 million limit. If the assessment for exploration exceeds OPOL's level of NZ\$300 million, operators need to provide additional financial assurance.

#### **Application of international regimes to New Zealand**

18. Prior to recent amendments, the Australian regime contained ambiguity regarding the scope of liability that operators faced. Operators were also only required to hold insurance for expenses and liabilities when directed to do so by the responsible Minister. The Australian regime is not directly comparable to New Zealand.
19. The United Kingdom has recently updated its requirements following the Deepwater Horizon well blowout in the Gulf of Mexico.
20. Operators in the United Kingdom are required to determine the impact and risk of an oil spill on four categories (marine fishing areas; aquaculture areas; amount of oil on the coastline; and length of coastline becoming oiled) using a deterministic or trajectory oil spill model. The model assumes that the well flows for 30 days before

being effectively capped. This impact assessment determines the band in which their operation falls.

21. The United Kingdom's industry association guidelines identify that in the majority of scenarios NZ\$300 million would be sufficient to meet the claims for clean-up and compensation for oil pollution damage.<sup>11</sup> However, in certain cases spill clean-up and pollution compensation costs could exceed the NZ\$300 million limit.

*Appropriate interim level*

22. There are considerable difficulties to estimating the possible cost of oil spill incidents. The United Kingdom's industry association guidelines have identified that in the majority of scenarios, NZ\$300 million would be sufficient to meet the claims for clean-up and compensation for oil pollution damage. Given the lack of detailed information, officials consider that until a more comprehensive and flexible regime is developed, a realistic and appropriate interim level would be a point in close proximity to the minimum requirement in the United Kingdom.
23. Officials consider that a financial requirement of NZ\$300 million provides a significant increase from the current NZ\$26 million. It will also provide better assurance that operators are able to meet their liabilities, in most cases, for clean-up and pollution damage without being unnecessarily prohibitive to companies exploring and extracting oil in New Zealand.

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<sup>11</sup> Oil and Gas UK *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.