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From: PS Matt Hancock (DECC)
Sent: 10 December 2014 12:59
To: [REDACTED] (Energy Development); DECC Ministers - SpAds & Perm Sec
Cc: Maxwell Clive (Consumers and Households); McNeal Hugh (Office for Renewable Energy Deployment); Williams Katrina (International Science and Resilience); Ridgwell Angie (Finance and Corporate Services); Stewart Rae (Communications); Storey - Shanmugalingam Jobshare; Loughhead John (Chief Scientific Advisers Office); Fries Steven (Economics); Speed Stephen (Energy Development); Toole Simon (Energy Development); Jordan Andrew (DECC LEGAL); [REDACTED] (Energy Development); [REDACTED]
[REDACTED]

Subject: RE: Submission for Mr Hancock regarding a notice under section 82 of the Energy Act 2011 to resolve a third party access dispute offshore

[REDACTED],
Thanks for your submission. The Minister is content to agree the Notice.

[REDACTED]
Private Secretary to the Minister of State, Matt Hancock MP
Email: ps.matt.hancock@decc.gsi.gov.uk & [REDACTED]@decc.gsi.gov.uk
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From: [REDACTED] (Energy Development)
Sent: 08 December 2014 14:56
To: DECC Ministers - SpAds & Perm Sec
Cc: Maxwell Clive (Consumers and Households); McNeal Hugh (Office for Renewable Energy Deployment); Williams Katrina (International Science and Resilience); Ridgwell Angie (Finance and Corporate Services); Stewart Rae (Communications); Storey - Shanmugalingam Jobshare; Loughhead John (Chief Scientific Advisers Office); Fries Steven (Economics); Speed Stephen (Energy Development); Toole Simon (Energy Development); Jordan Andrew (DECC LEGAL); [REDACTED] (Energy Development); [REDACTED]
[REDACTED]

Subject: Submission for Mr Hancock regarding a notice under section 82 of the Energy Act 2011 to resolve a third party access dispute offshore

Please find attached a submission for Mr Hancock.

Regards

[REDACTED] Licensing Exploration and Development
Department of Energy and Climate Change
3 Whitehall Place
London SW1A 2AW
0300 068 [REDACTED]

From: [REDACTED] Telephone: 0300 068 [REDACTED]
 Team: [REDACTED] EDU-LED Date: 8 December 2014

To: Mr Hancock

PROPOSED NOTICE UNDER SECTION 82 OF THE ENERGY ACT TO RESOLVE A THIRD PARTY ACCESS DISPUTE OFFSHORE

Issue Following a dispute over the terms for access by the Howe Field to the Nelson Platform in the North Sea, an application was made to DECC to use existing powers to bring about a resolution. After long and careful consideration, a Notice has been prepared and is ready for issue.

This would be the first Notice that has ever been given to resolve a third party access dispute offshore.

Timing Routine – but we would like to issue the Notice in the next few days to allow consideration and possible acceptance by the Howe Owners before Christmas.

Decision You are asked to agree that the Notice should be given to the Howe Field Owners.

Handling instructions No restrictions need to be imposed.

Context / Consideration

1. Background

The Howe Field is a small oil accumulation in the Central North Sea that was developed using a single subsea well, tied back by pipeline to the nearby Nelson processing platform. First production was in 2004. The Nelson platform was originally built to serve the Nelson Oil Field which started production in 1994. Shell operates both fields and has an interest of around 60% in both, although there are other parties who have an interest in one field but not the other. Although both fields are mature, predictions made by Shell in recent years have suggested that [REDACTED]
 [REDACTED] *[Redacted under section 43(2) of the Act]*

The Agreement (contract) for the processing and transportation of the Howe hydrocarbons by the Nelson Platform expired at the end of 2012; negotiations to agree new commercial terms started prior to that date without success. It became clear during 2013 that the various parties on both sides were not likely to agree and

so an application was made by the Howe Owners to DECC on 11 September 2013 under section 82 of the Energy Act 2011 to impose terms if appropriate. The central issue in the dispute is whether the Howe owners should continue to pay a tariff (per barrel of oil) for the service, or whether they should pay a proportion of the running costs of the Nelson Platform based on relative throughput. The Nelson Owners believed that the a proportion of running costs (termed 'cost-share') should be paid from now on, whereas the Howe Owners believed that a tariff should be paid for several further years before a switch to a cost-share arrangement.

The requirements of section 82 of the Energy Act 2011 were followed in seeking relevant information and in allowing all relevant parties to be heard. There is also well-established DECC guidance in this area. An early indication of the likely terms and associated explanation was shared with all parties in January 2014, and draft Notices were shared in August and November 2014, in all cases inviting comments. Annex 1 summarise the main interactions that took place during consideration of the application.

The proposed terms generally favour the position of the Howe Owners (i.e. the applicants), on the basis that this is consistent with the DECC guidance and should act to maximise economic recovery from both fields. Annex 2 contains the Notice and Explanatory Note which describes the factors and information used in considering the application. Extended dialogue has been held with one of the Nelson Owners [REDACTED] who has challenged DECC views from the start.

2. Relevant political context/decisions made previously/other factors

The use of short-term agreements has prevented the loss of any production from the Howe Field (which is modest – around 2,000 barrels of oil per day) during the dispute. The latest agreement runs out on 31 December and no further extension has been agreed to date.

No appeal mechanism exists in the legislation, so that Judicial Review is the only means to challenge the Notice. [REDACTED]

[REDACTED] *[Redacted under section 42(1) of the Act]*

Action 18 of the Wood Review stated 'The new Regulator must make full use of the current legal powers to resolve disputes and facilitate access to infrastructure'.

Options

3. Given that a long period of negotiation did not lead to agreement, giving a Notice to the Howe Owners appears to be the only option to resolve the dispute.

Clearance

4. This submission has been cleared by Simon Toole, Head of Licensing Exploration and Development in EDU.

Accounting Officer Issues

5. None envisaged.

Handling / Presentation

6. There may be external interest as this is first time that a Notice will have been given as a result of the use of our powers; three previous applications have been resolved through further negotiation after we described the terms that we were minded to set. Current lines to take:
- This is a quasi-judicial decision on which we do not propose to comment at this stage.
 - The legislation allows a summary of the Notice to be published and we envisage doing so once the risk of challenge has passed.

Next Steps

7. On the assumption that you agree with our proposal, we envisage sending the Notice to the parties by 12 December. The Howe Owners will need to accept it within 10 working days for the Notice to come into effect on 1 January 2015.

cc:

PS / all Ministers
PS / Special Advisers
Permanent Secretary
Directors General
DECC Strategy Director
DECC Chief Economist
DECC Chief Scientific Advisor
DECC Communications Director
Press Office

Stephen Speed
Simon Toole
[REDACTED]
Andrew Jordan
[REDACTED]

Annex 1: *[All redactions in this Annex under section 43(2) of the Act]*

Summary of the dispute between the Howe owners and the Nelson owners

The Nelson field's first oil was in 1994 and reached peak production two years later, producing around 150,000 barrels per day (bpd). In 2013 it produced an average of 12,356 bpd. It is owned by Enterprise Oil Limited (36.88%), Esso Exploration and Production UK Limited (21.23%), Shell U.K. Limited (21.23%), Apache North Sea Limited (11.53%), Idemitsu Petroleum UK Ltd. (7.47%), and Premier Oil UK Limited (1.66%).

The Howe field came on-stream 10 years after Nelson, reaching a peak production of 9,700 bpd in 2005, and produced 2.213 bpd in 2013. It is owned by Enterprise Oil Limited (36.00%), Shell EP Offshore Ventures Limited (24.00%), Idemitsu Petroleum UK Ltd. (20.00%), OMV (U.K.) Limited (20.00%).

Shell took over Enterprise Oil in 2002 and thus holds a 58.11% and a 60% share in Nelson and Howe respectively, and is the operator of both fields.

The initial commercial terms agreed for the [REDACTED] agreement [REDACTED] were for Howe oil to be processed and exported on a [REDACTED] basis, but, unusually, the [REDACTED] was time limited with an expiry date of 31st December 2012. Early in 2012, negotiations for new terms began, but reached an impasse with the Nelson group suggesting an Opex or cost sharing deal (whereby the operating costs of the platform would be shared on the basis of the relative throughputs), and the Howe group favouring a continuation of the tariff arrangement. With no new agreement in place, to avoid shutting in the Howe production a 12 month temporary deal (to the end of 2013) involving an increased tariff was agreed so that negotiations could continue. By the middle of 2013, no agreement had been reached.

The application for intervention by the Secretary of State was received on 11 September 2013 from Howe's substitute commercial operator OMV (due to Shell having a conflicted commercial position).

Having sought views from all the parties and reviewed the information in the application, it was decided that the case met the criteria for further consideration by the Secretary of State as defined by the Energy Act 2011.

In accordance with the Energy Act 2011 Section 82 subsection 6b, the opportunity to be heard was offered to the applicant(s) and the owner(s), any person with a right to have anything conveyed by the pipeline or processed by the facility, the Health and Safety Executive, and such other persons as the Secretary of State considers

appropriate. Those parties with interests in Howe and/or Nelson took up the opportunity, except for [REDACTED].

[REDACTED] met with DECC on the 31st Oct 2013 to present their case, accompanied by [REDACTED]. [REDACTED] requested a separate meeting in addition to a hearing with [REDACTED] and [REDACTED], both of which took place on 14th Nov 2013.

Subsequent to the meetings with the parties, DECC requested supplementary information from [REDACTED] on the 2nd October 2013. A further request for additional information was made on the 22 of November 2013.

After gathering all the required/requested information and analysing it alongside the information provided in the application, we were able to issue a draft 'minded to' letter which indicates the terms that we envisaged setting. This explained our current thinking regarding the terms that should be set and allows the parties to have an indication of what the notice will contain, hopefully facilitating them getting back to the negotiating table if appropriate. The draft 'Minded to' letter was sent to all parties on 9th January 2014. The letter gave the view that a switch to Opex or cost sharing should not happen until [REDACTED] from the Nelson field on the grounds of maximising economic recovery, and that the former tariff would be appropriate prior to that time.

A further extension to the temporary agreement had been agreed by the parties from 1 January to 31 March 2014.

[REDACTED] sought a meeting to clarify terms identified in the 'Minded to' letter and to make further representations on their position. This meeting was held at DECC on 15th January 2014.

Dialogue was held with [REDACTED] by telephone and email during March 2014 to seek further information so as to refine the terms described in the 'Minded to' letter.

A further extension to the temporary agreement was agreed by the parties on 1 April 2014, to expire on 31 December 2014.

Some proposed amendments to the terms proposed in the 'Minded to' letter were raised in a letter to the Nelson owners on 29 May 2014 and views were sought to support their contention that a switch to Opex or cost sharing should happen earlier.

Following further assessment and reassessment of information and external advice from consultants, a draft notice was drawn up. The draft notice was sent to all parties on 21st August 2014. This contained an Explanatory Note that was expanded from that used in the 'Minded to' letter to explain the basis for the terms and the information used to derive them.

After the draft notice was circulated [REDACTED] sought another meeting with DECC which was held on 10th October 2014.

A meeting was held with [REDACTED] on 17 October at the request of DECC to discuss the [REDACTED], as a guide to how a similar arrangement for the Howe Field might work.

Following some revisions to the proposed terms, a further version of the draft notice was sent to all parties on 5 November 2014. A further letter was received from [REDACTED] (the 8th in total during the process) following that draft.

A meeting was held on 24 November 2014 at the request of [REDACTED] and [REDACTED] to discuss the latest revisions to the proposed terms.

A further version of the draft notice was prepared on 26 November for internal DECC review.

Annex 2:

Proposed Notice (attached separately)

Notice served under section 82(11) of the Energy Act 2011 in respect of the Howe field seeking access to the Nelson Platform

The Owners of the Nelson Platform are hereby served notice of terms of access for the Howe Field as directed by the Secretary of State under section 82(11) of the Energy Act 2011.

This Notice applies to those parts of the Nelson Platform, located in block 22/11 of the UK North Sea, that are required by the Howe Field located in block 22/12 for oil and gas processing, and the conveyance of oil and gas for export through separate pipelines leading from the Nelson Platform to the Forties Pipeline System and the SEGAL System respectively.

The Notice terms have been prepared as a result of a commercial dispute between the Owners of the Nelson Platform; Enterprise Oil Limited, Esso Exploration And Production UK Limited, Shell U.K. Limited, Apache North Sea Limited, Idemitsu Petroleum UK Ltd and Premier Oil UK Limited ('the Nelson owners') and the Owners of the Howe field; Enterprise Oil Limited, Shell EP Offshore Ventures Limited, OMV (UK) Limited and Idemitsu Petroleum UK Ltd ('the Howe owners'). The Howe Owners applied to the Secretary of State for Energy and Climate Change to set terms on 11 September 2013, following a failure to reach agreement with the Nelson Owners.

The Howe Owners shall have the right to have hydrocarbons processed and conveyed by those parts of the Nelson Platform to which this Notice applies, as specified by the terms set out in Annex 1. The reasoning behind these terms is described in Annex 2, which does not form part of the notice. The terms include payment and financial arrangements that the Howe owners must make in the exercise of the right. The Nelson Owners must ensure that the right can be exercised.

This Notice will come into force on 1 January 2015 if the Howe Owners accept the terms of this Notice in writing to a representative of the Secretary of State on or

before 23 December 2014, in accordance with section 82(17) of the Energy Act 2011.

Any of the parties listed in this notice may apply to the Secretary of State to request variation of this Notice under section 85(2) of the Energy Act 2011. The parties may also agree to vary or set aside the notice in line with section 85(1) of the Energy Act 2011.

8 December 2014

Annex 1 of Notice: Specific terms imposed by this Notice

The terms comprise those set out in agreements and amendments listed below which were previously agreed between the Nelson owners and the Howe owners, amended as set out below.

[REDACTED]

The terms of this agreement should be applied in their entirety, subject to the following changes:

"Effective Date" in [REDACTED] shall be 1 January 2015.

New definitions in [REDACTED] should be added as follows:

"Aggregate Gas" means the total Gas derived from all users' production after processing through the Nelson System prior to any deduction of Fuel Gas and Flare Gas;

"Fuel Gas" means Gas used as fuel on the Nelson Platform;

"Howe Aggregate Gas" means the Gas derived from the Howe Fluids after processing through the Nelson System and attributed to the Howe Group prior to any deductions of Howe Fuel Gas and Howe Flare Gas;

"Howe Flare Gas" means the Howe Field's [REDACTED] share of the Flare Gas [REDACTED];

"Howe Fuel Gas" means the Howe Field's [REDACTED] share of Fuel Gas;

"Nelson Shared Opex" shall have the same meaning as in the [REDACTED]
[REDACTED]

"Net Value" shall have the same meaning as that used in the [REDACTED]
[REDACTED];

"Switch Date" shall mean the first day of the month following the date at which the sum of each calculated Net Value for each remaining year for the Nelson Field is less than zero and the associated forecasts and calculations have been approved by the Nelson Group and confirmed or amended if appropriate by the Expert appointed in connection with the [REDACTED]
[REDACTED];

"Year" shall mean any period of twelve (12) consecutive months beginning on 1 January and 31 December;

██████████ should be amended by the insertion of the following text immediately prior to the closing bracket on the fifth line; "and in the event that the Switch Date has been passed the Nelson Group should give the Howe Group a reasonable opportunity to make an increased contribution to the operating costs of the Nelson System prior to deciding to permanently cease production from the Nelson Field".

██████████ should be replaced by the words 'Not used'.

██████████ should be amended by the addition of the words 'some or all of' in the tenth line after the second occurrence of the word 'for'.

██████████ should be deleted.

██████████ should be replaced by the following: ██████████ the Nelson Group shall be entitled to recover from the Howe Group a charge for the provision of up to ██████████ million standard cubic feet of gas per Day (██████████ mmscf/d) supplied for Lift Gas purposes on a Day, provided that the charge covers only the actual production impact on the Nelson Group as a result of supplying the gas to the Howe Facilities and the Nelson Operator supplies sufficient information to the Howe Group to justify the charge. For the avoidance of doubt any gas imported for use as Lift Gas shall also be charged in accordance with ██████████.

██████████ should be replaced by the words 'Not used'.

██████████ should be amended to remove the words starting in the fourth line "any agreed revision to ██████████ and".

██████████ should be replaced with the following:
"From the Effective Date and prior to the Switch Date, Howe Group should pay to the Nelson Group a tariff in respect of ██████████
██████████
██████████.

██████████ should be amended by replacing the formula on the fourth line by:
$$T = \text{██████████} \times [E / E_0]$$

The following definitions should be added to Clause 11.1.2:

E = number of Pounds purchased by one US dollar as an average for the Quarter preceding the Quarter in question according to Bank of England index XUQAGBD.

E₀ = number of Pounds purchased by one US dollar as an average for the period October to December 2014 according to Bank of England index XUQAGBD.

New Clause ██████████ should be inserted:

"For every month from the Switch Date, Howe Group will pay to the Nelson Group a provisional tariff in Pounds (the "Howe Provisional Monthly Opex Sharing Tariff").

When the Nelson Operator reasonably believes that the Switch Date could be reached within the current Year, it should inform the Howe Group forthwith and not less than 30 days before the actual Switch Date in order that the Howe Group can prepare the required estimate of aggregate throughput

On or before the Switch Date, and annually on or before the 30th September thereafter, the Howe Operator shall submit to the Nelson Operator and the Nelson Group a good faith best estimate of the aggregate throughput over the Nelson System of Howe [REDACTED] for the subsequent Year (The "Howe Annual Throughput Forecast").

No later than 30 days after the Switch Date and annually on or before the 31st October thereafter, the Nelson Operator shall submit to the Nelson Group and the Howe Group the Howe Provisional Monthly Opex Sharing Tariff to apply to the subsequent Year calculated as follows:

Howe Provisional Monthly Opex sharing Tariff = $ENO \times HMT / ENT$

Where:

ENO equals the Nelson Operator's good faith best estimate of the Nelson Shared Opex for the Year in question (the "estimated Nelson Shared Opex")

ENT equals the Nelson Operator's good faith best estimate of the aggregate [REDACTED] to be processed through the Nelson System in the relevant Year (the "Estimated Nelson Throughput")

HMT equals one twelfth of the [REDACTED] for the Year in question

For the purpose of minimising the end of Year adjustment, the Nelson Operator shall on a Quarterly basis perform a manual reconciliation of the Howe Provisional Monthly Opex Sharing Tariff with the actual Howe Field share of the actual operating expenditure of the Nelson System for that Quarter to determine whether the Howe Provisional Monthly Opex Sharing Tariff for the remainder of that year requires revision. If the Nelson Operator in its sole discretion determines that a revision is required, the Nelson Operator shall provide the the Nelson Group and the Howe Group twenty (20) Working Days notice of a revision to the Howe Provisional Monthly Opex Sharing Tariff.

Not later than forty-five (45) Days after the end of each Year, the Nelson Operator shall send the Howe Operator an annual reconciliation statement containing the following calculations:

- a) the Howe share of the actual Nelson Shared Opex in Pounds (the "Howe Actual Opex Sharing Tariff") for that Year, according to the following formula:

Howe Actual Opex Sharing Tariff = $NO \times HT / NT$

Where:

NO equals the Nelson Shared Opex actually incurred for the Year in question

NT equals the aggregate throughput for all Users over the Nelson System of [REDACTED] in the relevant Year (the "Nelson Throughput")

HT equals the aggregate throughput over the Nelson System of Howe [REDACTED] for the Year in question (the "Howe Annual Throughput")

- b) the tariff paid, which shall be the total amount invoiced for the relevant Year in accordance with the Howe Provisional Monthly Opex Sharing Tariff calculations in Pounds (the "Tariff Paid")
- c) the tariff adjustment, which shall be the difference between the Howe Actual Opex Sharing Tariff and the Tariff Paid (the "Tariff Adjustment")

If the Tariff Adjustment is positive, the Tariff Adjustment shall be payable by the Howe Group to the Nelson Group as a further tariff payment in the next monthly invoice, and if the Tariff Adjustment is negative, the Nelson Operator shall credit in full the amount of the Tariff Adjustment in the next monthly invoice and, if the amount that would otherwise have been payable in respect of the next monthly invoice is insufficient to allow full set off of the Tariff Adjustment, in subsequent monthly invoices."

(end of new Clause [REDACTED])

Clause [REDACTED] should be deleted.

Schedule 4 shall be expanded to include the information in the Table below:

Date	Oil Prod stb/d	Water Prod stb/d	Gas Prod MMscfd
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

[REDACTED]

All the terms of the [REDACTED] have been reflected in the changes to [REDACTED] specified above.

[REDACTED]

The terms of this agreement should be applied in their entirety.

[REDACTED]

The terms of this agreement should be applied in their entirety.

5. [REDACTED]

The terms of this amendment should be applied in their entirety.

Annex 2 of Notice: Explanatory Note

Introduction

The Nelson Field was developed using a large processing platform and export pipelines to the Forties Pipeline System (for oil) and the SEGAL system (for gas). It started operation in February 1994 and achieved peak monthly production of around 166,000 barrels of oil per day nearly two years later. Reported monthly production levels during 2013 varied from around 8,000 to 15,700 barrels of oil per day (average 12,356), although this is associated with large volumes of water production (around 10 times the volume of oil). [REDACTED] wells were active at the end of 2013.

The Howe Field was developed as a subsea well with a pipeline to the Nelson platform where processing is carried out of the well fluids. It started operation in November 2004 and achieved peak monthly production of around 11,500 barrels of oil per day 8 months later. Reported monthly production levels during 2013 varied from 1,600 to 2,750 barrels of oil per day (average 2,213), with water production at 100 to 150 barrels per day.

The Bardolino Field was developed as a subsea well tied back to the Howe subsea facilities. It started operation in September 2010 and achieved peak monthly production of around 3,200 barrels of oil per day in the following month. Production subsequently declined sharply and reported monthly production levels during 2013 typically varied from around 200 to 800 barrels of oil per day (average 438), with similar quantities of water being produced.

Reference is made in the subsequent sections to the agreements governing the provision of services by Nelson to the Howe and Bardolino fields. These documents are:

[REDACTED]

The [REDACTED] was due to expire on 31 December 2012 but was extended to the end of 2013 with modified terms (and was subsequently extended to 31 March 2014 and again to 31 December 2014). It is the failure of the parties to reach agreement on a long term solution that is the cause of the current dispute and the application having been made to the Secretary of State by the Howe field owners. The Nelson owners have argued that the Howe owners should agree to pay a share of the relevant running costs of the Nelson platform, with the share based on the relative production of the field compared to the total production processed by the platform. This is termed 'cost share' or 'opex share'. On the other hand, the Howe owners have argued that they should continue with the terms of their previous agreement for a further period, whereby they paid a tariff per [REDACTED] to the Nelson owners for transportation and processing services, prior to a switch to cost share.

The [REDACTED] set the tariff as [REDACTED], escalated with oil price in US dollars in a linear fashion and referenced to a price of [REDACTED] (but subject to a 'floor' of \$13 per barrel). The tariff was reduced to [REDACTED] in the [REDACTED]

[REDACTED]. This change was introduced as a result of revised legislation that affected the post tax income received by the Nelson owners from the Howe business, and it was agreed that this benefit should be passed on to the Howe owners. The combined effect of the reduced base tariff and the escalation to current oil prices (October 2014) of US\$85 per barrel leads to a tariff of [REDACTED]. No clear explanation has been given by any party as to the basis for the original calculation of the tariff.

Legislative requirements

The legislation (Energy Act 2011) contains several requirements that should be followed when considering an application. These are summarised below:

S.82(6)(b) requires that a number of parties are given the opportunity to be heard. Each of the Nelson, Howe and Bardolino field owners were given this opportunity, although not all chose to be heard. Meetings were held with some of the parties, in some cases more than once. A number of the parties also made written submissions. The Health and Safety Executive confirmed that they did not wish to comment on the application, and that any health and safety implications arising from a notice would be assessed as part of a revised safety case for the Nelson platform if necessary. No other persons were identified who should have been offered the opportunity to be heard.

S.82(7) requires that a number of matters are taken into account (so far as relevant) when considering the application further:

- Capacity in the Nelson platform and pipelines is considered later
- The Nelson operator stated that the Howe field fluids have been processed on the Nelson platform since 2004 and there have not been any incompatibilities to date. No concerns on this matter have been raised by other parties
- No difficulties that cannot reasonably be overcome have been raised by any party
- The reasonable needs of the owners and any associates have been considered later
- The interests of all users and operators have been taken into account later, mainly in connection with capacity in the Nelson platform and pipelines
- The need to maintain security and regularity of supplies of petroleum is not considered to be a significant factor in this application
- There are several parties involved in the dispute and some have commercially conflicted positions. However, the process has ensured that the various parties have had the opportunity to be heard, and no further consideration has been thought necessary regarding the number involved.

S.82(8) requires that either the owner or an existing user does not suffer prejudice as a result of a notice (s.82(9)) or that provision is made for compensation of any party who suffers prejudice (s.82(10)). Information presented during consideration of the application suggests that the Nelson owners may suffer some prejudice as a

result of providing a service to the Howe Field. Compensation for this prejudice is discussed later.

DECC guidance

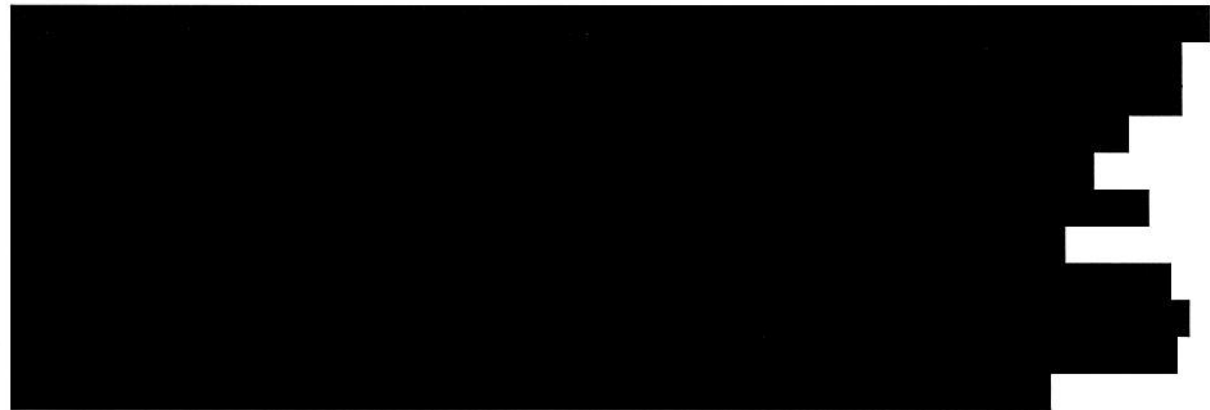
The legislation is supported by guidance published by DECC, entitled 'Guidance on Disputes over Third Party Access to Upstream Oil and Gas Infrastructure'. This guidance has been available for several years; the current version is dated 15 July 2013.

The maturity of the Nelson field and platform

Paragraph 53 of the DECC guidance sets out principles that cover some likely third party access scenarios. In considering which of the first three could apply to this situation, three questions arise:

1. Was the Nelson infrastructure built primarily for the exploitation of the Nelson field, or was there a view to taking third party business that was incorporated in the construction and subsequent modification?
2. If the answer to the first question is that the Nelson infrastructure was built primarily for the Nelson field, have the capital costs been recovered with a reasonable return?
3. Is the Nelson field at or near the end of its economic life?

No evidence has been presented to us that suggested that third party business was a significant factor in the development of the Nelson infrastructure. With regard to the second question, there has been no indication that capital costs for the Nelson development have not been recovered or that a reasonable return on investment has not been achieved.



Brief facts about the Nelson field are given in the Introduction. Future performance of the Nelson field and infrastructure is subject to some uncertainty as noted above. The lengthy production history (which forms an important input to forecasting), the diversity of well stock, and the separate and broadly consistent regulatory submissions to DECC over several years by the Nelson operator, lead us to believe that Nelson is more likely to last [redacted] than to cease production much earlier. [redacted]

However, we do not wish a situation to develop where an infrastructure owner could be left financially worse off as a result of third party business and so terms have been developed for the situation when the Nelson field becomes significantly less economic due to poor performance or external factors such as oil price. This is discussed later, along with the interpretation of 'at or near the end of economic life' for this case.

Capacity in Nelson

The fourth point of paragraph 53 of the DECC guidance states that an infrastructure owner should be able to benefit from competition for limited capacity. [REDACTED]

The fifth point of paragraph 53 of the DECC guidance requires that any terms should compensate the infrastructure owner for possible impacts on their own production. The published Infrastructure Code of Practice (ICoP) information for the Nelson platform (dated January 2014) shows that the spare capacity could be less than 5% in the following areas:

1. Gas compression
2. Gas export
3. Gas lift
4. Gas dehydration – as compression
5. Produced water handling
6. Water injection

The gas compressor on Nelson is used to raise the pressure of produced gas for several purposes, including gas injected in the Nelson wells to aid oil recovery (termed 'gas lift') and export of surplus gas into the SEGAL system. Provision is also made in the [REDACTED] for a small amount of gas to be made available for the gas lift in the Howe well, although it is understood that this has been required only infrequently (for starting up the field) to date. Information from the Nelson operator gave an estimate of the impact of Howe gas export on Nelson oil production, although this appears to vary considerably with operating conditions.

Provision was also made in the [REDACTED] for processing of water contained in the Howe well fluids, and this could impact upon the water injected into the Nelson field for the purposes of disposal. The figures quoted in the Introduction show that the volume of Howe water is currently negligible in comparison to the amount produced from the Nelson wells (1,000 times lower), although there is the potential for increases in the future. The [REDACTED] allows the Nelson operator to stop Howe production if the ratio of produced water to total fluids for Howe exceeds [REDACTED]%, and this provides a limit (when taken in conjunction with future production profiles) on the water handling capacity that Nelson would need to make available.

As a result of the conclusion reached above regarding the first three points of paragraph 53 of the DECC guidance, a tariff reflecting incremental costs and risks

appears to be appropriate. However, some of the Nelson owners suggested that a switch to cost-share is needed to maintain their confidence to make investments that could extend the life of the Nelson infrastructure and so possibly benefit the Howe field. This matter of the confidence to invest is now considered.

Confidence for further investment

The Nelson owners have been pursuing a number of infill drilling opportunities in the last two years, [REDACTED]

[REDACTED] Whilst a comparison of the relative risks of Nelson infill wells and [REDACTED] may not be valid, it is hard to argue that the Nelson owners have been lacking confidence recently to invest where they see a potential benefit to their production. [REDACTED]

Incremental costs and risks

In view of the lack of evidence for a negative impact on the confidence of the Nelson owners if Howe does not switch to cost share now, it is considered that a tariff reflecting incremental costs and risks is appropriate for now. Attempts have been made to quantify the incremental costs faced by the Nelson platform as a result of providing the existing services to the Howe field. The Nelson operator has stated that it is not possible to do this. [REDACTED]

With regard to incremental risks, [REDACTED]

The value of the tariff payments made by Howe using the original tariff formula with current oil prices and the 2013 average production rate would have been around [REDACTED]. This is similar in broad terms to the maximum impact estimated above; and

both figures are directly proportional to [REDACTED]. Use of the original tariff formula therefore appears to give an indication of the cost to Nelson of the incremental risks with a margin that would make allowance for the unknown incremental costs. The lack of knowledge of the incremental costs and the uncertainty associated with the production impact of Howe on Nelson makes setting a tariff difficult. As a result of the foregoing, however, it is considered that the tariff prior to 2013 should provide an upper bound to the incremental costs and risks of Howe on Nelson.

[REDACTED]

uncertainty

metering

Uncertainty (as distinct from bias) is random and can give advantage or disadvantage to either side.

[REDACTED]. In addition, our metering team have referenced published work indicating that, for two fields with different levels of metering uncertainty, the field with higher uncertainty is systematically under-allocated.

The Liabilities and Indemnities

[REDACTED] This appears to be a relatively balanced arrangement and does not suggest that any compensation is needed if these terms were used, nor has there been any representation from any party that these terms are inappropriate.

Taking account of the points discussed above, a tariff reflecting incremental costs and risks is judged to be approximately equal to that defined in the [REDACTED] prior to 2013. There is some uncertainty associated with this and the view could be reconsidered if the Nelson owners were able to provide better quantification of relevant costs and risks.

Howe production profile

The production profile for Howe that was included in the Application to the Secretary of State in September 2013 reflected the Business Plan 2011 figures (BP11) and ran to [REDACTED]. A revised profile was received in November 2013 reflecting the 2012 Business Plan figures (BP12); [REDACTED]

The legislation does not make any explicit provision for production profiles changing between "the access application" (i.e. information provided during negotiation) and the terms that are imposed through a notice, so our view is that the BP12 profile should not be incorporated in the terms. The Application to the Secretary of State did

not specify explicitly when the period to be covered by any notice should start, and given the uncertainty associated with the time taken for consideration, it was not within the knowledge of the Applicant to request this with confidence. In the event the process has taken more than one year to complete. This leaves uncertainty about the way in which the expected production quantity for 2014 should be handled, in view of the fact that this was covered by short-term agreements between the Nelson owners and the Howe owners. Consideration has been given to deferral of the BP11 profile by one year to take account of the lengthy consideration of the Application, or to carrying out some form of reconciliation of the 2014 production quantity against the terms contained in the Notice. However, the simplest approach is considered to be to continue the BP11 profile from 2015 onwards, ignoring the 2014 production quantity [REDACTED]

Cost escalation

The use of oil price in dollars as the basis for escalating the tariff over the lifetime of the Howe Field to date appears to have reflected the general escalation in both capital and operating costs fairly well, according to IHS data. As the main influence on the proposed tariff is the estimated production impact of Howe on Nelson (which is proportional to oil price), escalation with oil price appears to be justified in general.

With regard to the terms for the future, it is noted that the Nelson costs are likely to be incurred in pounds. An adjustment to the current escalation formula therefore appears appropriate, to ensure that the base tariff is escalated in line with the oil price in pounds. This will provide closer linkage between the value in sterling of the Howe production and the tariff paid.

Send or Pay

Compensation given to the Nelson owners

The existing agreement contains a term that required the Howe owners to give [REDACTED] of the first [REDACTED] that were originally produced by the Howe field to the Nelson owners. Some parties have suggested that this payment was intended to compensate for shut-down of the Nelson field while modification work for the Howe field was being undertaken, or for some measure of ongoing production impact ('back-out') on Nelson as a result of Howe. Both explanations are plausible, but no conclusive evidence of the reasoning behind this payment has been produced by any party. In view of the production impact of Howe on Nelson having been taken

into account separately, there does not appear to be any justification for repeating this payment.

Allowance for gas for Howe gas lift

Information from the Nelson operator states that the provision of gas lift for Howe (up to [REDACTED] million standard cubic feet per day is specified in the [REDACTED]. This gas is provided [REDACTED] according to the [REDACTED], although it is understood that it has only been required infrequently to date. The incremental cost and risk approach described here means that the impact on Nelson production would need to be explicitly covered by the Howe owners if gas lift became necessary at some future time. A term has therefore been included to allow for the Nelson owners to charge the Howe owners to cover the actual production impact on the Nelson production in the event that gas lift is needed for the Howe Field. It is considered that there is well-known information about the characteristics of the Nelson Field and facilities that should allow any such charge to be justified to the Howe owners without disagreement, but a Variation to the Notice could be sought under section 85(2) of the Energy Act 2011 to provide further clarification if necessary.

Termination rights

[REDACTED]

In view of the concerns expressed by some of the Nelson owners regarding [REDACTED], it is considered that these terms should remain for Nelson. In view of the [REDACTED] assumed incremental costs of accommodating Howe production on Nelson and the fact that the risks are production-related, there does not appear to be a disadvantage to Nelson if these terms also remain for Howe.

The existing [REDACTED]

In the foregoing sections, a number of terms from the Howe TPOSA have been discussed and these have generally been found to be relevant in the consideration of the application. In particular, the use of the tariff arrangement that existed prior to 2013 is considered appropriate. The Howe TPOSA is therefore assumed to form the basis of the terms that we propose to set, subject to [REDACTED] the impact of

providing [REDACTED] if this is needed, and a defined switch to a cost sharing arrangement described below.

Cost-share considerations

The third bullet point of paragraph 53 of the DECC guidance states that, for infrastructure associated with a field at or near the end of its economic life, tariffs may need to be set above incremental costs to ensure that it is maintained and remains available for third party use.

The reasoning behind this section of the guidance is that an earlier switch to a cost or opex sharing arrangement for a third party field is likely to lead to an earlier cessation of production for that field. This is likely to lead to less recovery from the field. On the assumption that the field associated with the host infrastructure outlives the third party field, it appears unlikely that increased contributions made by the third party a few years earlier under a cost share arrangement are going to help the host in the year that it becomes uneconomic. Should circumstances change and the field associated with the host infrastructure become economically challenged before the third party field reaches that point, there is a clear advantage to both fields if the third party field can contribute more. It is therefore considered important that any proposed terms should seek to maximise the economic recovery from both fields whilst taking account of the uncertainties regarding future performance.

Cost-share at Nelson

Some of the Nelson owners have suggested that a switch to cost-share arrangements during the late life of fields represents an approach where the parties are 'all in it together'. This is true when it comes to paying the bills, but the third parties (at least the non-conflicted ones) have no say over the scope and priority of work that is carried out on the Nelson facilities and infrastructure that could affect the Howe field. The Howe owners have argued conversely that a cost-share approach based on throughput alone does not take account of the fact that Howe makes little or no demands on some of the facilities on the Nelson platform. A further point in connection with a cost-share approach is that there is an incentive not to drill further wells, as the parties undertaking such activity will face a larger share of the operating costs if successful. The strength of this (dis)incentive will depend on a number of factors but could work against maximising economic recovery.

In order to help consideration of other factors that might influence the time of the switch to cost-share, the Nelson owners were asked if there were decisions that might be made some time before cessation of production that might hasten the end of the Nelson field or infrastructure. This could include 'downsizing' or partially decommissioning parts of the plant that might be difficult or impossible to reverse later, and might be carried out in the absence of an increased contribution to running costs from Howe. No information was received from the Nelson owners to suggest that such decisions might be made some time before cessation of production from Nelson that would have an adverse impact on Howe.

The wording of the third bullet point of paragraph 53 of the DECC guidance describes a situation where infrastructure is associated with a field at or near the end of its economic life. It will be clear when a field is **at** the end of its economic life, but there is less certainty about the time when it is **near** the end of its economic life.

Meetings and communications with the Nelson owners have been used to seek information to help a decision about what might constitute a time that is near to the end of the economic life of Nelson. No indication has been given by the Nelson owners that any actions would be undertaken in the next few years that would help to extend the life of both Nelson and Howe should Howe switch to cost-share now, other than increased confidence to invest as discussed earlier. The request to the Nelson owners to describe late-life decisions that could have an adverse impact on Howe in the absence of cost-share (as discussed in the previous paragraph) did not yield any information.

The foregoing points do not give any evidence to suggest that moving Howe to cost-share now will help to maximise economic recovery from Nelson and Howe, and there is the possibility that such a course would in fact lead to earlier cessation of production of Howe. This suggests that the switch to cost-share should take place at a late stage in this situation, i.e. 'near the end of economic life of Nelson' is close to 'at the end of economic life'.

It is therefore proposed that a term would be included that allows the Nelson owners to switch to an 'opex sharing tariff' along the lines of the arrangements described in [REDACTED]. For consistency with the DECC guidance and the points above, the switch can take place only at a point when the Nelson owners can demonstrate that an increased contribution is required from the Howe owners, without which the Nelson System is likely to become uneconomic. In order to avoid additional calculations, it is proposed that the results from the assessment carried out for the Decommissioning Security Agreement should be used. A zero or negative value of the sum of the Net Value terms, discounted as indicated in the DSA, for the remaining years would give a clear indication that the Nelson system needed an increased contribution. The calculations are checked periodically by an expert and this should give confidence to the Howe owners that the switch to cost-share was happening at the appropriate time. No need is therefore seen to give the Howe owners the right for expert referral on this matter

Subsequent to the switch to an opex sharing tariff, there is the possibility that Nelson requires (and Howe can provide) a larger contribution to operating costs. This suggests that a further term is needed regarding termination. The term in the [REDACTED] dealing with [REDACTED] to Nelson (summarised above under 'Termination Rights') can form a model for this situation, whereby the parties seek to agree a basis for continuing operation. Should Nelson decline at a faster rate than Howe over the next few years, a term of this nature might allow both fields to continue in production for a longer period than otherwise and so help to maximise recovery.

[REDACTED]

Without such agreement, the matter can be referred for Expert determination.



Publication of the terms of the Notice

It is envisaged that a summary of the Notice will be prepared in the same format that is described in Annex G of the Infrastructure Code of Practice for completed negotiations. In accordance with section 86(3) of the Energy Act 2011, relevant parties will be offered the opportunity to be heard before publishing the summary on the 'Oil and gas: infrastructure' page of the gov.uk web site.

