

Financial security regime for offshore installations draft Rule - Q&A

1. What's happening?

The Ministry of Transport and the Ministry of Business, Innovation and Employment have reviewed the financial security regime and have proposed changes to the financial assurance requirements, set out in Marine Protection Rules Part 102 (Part 102). The proposed amendments will ensure operators have the financial means to cover their liabilities should a spill occur. To give effect to the proposed changes to financial assurance, we have released a draft amendment to Part 102, and are seeking feedback from interested people and organisations.

This follows on from a previous period of consultation (December 2016 – February 2017) on a discussion document on proposed amendments to improve the financial security regime for offshore oil and gas installations. Options to improve the regime were further assessed in light of submissions received, and these have informed development of the draft Rule.

2. What is the Government's general approach to managing offshore installations?

New Zealand uses a prevention-control-response-recovery framework for regulating offshore exploration and production. The primary focus is on minimising hazards and preventing spills from occurring by ensuring that permit holders have the capability, plans and resources necessary to minimise the likelihood, and reduce the effect, of any adverse event.

3. What does the financial security regime cover?

The financial security regime aims to ensure permit holders of offshore installations are able to meet the costs of their proposed activities, meet their legal obligations and cover their potential liabilities in the event of a spill.

Officials have reviewed the financial security regime and concluded that most of the regime is working well. We have identified a need to improve the financial security regime by better ensuring that permit holders have the financial means to pay for control, clean-up and compensation should a spill occur.

Financial assurance ensures permit holders are able to cover costs arising from their liabilities following a spill event to the limit assured. If a permit holder does not, or cannot, fulfil their legal obligations to respond to an incident, the Crown would need to resolve the situation. This may include paying for the cost of well containment, in addition to other response and environmental clean-up costs. A strong financial assurance regime would help protect the Crown from this potentially significant cost exposure.

4. What is the current situation for liability in case of a spill?

Part 26A of the Maritime Transport Act 1994 (MTA) sets out the liabilities of permit holders. In the event of a spill, owners and permit holders of offshore installations are liable for the full costs of regaining the control of a well, pollution damage and losses incurred by third parties, and the costs incurred by public agencies in preventing, mitigating and cleaning up the spill. The changes being proposed under this amendment will not affect the liabilities of permit holders.

5. What are the financial assurance requirements currently?

The MTA requires all offshore installation permit holders to have a Certificate of Insurance issued by Maritime New Zealand before commencing their activity. Marine Protection Rules Part 102 : Certificates of Insurance (Part 102), sets out requirements that permit holders must meet to be issued with a certificate. Specifically, Part 102 sets a fixed minimum financial assurance requirement for all offshore installations. This requirement is currently approximately NZ\$27 million (the financial assurance is set at 14 million International Monetary Fund Units of Account, or approximately NZ\$27 million). Modelling and comparisons with other jurisdictions suggests that this level is too low to meet the potential costs of an offshore incident.

Most or all permit holders currently voluntarily hold higher levels of insurance than what is required. However, there is a need to ensure that a more realistic level of assurance is explicitly required.

6. What is being proposed instead?

Following public consultation on options to improve the financial security regime for offshore installations, the Government has progressed the following changes to the financial assurance requirements:

- Introducing a financial assurance requirement sufficient to cover the costs of well control, to address the current lack of any explicit requirement in this area;
- Introducing a scaled framework for the level of financial assurance required for clean-up and compensation, which will result in an increase to the level required for most installations; and
- Refining the scope of liabilities under Part 26A of the Maritime Transport Act 1994 (MTA) that the financial assurance must cover, to address the mismatch of current requirements with conventional insurance policies.

These changes require amendments to [Marine Protection Rule Part 102: Certificates of Insurance \(Part 102\)](#). Part 102 requires permit holders of offshore installations to provide financial assurance in respect of their potential liability to the Crown and

others under Part 26A of the MTA. The draft Rule amendment relates entirely to Part 102.

7. What are the benefits that would arise from the draft amendments, if adopted?

The draft amendments will ensure that financial assurance provided by permit holders is more aligned with the risk associated with their activity and will provide greater protection to the Crown and the public in the event of a significant oil spill.

The current level and scope of cover set out in Part 102 was based on the requirement for ships. The amendments will ensure that they better address the risks associated with the oil and gas industry.

Refining the scope of liabilities also enables permit holders to use conventional insurance policies to meet their assurance requirements.

8. Who would be affected by the draft amendments, if adopted?

The offshore oil and gas industry is directly affected by the draft amendments. The proposals amend the financial requirements permit holders must meet to be issued with a Certificate of Insurance.

The Crown is also affected by the proposals. One of the key objectives for the proposed changes is to increase protection to the Crown, which would likely have to respond to an incident in the event that a permit holder cannot or does not respond. The existing assurance requirements do not provide sufficient cover for a permit holder's liability, thus exposing the Crown to a risk of having to cover the costs of clean up and pollution damage. The proposed changes aim to reduce the Crown's exposure to this risk.

9. How will the draft amendments, if adopted, affect the general public?

The general public is potentially affected by the proposals, particularly the fishing and tourism sectors. By aligning the assurance requirements to the associated risk, it increases the likelihood that the level of assurance will be sufficient for third parties to be compensated for damage arising directly from an oil spill. However, refining the scope of the assurance requirements poses a small risk that third parties might not be compensated for losses of profit resulting from impairment of the environment, if permit holders are not able to cover their liabilities in this area.

Because existing offshore installations are located in the Taranaki region, it is this region that is immediately affected. However, the proposals anticipate offshore

petroleum activities occurring in other areas, hence the amendments may in the future become directly relevant to other regions.

10. Once the consultation period finishes, what then?

Following consultation on the draft rule amendment, a final rule amendment will be developed for the Minister of Transport's signature.

In order to provide time for industry and Maritime New Zealand to adapt procedures and policies as required, it is proposed that the rule would come into force 12 months after signing. During the first 6 months of this transition period, a guideline for the financial assurance requirements will be developed. The accompanying Invitation to Comment includes further detail on what information could be included in a guideline supporting the amended rule.

11. How have the proposed scale levels of cover been chosen?

The scaled increase proposed in the discussion document is based on modelling of potential offshore spills in the Taranaki, Pegasus and Canterbury-Great South Basins. This modelling is available [on the Ministry of Transport website](#). These scenarios represent a plausible worst case scenario - the probability of a spill occurring is very low.

This modelling indicated that the potential control, clean-up and compensation costs of worst-case spill scenarios in these basins could range from \$12 million (in Great-South Canterbury) to \$926 million (in Deepwater Taranaki). With third party losses of profits excluded, the cost of a worst-case spill in Deepwater Taranaki would be about \$800 million.

The scaled levels proposed go to a maximum level of \$600 million. This has been reduced from the previous proposal to better align the New Zealand framework with Australia's requirements.

12. Why is the financial assurance being proposed for some installations below the current minimum?

The proposed scaled approach reflects the expected risks and clean-up costs of a spill. It would take into account the length of shoreline affected, the volume of oil reaching the shore, and the hydrocarbon type.

An installation likely to only release dry gas (i.e. with no liquid content) would have a minimal clean-up cost, as there would be no liquid reaching the shore. It would be subject to a requirement to provide NZ\$25 million.

At the other end of the scale, a very large spill that affects a very long stretch of shoreline would be subject to the proposed financial assurance requirement of NZ\$600 million.

13. What happens if the clean-up costs are higher than the amount of assurance required can cover?

In the event of a spill requiring clean-up and compensation above what has been set in the financial assurance requirement, permit holders retain full (100 percent) liability for these costs. Offshore operations tend to be joint ventures, often with large international companies. These international companies have significant financial resources and reputational incentives to meet their liabilities in the event of a spill.

Modelling has been completed which shows that the potential cost of a worst-case spill is highly variable, depending on factors like the location and the type of hydrocarbon released. The levels in the scaled framework have been set to be comparable with requirements in other countries and are expected to cover the majority of the cost in most spill scenarios.

14. How does this compare to overseas jurisdictions?

The scaled assurance framework is similar to that used in Australia and the United Kingdom.

The proposed top band in New Zealand sits below the United Kingdom and Canada, but is closely aligned with Australia.

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.

15. What is the actual risk of an oil spill?

Oil exploration and production carries a degree of risk. However, oil spills are extremely rare. New Zealand has never experienced a significant oil spill from an offshore installation. The largest was a 23 tonne spill from the Umuroa FPSO off the Taranaki coast in 2007. A 13 kilometre stretch of beach off the Taranaki coast was temporarily affected by this spill.

The regulatory framework for oil exploration and production in New Zealand minimises the risk of an oil spill occurring. Our regulatory framework is based on international best practice and comprises a multi-stage system covering permitting, health and safety, environmental considerations, and response planning (including well control). The regime's primary focus is to prevent hazards and discharges from occurring, and ensures that permit holders have sufficient plans and resources in place to decrease the likelihood of any adverse event.

The regulatory framework also requires permit holders to undergo financial capability checks before permits are granted, to ensure that companies are financially capable of meeting the obligations and liabilities under the permit.

16. What would these changes mean in the event of a spill?

If a permit holder does not, or cannot, fulfil their legal obligation to respond to an incident, the Crown would respond to resolve an incident. Without financial assurance for well containment, there is no guarantee that the Crown, or any contracted parties, could easily recoup any clean-up costs.

External assurance requires permit holders to provide a guarantee that costs will be covered from outside the company, for example through insurance, bonds or parent company guarantees. Amending the level of financial assurance would provide a better guarantee that the Crown or contracted parties could recoup the costs of clean-up, in the event that the company is not able to cover these.

17. How many offshore installations does New Zealand have?

New Zealand currently has five offshore production facilities. Two of these predominantly produce oil, and the other three produce gas and condensate.

18. How much do offshore installations contribute to New Zealand's economy?

New Zealand's oil and gas production, and its associated benefits, are currently generated from the Taranaki Basin.

Crude oil is a significant commodity export for New Zealand. It is currently worth around NZ\$600 million a year, having been affected by recent reductions in price and production.

In 2013, the oil and gas industry directly employed 5,068 full-time equivalent staff.

19. How can I make a submission?

The deadline for making submissions on the draft amendments to Part 102 is **5pm, 2 August 2017**. You may make your submission by:

- Email: info@transport.govt.nz
- Post: Consultation on Improving the Financial Security Regime for Offshore Oil and Gas Installations
Ministry of Transport
PO Box 3175
WELLINGTON 6140.