Offshore Oil & Gas Decommissioning Cost Recovery

Consultation Stage Impact Assessment

Contents

Background

1. The decommissioning of offshore oil and gas installations and pipelines on the United Kingdom Continental Shelf (UKCS) is controlled through the Petroleum Act 1998, as amended by subsequent Energy Bills.

2. The UK's international obligations on decommissioning are governed principally by the 1992 Convention for the Protection of the Marine Environment of the North East Atlantic (OSPAR Convention). Agreement on the regime to be applied to the decommissioning of offshore installations in the Convention area was reached at a meeting of the OSPAR Commission in July 1998.

3. The Offshore Petroleum Regulator for Environment and Decommissioning (OPRED), which sits within the Department of Business, Energy and Industrial Strategy (the "Department"), has the responsibility for ensuring that the requirements of the Petroleum Act 1998 and international obligations are complied with. OPRED is also the competent authority on decommissioning in the UK for OSPAR (international regulations) purposes.

4. In line with the fundamental polluter pays principle of environmental law, those who are responsible for putting in place offshore oil and gas installations and pipelines to benefit from the extraction of hydrocarbons should pay for its decommissioning. Those responsible are referred to as 'duty holders' throughout this document. To avoid passing costs onto the taxpayer, under the Petroleum Act 1998, the Secretary of State has the power to make regulations to charge for the Department's work in relation to regulating decommissioning – so in 2012 the Government made the Offshore (Oil and Gas) Installation and Pipeline Abandonment Fees Regulations 2012, which put in place the existing fee charging regime.

5. Under the existing fee charging regime, the Department charges industry a fee when submitting decommissioning programmes or requesting the revision of programmes, to recover its costs of carrying out functions in relation to the decommissioning of offshore (oil and gas) installations and pipelines. As a fee cannot be charged until the point of decommissioning programme or revision approval, and the timing of this can be hard to accurately forecast, both BEIS and industry struggle to manage their financial accounting processes for the costs associated with the fee charging regime.

Problem under consideration and rationale for intervention

6. The existing regime was implemented at a time when the decommissioning process was still immature. In recent years, as operators have commenced decommissioning in the UKCS, it has become clear that the fee-charging regime does not sufficiently cover the full life cycle of the work involved in delivering the service to industry which can take place over a period of 1 to 15 years. This is particularly evident for monitoring the execution of decommissioning activity, which is done to ensure these are consistent with the approved plans, and financial assessment to protect the taxpayer from the risk of funding decommissioning liabilities in the event of company default. Due to aging infrastructure in a mature basin and the decline of the oil price,

operations are no longer achieving maximum recovery resulting in the levels of decommissioning activity significantly increasing year-on-year, and BEIS is currently unable to recover from industry its full costs of providing its regulatory functions. BEIS can only charge at two points in the process: at programme approval or revision approval. Therefore, we cannot charge for all work that takes place once a programme is approved, such as monitoring the execution of the programme or formally accepting that the decommissioning works have been finalised. At this stage, we cannot accurately quantify what the increase in decommissioning activity means in terms of cost increase for BEIS but, as decommissioning accelerates within the UKCS, the proportion of activities undertaken by OPRED relating to post decommissioning monitoring and execution are expected to increase significantly.

7. The shortfall in the costs is currently met through central budgets, therefore falling on the taxpayer. The Department is considering whether primary legislation is needed to better recover its costs for fulfilling its regulatory functions, to ensure the effectiveness of the 'polluter pays' principle and in line with HM Treasury's guidance on Managing Public Money. The proposed changes to the fee charging regime and primary legislation would ensure that government can fully recover from industry the cost of providing these services. The changes will only affect businesses responsible for the development, operation and decommissioning of offshore (oil and gas) installations and pipelines. The costs of fulfilling these regulatory functions are referred to as 'decommissioning costs' throughout this document.

8. Considering current economic conditions, it is essential that BEIS recovers costs wherever possible, rather than them falling to the taxpayer. The Department would not be seeking to make a profit from such a fee or charge but fully recover its costs in carrying out those functions. As the Department facilitates the decommissioning process, it would therefore seem reasonable that the companies leading to this expenditure should contribute to such costs and enable BEIS to maintain those statutory functions.

Policy options

9. Three policy options have been considered.

Option 1 – The current charging regime remains unchanged (BAU)

10. Under this option, the charging regime remains unchanged. BEIS continues to charge only at decommissioning programme approval and revision approval based on an indicative fee per type of installation or pipeline.

11. BEIS will not recover its full costs from industry for executing its statutory functions and the shortfall will continue to be met through central budgets, therefore falling on the taxpayer.

12. With charges not being made at regular points, BEIS and industry will continue to find it challenging to manage the financial accounting process for the costs associated with the fee charging regime.

Option 2 – Introduce amendments to the charging regime with regular charging points

13. Option 2 introduces amendments to our current charging regime, to charge for all services provided to industry under part IV of the Petroleum Act 1998 (the Act). This option ensures that the companies directly benefitting from the regulatory services fully meet the cost associated with its provision.

14. The charging process for decommissioning activities would be based on the application of an hourly rate system and the number of personnel undertaking the work with charges being made at regular points. The process would be fully aligned with existing fee regimes within OPRED for offshore environmental fee recovery. Charging regularly also has additional benefits, as it would help the Department and industry to better forecast and accrue costs.

15. The proposed changes under Option 2 would have no impact on small and medium-sized enterprises (SMEs), as none of the existing operators fall within this definition.

Option 3 – Introduce amendments to the charging regime with charging on completion of activity

16. Option 3 introduces amendments to the charging regime as described above for Option 2. However, charging would occur on completion of the statutory function or activity, rather than regularly as proposed in Option 2. Therefore, the additional benefits achieved through regular charging would not be achieved.

17. The proposed changes under Option 3 would also have no impact on SMEs, as none of the existing operators fall within this definition.

Impacts of each policy option

18. The impacts of each policy option are outlined below in terms of costs and benefits. A qualitative description of impacts is included where it was not possible to monetise that impact.

19. Table 1 below estimates the decommissioning costs under the three policy options in 2021/22. These estimated costs have been calculated using average recovered costs from the last three financial years. The total running costs is assumed to be around £3.4m under all options.[1] Options 2 and 3 enable the UK Government to fully recover from industry the costs of providing its services. This is estimated to be £2.7m, approximately 80% of total running costs. However, not all costs are recoverable, such as policy development. Therefore, £0.7m would still fall on the taxpayer under Options 2 and 3. Table 1 informs the modelled scenarios in Table 2 below.

[1] Total running costs are based on our headcount, overheads (such as IT, estates) and are based on business planning. We do not expect the headcount to increase above the current levels. However, overheads could increase marginally.

Table 1: 2021/22 Estimated decommissioning costs under the existing and proposed fee charging regime.

2021/22	**Option 1: Existing fee charging regime**		**Options 2 and 3: Proposed fee charging regime**	
	Duty holder	**Taxpayer**	**Duty holder**	**Taxpayer**
Decommissioning cost	£1.0m - £1.5m	£1.9m – £2.4m	£2.7m	£0.7m
Total running costs	£3.4m		£3.4m	

20. Due to the uncertainties around forecasting fee recovery and decommissioning costs, multiple scenarios have been modelled, with impacts monetised where possible, between 2022/23-2031/32, a 10-year period. The modelling shows how estimated decommissioning costs are affected by changes to annual total running costs and to changes in the percentage of decommissioning cost that fall to the duty holders given the uncertainties in both. Table 2 below presents the scenarios modelled in this analysis, which were informed by the estimated decommissioning costs in Table 1 for 2021/22. As mentioned, the decommissioning costs in Table 1 have been estimated using average recovered costs from the last three financial years. Annex A presents the estimated decommissioning costs in all the modelled scenarios in present value terms.[2]

Table 2: Modelled scenarios to account for uncertainties around decommissioning costs

Assumption	**Assumption**	**Modelled Scenarios**
1	Total annual running costs (real % annual increase from £3.4m) **under all three options**	0%, 2.5%
2	Decommissioning cost to the duty holder (% of total running cost) **under Option 1**	25%, 37%, 45%
3	Decommissioning cost to the duty holder (% of total running cost) **under Options 2 and 3**	75%, 80%, 85%

21. While there are no current plans to increase total running costs above £3.4m (the estimated running costs for 2021/22), a 2.5% real increase has been modelled to illustrate the potential impact of an annual increase. Costs to duty holders could potentially increase incrementally each year as decommissioning activity increases and OPRED undertakes a greater proportion of work post approval of decommissioning programmes.[3] This would be in line with any increase in total annual running costs. The 2021/22 decommissioning cost estimates presented in Table 1 have been used to inform the analysis which is used to assess the impacts of each policy option.

22. Based on the 2021/22 estimated decommissioning costs for Option 1, which as mentioned are estimated using data from the three preceding financial years, between 29%-44% of total running costs will fall on the duty holder. To account for

[2] The estimated decommissioning costs have been discounted by 3.5% in line with Green Book guidance to adjust for social time preference.
[3] The decommissioning cost to the duty holder under Options 2 and 3 may therefore be greater than £2.7m as decommissioning activities post approval increase each year.

uncertainty, three scenarios have been modelled: 25%, 37% and 45% where the highest (lowest) value was rounded up (down) to the nearest 5%, with 37% illustrating a central scenario.

23. Three scenarios have also been modelled for cost recovery under Options 2 and 3: 75%, 80% and 85%. Based on our estimates for 2021/2022, we would expect Options 2 and 3 to recover approximately 80% of total running costs (with the remaining 20% being unrecoverable costs). Two scenarios have therefore been modelled around this. We have greater certainty over the cost recovery for Options 2 and 3, since the proposals are to charge for all the work that is undertaken with regards to BEIS's statutory functions which accounts for circa 80% of the time. Since charges would be made using an hourly rate per statutory function under Options 2 and 3, forecasting would be relatively easier. Whereas charges can only be made under Option 1 at programme approval/revision and the timing and amount is only known on approval.

24. The impacts have been presented from the point of view of different stakeholders. Impacts are presented from the point of view of duty holders and the UK Government. The duty holders are those companies who are responsible for the development, operation and decommissioning of offshore (oil and gas) installations and pipelines and are directly benefitting from the regulatory services provided by the UK Government.

25. For options 2 and 3, the impacts have been compared against the current charging regime remaining unchanged (Option 1).

Impacts of Option 1 - the current charging regime remains unchanged (BAU)

Costs to duty holders

26. Under the current charging regime, the UK Government would continue to charge only at decommissioning programme approval and revision approval based on an indicative fee per type of installation or pipeline. Over the period 2022/23-2031/32, the cost to duty holders is estimated to be between around £7m and £14m in present value terms (2018/19 prices).

Costs to UK Government

27. Under the current fee charging regime, the UK Government would continue to incur costs. Between 2022/23-2031/32, the cost to the UK government is estimated to be between around £16m and £24m in present value terms (2018/19 prices). Over the 10-year period, the UK Government is therefore only able to recover between 25%-45% of total running costs from industry under the existing regime. However, as mentioned, not all running costs are recoverable, such as policy development.

28. In addition, BEIS and industry will continue to find it challenging to manage their financial accounting process with issues around forecasting and accruing the regulatory costs of decommissioning. This is because fees are charged as one-off occurrences, with the timing for payment often uncertain until very close to the event.

Impacts of Option 2 - introduce amendments to the charging regime with regular charging

Costs to duty holders

29. Under Option 2, duty holders would continue to pay fees or charges to the UK Government for fulfilling its regulatory obligations. However, the new regime would mean charging duty holders at more regular points and for all statutory functions associated with the regulatory obligations, to meet the full costs of providing the regime.

30. The estimated cost to the duty holder under Option 2 for 2022/23-2031/32, is between around £21m and £27m in present value terms (2018/19 prices). The annual cost to duty holders could potentially increase incrementally year on year due to the expected increase in decommissioning work, in particular the work required post decommissioning programme approval. This would be in line with any increase in total annual running costs.

31. As the new regime would be aligned with the environmental fee recovery regime already in place, it would not place additional administrative burden on the companies and therefore familiarisation costs would be minimal.

Benefits to UK Government

32. Under Option 2, the UK Government is able to fully recover from industry the costs of providing its services in executing its statutory functions. This is in line with the ‘polluter pays’ principle of environmental law.

33. Full cost recovery from industry under Option 2 would be between around £21m and £27m in present value terms (2018/19 prices) over the 10-year period. Therefore, compared to the current fee charging regime, this would result in a cost transfer to government of between around £8m and £19m in present value terms (2018/19 prices) over the 10-year period.

34. This would equate to increasing the UK Government’s cost recovery from between 25%-45% to 75%-85% over the 10-year period. However, as mentioned previously, not all costs are recoverable. Therefore, between around £4m and £8m of total running costs would continue to be met by central budgets in present value terms (2018/19 prices) over the 10-year period. These unrecoverable costs would therefore continue to fall on the taxpayer.

35. In addition, by moving to charging at regular points, the department and industry will be better able to forecast and accrue the costs associated with the decommissioning fees. This would enable the Department to better monitor and manage the budgets related to decommissioning.

Impacts of Option 3 - introduce amendments to the charging regime without regular charging

Costs to duty holders

36. Under Option 3, duty holders would continue to pay fees to the UK Government for fulfilling its regulatory obligations. As under Option 2, Option 3 would introduce amendments to our charging regime. However, charging would occur on completion of statutory function/activity, rather than regularly as proposed in Option 2.

37. As under Option 2, over the 10-year period duty holders would be charged between around £21m and £27m in present value terms (2018/19 prices), an increase of between around £8m and £19m compared to the current fee charging regime.

Costs to UK Government

38. As under Option 2, Option 3 enables the UK Government to fully recover from industry the costs of providing its services in executing its statutory functions. Full cost recovery from industry under Option 3 would be between around £21m and £27m in present value terms (2018/19 prices) over the 10-year period. This equates to cost recovery for the UK government of between 75%-85% of total running costs. The remaining 15%-25% will continue to fall on the taxpayer in unrecoverable fees.

39. However, as charging would take place irregularly, the UK Government and industry would still struggle with forecasting costs and accruals. The UK Government would also experience lags with recovering costs, as they do under the existing regime.

Conclusion

40. BEIS believes that it is appropriate for duty holders to meet the full costs of providing the regime. For this reason, Option 1 is therefore not the preferred option.

41. Although Option 3 would allow the department to fully recover the costs of carrying out its statutory functions, and is therefore preferred to Option 1, there are the additional benefits under Option 2 which arise from charging industry more regularly. Irregular charging under Option 3 would not solve the current financial accounting issues with being unable to accurately forecast and accrue the costs. Therefore, Option 3 would not provide HMG and duty holders the full benefits of changing the fee charging regime.

42. By inserting new charging powers into the Act, Option 2 makes amendments to our charging regime to align with the statutory functions of the Secretary of State which provide a service to industry under Part IV of the Act. This option ensures that those companies directly benefiting from the regulatory services meet the cost associated with its provision, and industry would be charged at regular points.

43. This would align better to the environmental fee recovery regime in place and therefore would not place additional administrative burden on companies. Industry

would therefore cover the costs incurred, rather than the taxpayer. The new regime would also enable better forecasting of costs and accruals in the accounts.

44. Option 2 would be implemented via a change in primary legislation to charge for all statutory provisions under part IV of the Act where OPRED acts on behalf of the Secretary of State. OPRED would be responsible for the implementation, ongoing operation and enforcement of the new arrangements. Secondary legislation will be implemented to cover the application of an hourly rate system.

45. Therefore, Option 2 is BEIS's preferred policy option.

Annex A – Modelled decommissioning cost scenarios[4]

Modelled decommissioning cost scenarios for Option 1 (2022/23-2031/32)

			Estimated cost (£m, present value, 2018/2019 prices, 2022/23-2031/32)		
	Modelled assumption		Option 1: Existing fee charging regime		
Scenario	**Total annual running cost (% increase from £3.4m)**	**Option 1 - Decommissioning cost to the duty holder (% of total running cost)**	**Duty holder**	**Taxpayer**	**Total running cost**
1	0%	25%	7.1	21.2	28.3
2	0%	37%	10.5	17.8	28.3
3	0%	45%	12.7	15.6	28.3
4	2.5%	25%	7.9	23.6	31.5
5	2.5%	37%	11.6	19.8	31.5
6	2.5%	45%	14.2	17.3	31.5

Modelled decommissioning cost scenarios for Options 2 and 3 (2022/23-2031/32)

			Estimated cost (£m, present value, 2018/19 prices, 2022/23-2031/32)		
	Modelled assumption		Options 2 and 3: Proposed fee charging regime		
Scenario	**Total annual running cost (% increase from £3.4m)**	**Options 2 and 3 - Decommissioning cost to the duty holder (% of total running cost)**	**Duty holder**	**Taxpayer**	**Total running cost**
1	0%	75%	21.2	7.1	28.3
2	0%	80%	22.6	5.7	28.3
3	0%	85%	24.0	4.2	28.3
4	2.5%	75%	23.6	7.9	31.5
5	2.5%	80%	25.2	6.3	31.5
6	2.5%	85%	26.7	4.7	31.5

[4] Note, the sum of the costs to the duty holder and taxpayer differ slightly under certain scenarios with the total running cost column. This is because the annual decommissioning costs have been rounded to one decimal place.