In Confidence

Office of the Minister of Transport

Chair, Cabinet Economic Growth and Infrastructure Committee

Draft rule amendments to the financial security regime for offshore installations

Proposal

1 This paper reports back to Cabinet on the outcome of public consultation on proposed amendments to Marine Protection Rules Part 102: Certificates of Insurance (Part 102). Also attached for Cabinet's information is the proposed rule amendment.

Executive Summary

2 In June 2017 [CAB-17-MIN-0337 refers], Cabinet agreed that a draft rule amendment to Marine Protection Rule Part 102: Certificates of Insurance (Part 102) be released for public consultation. Cabinet also invited the Minister of Transport, following consultation and subject to the feedback received, to report back to Cabinet with a proposed draft rule.

3 The draft rule amendment addresses issues identified with the financial assurance requirements for offshore oil and gas installations following a review of the wider financial security regime completed in 2016. Those issues are:

3.1 the lack of an assurance requirement regarding well containment;

3.2 the current level of assurance required for clean-up and compensation being too low; and

3.3 the lack of alignment between current assurance requirements and conventional insurance policies.

4 Consultation began on 11 July 2017 and concluded on 2 August 2017. Eight submissions were received, from the oil and gas, insurance and local government sectors. One submission was received from a private individual.

5 Submissions from industry and the insurance sector supported the intent of the rule but reiterated the need to ensure that the proposed new rule provides for an insurable regime. Other feedback included the need for greater clarity regarding the calculation of assurance requirements for well containment and clean-up and compensation, as well as the need for a transition period sufficient to allow industry to ensure it can meet the new requirements.

6 Following consultation, officials have finalised the draft rule amendment, attached at Appendix 1. The amendment:

6.1 provides for the Director of Maritime New Zealand (the Director) to take account of oil spill contingency measures, which include well containment, in determining the level of financial assurance required (addresses issue 3.1 above);

6.2 introduces a scaled framework up to a maximum requirement of NZ$600 million for financial assurance for clean-up and compensation (addresses issue 3.2); and

6.3 refines the scope of liabilities under Part 26A of the Maritime Transport Act 1994 (MTA) that the financial assurance must cover, to align requirements with international regimes and insurance markets (addresses issue 3.3).

7 In response to feedback from submissions, there has been further clarification in the rule of the calculation of assurance requirements, and the transition period for the new rule's entry into effect.

8 In response to concerns regarding the insurability of the new assurance requirements, officials have reviewed the proposed amendments so that industry can more easily meet the requirements with insurance products that are reasonably available in the market. Officials are continuing to work with industry and with the insurance sector in the development of guidelines, to ensure the new requirements are insurable, while still providing sufficient protection to the Crown.

9 I wish to notify Cabinet of the proposed changes to the financial assurance requirements, which will be made through amendments to Part 102. Subject to Cabinet's noting, I will sign the amended rule, and publication of the rule change will be provided through a Gazette notice.

10 I propose that the rule come into force on a date to be notified in the Gazette, which will be approximately 12 months after signing. This is contingent on the issuing of supporting guidelines, which I expect to be developed during the first six months after signing.

11 During the 12 months following the rule's entry into force, existing certificates of insurance will remain valid until they need to be renewed. I therefore expect that all installations will be compliant by August 2019. This will provide time for industry participants and Maritime New Zealand (Maritime NZ) to adapt procedures and policies as required.

Background

Current financial security regime for offshore installations

12 As part of the regulatory framework for offshore exploration and production, New Zealand operates a financial security regime to ensure that permit holders are financially able to meet the costs of their proposed activities, meet their legal obligations and cover their potential liabilities. Financial assurance is one aspect of this regime.

13 Under Part 26A of the Maritime Transport Act 1994 (MTA), in the event of an oil spill from their operations, offshore permit holders are liable for all response costs incurred by public agencies and other pollution damage and losses incurred by third parties as a result of the spill.

14 Part 26A also requires offshore permit holders to hold a certificate of insurance from Maritime NZ, which demonstrates that funds are available to meet certain liabilities in the

event the permit holder is unable to do so. Part 102 currently requires permit holders to provide third party assurance of 14 million International Monetary Fund Units of Account – approximately NZ$27 million[1] – to obtain a certificate of insurance.

15 The costs of an oil spill incident could be significant. Modelling[2] indicates that the possible cost of a worst-case spill occurring in New Zealand could be over NZ$1 billion. The cost would depend on a number of factors, including the spill's location and the type of hydrocarbon spilled.

16 The current financial assurance requirement of NZ$27 million is therefore significantly lower than the likely cost of most spills. In the event that a permit holder does not meet its liabilities with regard to the costs of a significant spill, it is likely that the Crown will be expected to meet these costs. A robust financial assurance regime would reduce the risk posed to the Crown and the public by this potentially significant cost exposure.

Previous decisions

17 In December 2016, following completion of the review of the financial security regime, Cabinet agreed to release a consultation document on options to address the key issues identified [CAB-16-MIN-0683 refers]. Cabinet also noted that the Minister of Transport would report back on final recommendations following consultation.

18 In June 2017, the Minister of Transport reported back to Cabinet with final recommendations on options to improve financial assurance requirements following public consultation. Cabinet noted those recommendations and invited the Minister of Transport, following further consultation on a draft rule amendment and subject to the feedback received, to report back with a proposed draft rule [CAB-17-MIN-0337 refers].

Consultation on proposed amendments to Part 102

19 Public consultation on proposed amendments to Part 102, as well as proposed content for supporting guidelines, occurred from 11 July 2017 until 2 August 2017.

20 Eight submissions were received. Most submissions were from the oil and gas industry, with two from the insurance sector, one from Local Government New Zealand (LGNZ) and one from a private individual.

21 The oil and gas industry and the insurance sector were broadly supportive of the intent behind the rule; however, there were some remaining concerns about the insurability of the requirements. LGNZ wanted the regime to ensure that taxpayers were protected from paying for the costs of an event. The private individual raised concerns regarding the broader Government policy to promote oil and gas activity.

Feedback received from submitters and officials' response

1 As at 8 June 2017, 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$26.99 million.

2 Navigatus Consulting completed modelling and a report to quantify the financial liabilities that could arise from a significant oil spill in New Zealand. Refer to *Financial Assurance Review – Integrated Damages Assessment Model*, Kevin Oldham, November 2015.

22 The key themes from the feedback were:

22.1 the need to provide an insurable regime;

22.2 the need for greater clarity regarding the calculation of assurance requirements for well containment and for clean-up and compensation costs; and

22.3 the need for a transition period sufficient to allow industry to meet the new requirements.

Providing an insurable regime

23 Submissions from the insurance sector and the offshore industry emphasised that the proposed new rule needs to provide for an insurable regime. Offshore industry submissions broadly supported the intent of the rule but sought greater clarity on the ability to meet assurance requirements under the rule through insurance policies widely available in the insurance market. The insurance sector reiterated the difficulties in providing an insurance policy that meets the current assurance requirements, specifically the strict liabilities provided for under the MTA. They expressed a willingness to work alongside government during the transition period to make sure insurance policies meet the new requirements.

24 Some aspects of the new assurance requirements require further clarity to ensure that they can be covered by available insurance policies. These will be addressed during the development of guidelines, in close consultation with industry and the insurance sector. They are as follows:

24.1 Many typically available insurance policies have a combined single limit, which means that a total figure is insured. In the event of a spill, those policies pay out in order of priorty, first to the costs of well control and redrilling, and then to third parties for clean-up and compensation. These policies will be accepted, provided the combined single limit is the sum total of the permit holder's well containment costs and clean-up and compensation requirement, as well as any other costs that may be included under the same policy.

24.2 Different insurance policies cover different types of spill events, with differentiation between sudden and gradual events. For instance, pipeline rupture events are not always covered, yet they pose a significant degree of risk. Therefore, policies will be required to cover rupture events. This is in line with requirements in Australia, and officials will work closely with the insurance sector and with industry to ensure policies can cover this requirement.

25 PEPANZ and other submitters from the oil and gas industry requested that the rule explicitly refer to insurance policies available in the international insurance market as being acceptable to the Director. Their view is that this would remove any doubt as to whether such insurance policies would be accepted.

26 The proposal to have an explicit reference in the rule is not consistent with the requirements for rules, as it is not sufficiently certain as to what such policies might contain in the future. This concern can be addressed through the development of guidelines which will provide further clarification on what requirements insurance policies must meet, as outlined above.

Clarity of requirements for well control and clean-up and compensation

27 Submissions from industry also requested greater clarity as to what assurance is required for well containment and what is required for clean-up and compensation costs, as well as the relationship between these.

28 Officials have sought to make this clearer in the rule by providing for the Director of Maritime New Zealand to take account of oil spill contingency measures, which include well containment. Clean-up and compensation is separately determined according to the scaled framework, up to a maximum amount of NZ$600 million. Further detail is provided in paragraphs 36-38 below.

Transition period

29 Submissions from industry also requested a transition period sufficient to allow them to meet the new requirements. Because much of the detail will be confirmed through subsidiary guidelines, submitters requested the rule come into force at least three months after the issuing of guidance, and that 12 months be allowed following the rule coming into force for industry to provide assurance that meets the new requirements. This will allow industry to update their policies as they expire.

30 Officials agree that a reasonable transition period is crucial to give industry time to ensure they can meet the new requirements and propose the inclusion of a 12 month transition period, as detailed in paragraph 44.

Proposed amendments to Part 102

31 Officials have reviewed and updated the draft amendment rule as outlined below in response to consultation and to address matters carried over from earlier Cabinet consideration of the financial assurance proposals. The updated rule is attached at Appendix 1 for your consideration. Subject to noting by Cabinet, I will sign the rule amendment.

Scaled framework

32 Following agreement from Cabinet [CAB-17-MIN-0337], the draft rule amendment refers to a scaled framework for identifying a permit holder's assurance requirement for clean-up and compensation, up to a maximum requirement of NZ$600 million. This is in line with the maximum requirements in equivalent international regimes.

33 The amendment lists the criteria to use in identifying the required assurance band, namely:

33.1 hydrocarbon type;

33.2 length of shoreline oiled; and

33.3 volume of oil reaching shore.

34 The scaled framework banding table, including the points system for criteria listed above, is to be included in a supporting guideline.

35 In response to submissions, the rule has included a provision that enables applicants to provide assurance for clean up and compensation at the maximum level, without being

required to provide information regarding the potential shoreline impact and the volume of oil reaching shore.

Clarity of requirements for well control and clean-up and compensation

36 The amended rule provides for the Director to take account of oil spill contingency measures under Marine Protection Rules Part 131: Offshore Installations – Oil Spill Contningency Plans and Oil Pollution Prevention Certification (Part 131), which include well containment, in determining the level of financial assurance required. Initial estimates of the cost of well containment are up to NZ$360 million, depending on the type of well, hydrocarbon, and the nature of the release. The clean-up and compensation assurance level is determined according to the scaled framework, up to a maximum anount of $600 million.

37 The amendment does not explicitly refer to "well containment". Part 26A of the MTA addresses third party liability and does not require financial assurance to be held for well containment carried out by an offshore permit holder. Instead, the amendment implicitly includes an assurance requirement for well containment due to this being part of a permit holder's liability to the Crown or marine agencies for costs incurred in "dealing with" a harmful substance, under section 385B. "Dealing with" is defined in section 385B(3) as including the process of containing the substance.

38 Further clarification has been made in reference to section 385B, by referring to dealing with a "harmful substance" instead of pollution.

Refining the scope of assurance requirements

39 The requirements in the proposed rule amendment refine the scope of liabilities under Part 26A of the MTA that the financial assurance must cover. Specifically, they do not include third party losses of profit from impairment of the environment. This reflects that internationally available conventional insurance policies do not cover third party losses of profit, and brings our regime in line with international comparators.

40 Refining the scope of liabilities that financial assurance must cover in this way does not affect a permit holder's liability under Part 26A of the MTA for such losses. Permit holders remain wholly liable for all costs, damages and losses arising from a spill from their operations.

41 In response to questions from members of EGI Committee on 28 June 2017 about refining the scope of assurance, officials have further investigated this issue of insurability for third party loss of profit from impairment of the environment. Based on feedback from members of the insurance industry in New Zealand and the United Kingdom, officials have concluded that no consistently available insurance policies are available that cover this form of liability at the levels required. Officials will continue to monitor any international developments in this area.

42 In response to concerns raised in submissions regarding the scope of liabilities that assurance must cover, further amendments have been made to clarify what liabilities must be covered by assurance, under section 385B for dealing with harmful substances in relation to well containment, and section 385C in relation to clean-up and compensation.

43 As mentioned earlier, industry members retain some concerns regarding the insurability of the new assurance requirements. Officials are continuing to work with industry and with the insurance sector in the development of guidelines, to make sure that the new requirements are both clear and insurable, while still providing sufficient protection to the Crown.

Transition period

44 The amended draft includes commencement and transition provisions to allow the rule to come into force at least three months after the issuing of guidance and provide for a 12 month transitional period following the rule coming into force. The commencement date will be notified in the Gazette, as provided for in section 451(3) of the MTA. Guidelines are expected to be finalised by March 2018, and I expect that the rule would then come into force from 1 August 2018. All new applications and any renewals after this date will need to comply with the new rule and all installations will be required to be compliant 12 months later. Between August 2018 and August 2019, existing certificates issued under the previous requirements will remain valid until their expiry date.

Proposed guidance

45 Once the rule is signed, officials at the Ministry of Transport, the Ministry of Business, Innovation and Employment (MBIE) and Maritime NZ, will work with industry to develop guidance to support the new rule. The guidance will cover:

45.1 requirements of permit holders in undertaking modelling of a worst-case scenario;

45.2 how to apply the required modelling to the scaled framework, including what factors must be identified for calculating the required financial assurance band;

45.3 identifying the cost of well containment according to Well Control Contingency Plans under Part 131;

45.4 acceptable insurance policies for obtaining a certificate of insurance; and

45.5 clarification of terminology.

Consultation

46 In the development of this paper, the Ministry of Transport and MBIE have consulted with the following agencies: the Ministry for the Environment, the Department of Conservation, Maritime NZ, the Environmental Protection Authority and the Treasury. The Department of the Prime Minister and Cabinet has been informed.

47 Engagement with key stakeholders has been undertaken at key points in the policy development process. Members and representatives of the oil and gas and insurance industries have been consulted throughout the process of reviewing the regime including, as discussed above, consultation on options to improve the regime and the draft rule amendment.

Financial Implications

48 There are no direct fiscal implications resulting from the proposed rule amendment.

49 Permit holders are currently not required to provide financial assurance commensurate with the potential cost of spill response measures or pollution damage as the result of a significant spill. This exposes the Crown and other third parties to the risk of being unable to recover these costs from a permit holder. The proposed amendments are intended to reduce this risk exposure.

50 The proposed amendments to the regime will likely result in implementation and regulatory costs for both industry and the regulator. While some permit holders in New Zealand currently hold insurance for an amount that is significantly higher than the current minimum assurance requirement, that cover would not necessarily meet their obligations under the proposed amendments to Part 102.

51 Increases in required cover will result in increased insurance premiums for most installations. Insurance is a cost-effective way to provide financial assurance, and is strongly supported by the industry. Indications are that the additional insurance costs resulting from the proposed amendments (collectively estimated at up to $10 million) are a reasonable cost in comparison with the amount required to operate an offshore installation.

52 Administrative costs are still being quantified, although it appears most of these costs would occur in the set-up phase. Any ongoing costs to Maritime NZ, such as assessment of which assurance band an installation falls in, will be passed on to the applicant as part of the normal fee process. Fees are charged on an hourly basis, reflecting the time taken to assess applications. This means there will be increased costs for industry.

53 The proposed amendments would bring the New Zealand regime into line with equivalent regimes in other countries. It is therefore not expected that the amended regime would deter investment in New Zealand from exploration and production companies.

Human Rights

54 There are no human rights implications.

Legislative Implications

55 This paper proposes amendments to Part 102. It does not propose any changes to the MTA, as amendments are within the existing scope of the MTA.

Regulatory Impact Analysis

56 A regulatory impact statement (RIS) is attached. The transport sector Regulatory Impact Assessment Quality Assurance Panel has reviewed this RIS and considers that the information and analysis summarised in the RIS partially meet the quality assurance criteria. The nature of the problem is comprehensively described. However, the issues are complex and intertwined. Information is lacking on the actual extent and magnitude of gaps in financial assurance. The likely extra costs to industry are therefore not set out. Implementation costs are not fully known at this time.

Publicity

57 Should Cabinet agree to the proposed changes to financial assurance requirements, the rule amendment to Part 102 giving effect to those changes will be notified through a Gazette notice. Subject to Cabinet's approval, this Cabinet paper will be released on the Ministry of Transport's website. The RIS will also be published on the Ministry's website.

58 There could be heightened public and media interest in the potential impact and cost of an oil spill as a result of the proposed rule change. To address these comments, I plan to highlight that these scenarios represent a worst case with an extremely low probability of occurrence[3].

59 I will also reiterate that New Zealand's regulatory framework for offshore exploration and production is robust, and focuses on preventing spills by ensuring permit holders have plans and resources in place to minimise the likelihood, and reduce the effect, of any adverse event.

60 Stakeholders may also perceive amendments to address the incompatibility of conventional insurance policies as an attempt to loosen regulation. I plan to highlight that higher financial assurance is not currently possible without narrowing its scope and that permit holders are still liable for all costs and damages. I will also highlight the fact that the required level of assurance has been greatly increased.

3 The estimated probability of a well blow-out, or loss of control, occurring in New Zealand is less than 1% per year.

Recommendations

The Minister of Transport recommends that the Committee:

61 **note** that on 28 June 2017, Cabinet agreed that a draft rule amendment to financial assurance requirements be released for public consultation [CAB-17-MIN-0337 refers]

62 **note** that consultation on a draft rule amendment to Marine Protection Rule Part 102 occurred from 11 July 2017 until 2 August 2017, with eight submissions received

63 **note** that following consultation, the draft rule amendment was updated and reviewed

64 **note** that the following changes will be made to the financial assurance requirements:

64.1 introducing a scaled framework up to a maximum requirement of NZ$600 million for clean-up and compensation;

64.2 providing for the Director of Maritime New Zealand, to take account of oil spill contingency measures, which include well containment, in determining the level of financial assurance required; and

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

65 **note** that the proposed rule amendment accompanying this paper gives effect to the changes proposed in recommendation 4 and will be signed by the Minister of Transport

66 **note** that a supporting guideline will be developed by officials, and will be finalised prior to the amendments coming into force.

Authorised for lodgement

Hon Simon Bridges

Minister of Transport

Appendix 1: Draft rule amendments to Part 102

102.8 Application for and issue or recognition of certificate of insurance

(1) The owner of a regulated offshore installation to which this rule applies must ensure that every application for the issue or recognition of a certificate of insurance for that regulated offshore installation is —

(a) submitted to the Director in accordance with section 269 of the Act; and

(b) accompanied by:

(i) such evidence of the existence of the contract of insurance or other financial security as the Director specifies; and

(ii) a translation into English if the language of the certificate of insurance for which recognition is sought is not English.

(c) subject to (d), accompanied by such information as may be reasonably required by the Director to assess the level of financial assurance required under this rule in respect of each offshore installation for which a certificate of assurance is to be issued including, but not limited to:

(i) the applicant's planned work programme during the period to which the certificate of insurance will apply

(ii) the location of each installation to be covered by a certificate of insurance

(iii) the nature of the hydrocarbon being prospected for, explored, or mined

(iv) the total volume of hydrocarbon likely to be released in the event of an oil spill

(v) the potential impact of hydrocarbon on the shoreline in the event of an oil spill

(vi) the applicant's oil spill contingency plan under Marine Protection Rules Part 131

(d) provided however, that the owner shall not be required to provide the information contained in rules 102.8(1)(iv) and (v) if that owner has provided with its application a contract of insurance or other financial security for an amount not less than $600 million in relation to the owners liability under rule 102.8(2)(b)(ii).

(2) The Director must issue or recognise a certificate of insurance for a regulated offshore installation to which this rule applies where he or she is satisfied that —

(a) the requirements of section 270 of the Act are met; and

(b) the contract or contracts of insurance or other financial security in respect of the regulated offshore installation provides public liability coverage for an amount not less than that determined by the Director under rule 102.8(2A) and of a kind and scope suitable to meet the owner's potential liability under Part 26A of the Act for:

(i) costs of dealing with harmful substances under section 385B of the Act

(ii) pollution damage to property and costs of reasonable preventive measures and measures of reinstatement under section 385C of the Act

(c) the contract of insurance or other financial security will be in force in respect of the regulated offshore installation throughout the period for which the certificate is to be issued or recognised; and

(d) the insurer or guarantor named in the application is financially capable of meeting a claim for the full amount specified in the contract of insurance or other financial security taking into account the rating, if any, of that insurer or guarantor under the Insurance (Prudential Supervision) Act 2010; and

(e) the insurer party to the contract of insurance complies with any provisions of the Insurance (Prudential Supervision) Act 2010 applicable to that insurer.

(2A) The Director will apply rules (2B) and (2C) to determine the levels of public liability coverage required under rule 102.8(2)(b), taking into account:

(a) the information provided by the applicant in accordance with rule 102.8(1)(c); and

(b) any further technical information, data, advice and guidance relevant for the purposes of the Director's determination.

(2B) In relation to rule 102.8(2)(b), the Director must establish a scaled framework for determining financial assurance requirements, up to a maximum of $600 million, based on:

(a) the nature of the hydrocarbon being prospected for, explored, or mined

(b) the location of the prospecting, exploration, or mining activity

(c) the total volume of hydrocarbon likely to be released in the event of an oil spill

(d) the potential impact of hydrocarbon on the shoreline in the event of an oil spill

(e) relevant technical information, data, advice and guidance.

(2C) In establishing the scaled framework under (2B):

(a) the Director may consider the extent to which the requirement for financial assurance under this rule is mitigated by the measures the operator has in place to address an oil spill including, but not limited to:

(i) the operator's oil spill contingency plan

(ii) the financial resources available to the operator to implement that oil spill contingency plan, including any insurance available to the operator to meet those costs

(b) the Director must consult on, and publish, any general policy that the Director intends to apply in making determinations under (2A).

(3) Every certificate issued by the Director for a regulated offshore installation to which this rule applies must be in the form specified in Appendix 2 and must contain the following particulars —

(a) the name of the owner of the regulated offshore installation and the principal place of business of that owner; and

(b) the nature of the contract of insurance or other financial security for the regulated offshore installation; and

(c) the name and principal place of business of the insurer or other person giving security for the regulated offshore installation and the place of business where the insurance or security is established; and

(d) the period of validity of the insurance or other financial security in respect of the regulated offshore installation; and

(e) the period of validity of the certificate of insurance, which shall be for:

(i) a maximum period of 12 months; or

(ii) the period of validity of the insurance or other financial security;

whichever is the shorter period.

Entry into force

The amendment rule will include a commencement provision bringing it into force on a date to be notified in the *Gazette* as provided for in section 451(3) of the Act.

Transition provision relating to persons holding certificate of insurance under former Part 102 Subpart 2

The amendment rule will include a transition provision that a certificate of insurance for a regulated offshore installation issued or recognised by the Director under rule 102.8 and in force immediately prior to the commencement of the amendment rule continues until the expiry date of that certificate of insurance or earlier surrender or revocation of the certificate.