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Offshore Oil and Gas Field Decommissioning: Disputes and Other Challenges

As offshore assets age, oil and gas companies face a wave of decommissioning obligations, with expenditures estimated to exceed US\$200 billion in coming decades. Decommissioning is not simply demolition. It requires plugging and abandonment of subsea wells. It requires reverse engineering structures in order to dismantle them safely and efficiently. It requires the destruction or recycling of substantial waste products, including hazardous chemicals. It also may require substantial environmental remediation. Decommissioning represents not just an operational challenge but also a legal one. The global dispersion of facilities and their offshore location necessarily implicates a complex and overlapping set of international, regional, national, and intranational legal regimes. Decommissioning activities inevitably will entangle oil and gas companies in a wide range of disputes, including with host governments, regulators, business partners, and contractors.

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As offshore assets age, oil and gas companies face a growing wave of decommissioning work. This wave could accelerate depending on market conditions, particularly the future erosion of oil and gas prices. If the transition to alternative energy sources and other economic factors push prices down, assets will reach the end of their economic lifespan more quickly. Assets that can be operated economically in a ~\$100-per-barrel environment may not be economical in a ~\$60-per-barrel environment.

Decommissioning is not simply demolition. It includes all activities necessary to manage and dispose of installations and platforms and to restore the environment. It includes pre-abandonment surveys, development of a decommissioning plan and its submission for regulatory approval, plugging and abandonment of wells, dismantling and removal of topsides, subsea structures and pipelines, and disposal of associated waste. It requires reverse engineering structures in order to safely and efficiently dismantle them. It requires the destruction or recycling of substantial waste products, including hazardous chemicals. It also may require substantial environmental remediation.

The cost and scope of decommissioning operations varies widely depending on the type and location of the structures at issue. Small structures in shallow waters sometimes can be decommissioned for several hundred thousand dollars. A complex web of large and heavy structures in deep water are more challenging and can involve costs running into the billions of dollars.

The scope of anticipated future decommissioning activity is massive. Global decommissioning expenditures between 2010 and 2040 have been estimated at more than US\$210 billion.¹ An estimated 2,000 offshore projects will require decommissioning between 2021 and 2040.² Although decommissioning obligations are geographically dispersed, the bulk of the nearer-term costs will be incurred in the United Kingdom and United States, which have the oldest and some of the most extensive offshore operations. However, substantial offshore assets in Brazil, Norway, Thailand, Angola, Nigeria, Australia, and elsewhere are also set to reach the end of their economic life in the coming years and require decommissioning.³ For example, the decommissioning liability in Australia is estimated to be more than AU\$60 billion between 2020 and 2050.⁴

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their offshore location necessarily implicates a complex and overlapping set of international, regional, national, and intra-national legal regimes. Decommissioning activities inevitably will entangle oil and gas companies in a wide range of disputes, including with host governments, regulators, business partners, and contractors.

THE LEGAL FRAMEWORK FOR DECOMMISSIONING

The overarching legal backdrop for offshore decommissioning is the 1982 United Nations Convention on the Law of the Sea (“UNCLOS”). UNCLOS has been ratified by 167 UN member states and the European Union. Fourteen other member states have signed UNCLOS but not ratified it. The United States is a notable exception, having neither ratified nor signed UNCLOS. Articles 56 and 60 of UNCLOS recognize the sovereign right of coastal states to explore for and exploit the resources within their exclusive economic zones—which stretch 200 nautical miles from the baseline—including the right to authorize and regulate the construction and operation of installations and structures. Article 60(3) goes on to state that “[a]ny installations or structures which are abandoned or disused shall be removed to ensure safety of navigation, taking into account any generally accepted international standards established in this regard by the competent international organization.”

It is generally accepted that the “competent international organization” referred to in Article 60(3) of UNCLOS is the International Maritime Organisation (“IMO”), which promulgated generally accepted international standards in the form of its *Guidelines and Standards for the Removal of Offshore Installations and Structures on the Continental Shelf and in the Exclusive Economic Zone* (1989) (“IMO Guidelines”). The IMO Guidelines authorize states, on a case-by-case basis, to allow decommissioned offshore installations and structures to remain *in situ* based on an evaluation of six factors, including the potential effect on navigation, the impact on the marine environment, and the costs and technical feasibility of removal.

A series of regional seas conventions and other instruments impose additional obligations and guidelines in relation to offshore decommissioning. These include the 1992 Convention for the Protection of the Marine Environment of the North-East Atlantic, the 1995 Convention for the Protection of the Marine Environment and the Coastal Region of the Mediterranean,

the 1978 Kuwait Regional Convention for Co-operation on the Protection of the Marine Environment from Pollution, the 1987 Convention for the Protection of Natural Resources and Environment of the South Pacific Region, and the Association of Southeast Asian Nations' Council on Petroleum's Decommissioning Guideline for Oil and Gas Facilities, which were published in 2015.

Sitting beneath these international and regional treaties and guidelines are national and subnational decommissioning regimes. Some states already have overseen significant offshore decommissioning work and have mature, detailed regimes in place to govern these activities. Principal among these states are the United States and the United Kingdom, where decommissioning has been ongoing in the Gulf of Mexico and the North Sea (respectively) for many years.

Decommissioning in the United Kingdom is governed by the Petroleum Act 1998, as amended, and the accompanying Decommissioning Guidance Notes. The Secretary of State for Business, Energy and Industrial Strategy ("BEIS"), through the Offshore Petroleum Regulator for Environment and Decommissioning, has responsibility for ensuring implementation and compliance with the provisions of the Petroleum Act regarding decommissioning. This is done primarily by requiring responsible persons to submit a decommissioning program supported by an Environmental Impact Assessment. Responsible persons are identified through service of notice by the Secretary of State under Section 29 of the Petroleum Act. A Section 29 notice may be served on any person that derived financial or other benefit from the asset, including current and former operators, license holders, and owners. The Secretary of State may approve, modify, or reject a proposed decommissioning program. Once the program is approved, all responsible persons served with a Section 29 notice are jointly and severally responsible for carrying it out.

Decommissioning in the United States is governed by state law for facilities within three nautical miles of shore and federal law for facilities farther out at sea. Offshore decommissioning is regulated under federal law by the Bureau of Ocean Energy Management and the Bureau of Safety and Environmental Management, which both sit within the Department of the Interior. Federal regulations provide that decommissioning

obligations accrue immediately upon drilling a well, installing a platform or other facility, or acquiring rights as a lessee or owner of a facility. Decommissioning must be carried out when facilities are no longer being operated or within one year of the expiration of a lease. The responsible party must submit a decommissioning plan for approval by the Bureau of Safety and Environmental Management, which must include permanently plugging all wells, removing all platforms and other facilities, and clearing the seafloor of all obstructions created by the operations. However, as an alternative to complete removal, a platform is sometimes allowed to be converted into an artificial reef under the "Rigs to Reefs Program," in which case it is donated to a state to become part of the state's artificial reefs program, and the former owners and operators typically cease to have any further liability for the platform.

Many coastal oil-producing countries' decommissioning regimes are still evolving. For example, under current Australian law, only the registered titleholder is responsible for decommissioning. No specific financial assurances or security are required to ensure that the titleholder retains sufficient liquidity to cover decommissioning costs. This regime came under significant strain in late 2019 and early 2020 when the NOGA group of companies went into liquidation. One of those companies, Timor Sea Oil & Gas Australia Pty Ltd., was the titleholder for two oil fields located approximately 550 km north of Darwin and owned the Northern Endeavour FPSO, which was used in connection with operations at those fields. This left the Australian government and taxpayers potentially responsible for an estimated US\$196 million in decommissioning costs. On May 11, 2021, the Australian government announced a special levy on offshore petroleum production to cover these costs. More broadly, the Australian government is currently engaged in a process to update its legislative and regulatory framework for decommissioning, in part to avoid these types of issues.

Lastly, decommissioning obligations can be imposed or impacted by production-sharing contracts ("PSC"), concession agreements, and similar contracts. Older agreements often do not address decommissioning explicitly. However, a host of other contractual provisions may effect a company's decommissioning obligations, including stabilization clauses, choice of law clauses, forum selection or arbitration clauses, and environmental provisions.

Companies will need to navigate this multi-tiered and evolving legal framework as they prepare for and meet their increasing decommissioning obligations and handle related disputes.

DECOMMISSIONING ACTIVITIES WILL GIVE RISE TO A WIDE RANGE OF DISPUTES

As decommissioning activity increases, companies will inevitably be confronted with the prospect of associated disputes arising in myriad contexts with a wide variety of parties. These disputes will include disagreements with governments concerning the scope and implementation of decommissioning requirements, disputes among business partners over their relative responsibility for meeting decommissioning requirements, and disputes with contractors retained to implement decommissioning plans. The following sections summarize some of the types of disputes expected to be most frequent and significant.

Disputes with Governments and National Oil Companies

Governments frequently act not only as regulators of decommissioning activities but also, through state-owned enterprises, as partners in exploration and production activities. This creates conflicts of interest and fertile ground for potential disputes.

The expiration of a lease or concession agreement frequently will not coincide with the end of an asset's economic life. When a lease or concession expires, the asset and associated operations typically are handed over to the host government or national oil company, which will continue to operate them until it becomes uneconomical to do so. This can lead to disputes at the time of handover over responsibility for future decommissioning costs. Does the national oil company, as the sole remaining owner and operator of the asset, become wholly responsible for carrying out and paying for eventual decommissioning activities, or do exiting private companies remain liable for future decommissioning? If liability continues to be shared, how is it allocated between current and former owners and operators?

Even if the existence and allocation of future decommissioning liability is clear (and it frequently will not be), quantification of future costs will necessarily be speculative. A host country will be eager to ensure that a foreign oil and gas company deposits funds for decommissioning liabilities before ending

its operations and exiting the country, which will sometimes make it necessary to estimate decommissioning costs years or even decades before they will be incurred. Host governments will press to establish estimates that are high enough to account for any reasonable eventualities, but companies will want to ensure that estimated costs are reasonable and account for efficiencies expected to be realized as decommissioning works become more common and associated technologies and practices continue to develop.

These issues are complicated by legal regimes that have changed over the decades since concessions agreements, PSCs, or other relevant agreements were executed. Such agreements often include stabilization or change of law clauses granting companies bargained-for protections from later-enacted legislation or regulations. The interplay between evolving decommissioning laws and these types of contractual protections is yet another area where disputes are likely to develop.

In some circumstances, international law may provide protection from retroactive legislation under bilateral or multilateral investment treaties. A company's ability to invoke the protection of such treaties will depend on its ownership structure, in particular on whether its corporate parents are nationals of a country that is a party to an investment treaty with the host country. The ownership structure of a subsidiary company may be changed from time to time for tax, business, or other reasons, and these changes can have the effect of extending or withdrawing investment-treaty protections. Accordingly, it is critical to consider the implications of such changes on a company's ability to claim protection under potentially applicable investment treaties and to ensure that such protection is in place before the disputed government conduct has occurred.

Disputes will develop between oil companies and host governments over the scope and execution of decommissioning requirements. As noted above, UNCLOS and the IMO Guidelines allow states to permit decommissioned facilities to remain *in situ* on a case-by-case basis after consideration of several factors. There may be disagreements with governments over whether these factors are satisfied, including over whether complete removal of assets is practical and economically feasible and if alternative strategies—such as repurposing an asset in an artificial-reefs program—might more effectively advance the purposes of decommissioning and

the policies of the host state. The potential for such disputes is amplified by the fact that significant time frequently elapses between approval of a decommissioning plan and execution of the associated works. Conditions may change in the interim, particularly in areas prone to extreme weather conditions where damage caused by hurricanes, cyclones, or other natural disasters can render previously approved decommissioning plans impractical or dangerous.

Disagreements also will arise over the extent to which environmental remediation must be performed in association with decommissioning and the nature of any such remediation. Changes in environmental standards and regulations may trigger stabilization clauses in concession agreements or similar contracts. And even where the scope of work is agreed between a company and host government, there will sometimes be disputes over whether the work has been properly performed and completed.

Disputes with Business Partners

Offshore oil and gas facilities frequently are developed by joint ventures consisting of several companies, sometimes including a state-owned entity. These ventures typically operate under Joint Operating Agreements (“JOA”) or similar arrangements that designate one of the members—usually the one with the largest interest—to act as operator. JOAs vary in their terms. However, a number of model JOAs have been promulgated, and they provide a preview into the types of issues joint venture partners are likely to confront in relation to decommissioning.

For example, under Article 10 of the 2012 Association of International Petroleum Negotiators (“AIPN”) model JOA, the operator is required to develop a proposal for decommissioning joint assets along with an estimate of decommissioning costs. Section 4.3 of Exhibit E provides for the creation of a Decommissioning Trust Fund, to which all joint venture partners are required to contribute beginning on a “trigger date,” which is reached when the net value of the remaining reserves is less than a specified percentage of the estimated decommissioning costs. Estimating decommissioning costs and the net value of reserves necessarily will turn on assumptions, including forecasting future prices. With the cost of decommissioning sometimes running to billions of dollars, this creates ample scope for potential disputes over the terms of decommissioning proposals, the estimated costs of carrying them

out, and the determination of the trigger date at which partners are required to begin contributing to a decommissioning trust fund or similar security arrangement.

There also will be disputes regarding the decision to commence decommissioning an asset. Under the AIPN model JOA, the decision to decommission an asset must be approved by a vote of the operating committee. Disagreement over whether to commence decommissioning can lead to disputes among joint venture members, particularly where the operator is at odds with other members. The AIPN model JOA provides the option for a joint venture member to take over exclusive operation of an asset that the other members have voted to decommission. Where such an option is exercised, however, the parties will need to work out their respective liabilities and responsibilities for future decommissioning costs. If a JOA fails to anticipate and provide for this contingency at the outset, the parties will have to engage in difficult negotiations later on, with the promise of a dispute where agreement cannot be reached.

Disputes also will arise in relation to the decommissioning obligations of former interest holders. Joint venture agreements and assignment agreements—particularly older agreements—may not deal with the extent to which a party retains decommissioning responsibilities after assigning its interest. For example, assignment agreements sometimes will state that the assignee is responsible for liabilities that result after the effective date of the assignment, while the assignor remains responsible for preexisting liabilities. Under such a provision, responsibility for decommissioning costs may turn on a determination of when liability for decommissioning arises: Does it arise throughout the course of operations or only at the conclusion when the assets come to be decommissioned? The answer may turn on the specific language of the contract, the terms of applicable local law, or both. Further, even where a joint venture agreement does not impose liability on former interest holders, applicable legislation and regulations may.

Unitization and unit operating agreements (“UJOA”)—where multiple concessions within a field are operated together as a unit—will give rise to the same types of disputes as joint venture agreements and JOAs. However, UJOAs also raise additional issues. For example, different concessionaires may seek to exit their operations and decommission their assets at different times. This leads to questions regarding the timing and

responsibility for decommissioning shared assets, such as pipelines or flow stations servicing the unitized field. In addition, decommissioning and associated disputes can be further complicated where unitized fields extend across national boundaries, which can subject the parties to overlapping and potentially conflicting national decommissioning laws and regulations.

Disputes with Contractors

In many respects, decommissioning offshore and subsea facilities is equivalent to a large construction project conducted in reverse. The party responsible for the facilities typically will engage specialized contractors to deconstruct them, remove them from the site, and dispose of the waste. These works can be complex and difficult, especially for large structures located in deep waters. In some cases, additional specialized contractors may be required to perform environmental remediation.

The difficulties inherent in decommissioning projects may be exacerbated by incomplete or inaccurate information about the facilities. Platforms, pipelines, and other assets are usually decommissioned decades after they were constructed. The records regarding the original construction are frequently predigital and incomplete. Moreover, many structures have undergone repairs, upgrades, or other changes during their decades of operation. Site conditions also may be uncertain. Thorough surveys generally will have been performed before the assets were installed. However, the original surveys may be incomplete or unavailable, and conditions may have changed significantly in the intervening decades.

All of this creates fertile ground for disputes where facilities or site conditions prove to be different than the parties anticipated. These disputes will turn on issues common in large-scale construction disputes, including: the contractual allocation for risks and variation provisions; the contractor's compliance with the variation procedure; the assumptions on which the project was tendered; and the extent to which the variance from anticipated conditions could have been anticipated by a reasonable contractor.

Decommissioning works are also subject to delay for countless reasons. For example, offshore decommissioning works are inherently vulnerable to weather and sea conditions. They will require mobilization of specialized equipment, which may need to be modified to suit a particular job. Equipment may break down and need repairs from time to time. Some works will require government approvals before proceeding. Decommissioning projects may involve multiple contractors performing successive and mutually dependent scopes of work, such that delays in one stage can ripple through the project and cause knock-on delays to contractors performing subsequent works.

Time is usually not of the essence for decommissioning in the same way as it is for conventional construction projects. Nevertheless, delays can lead to substantial increased costs, including for extended mobilization periods and price fluctuations. Equipment scheduled to be used may become unavailable if works are delayed, leading to the need to procure substitutes at potentially higher rates. Resolution of these disputes will turn on the particular terms of the parties' contract as well as governing law.

CONCLUSION

The number and geographical dispersion of decommissioning projects will continue to increase in coming years. Given the scope, cost, complexity, and difficulty of required decommissioning works, it is inevitable that disputes will arise with governments, state-owned enterprises, business partners, and contractors. These disputes will play out in a variety of fora against a complex and multi-tiered legal landscape that includes international, national, and subnational law, as well as a web of contracts with governments, business partners, and contractors. For decommissioning projects to be successful, companies will need to deftly manage not only the decommissioning works themselves—but also the disputes they will engender.

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ENDNOTES

- 1 "Decommissioning of Aging Offshore Oil and Gas Facilities Increasing Significantly, with Annual Spending Rising to \$13 Billion by 2040, IHS Markit Says" (November 29, 2016).
- 2 *Id.*
- 3 Oil and Gas UK, Decommissioning Insight 2019 at 25.
- 4 Australian Government, Department of Industry, Science, Energy and Resources, *Enhancing Australia's decommissioning framework* (December 2020).

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