



Department for
Energy Security
& Net Zero

Establishing the offshore decommissioning regime for CO₂ transport and storage networks

Update to government response to
consultation



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Introduction

In August 2021, the government consulted¹ on its plans to establish an offshore decommissioning regime for CO₂ transport and storage networks. It outlined the government's proposal to create a funded decommissioning regime to ensure CO₂ transport and storage companies (T&SCos) accumulate sufficient funds to manage their decommissioning liabilities when decommissioning is due.

The consultation covered the fundamental design proposals for the decommissioning funds, including their scope, their mechanism for accruing capital, how they would be managed and how they would be drawn on to pay for decommissioning and post-closure obligations. The consultation also outlined how regulatory authorities would interact with the fund. For example, it included proposals for the role the Offshore Petroleum Regulator for the Environment and Decommissioning (OPRED) would play in supporting the development of decommissioning estimates, approving decommissioning plans, assessing the need for financial securities, and instructing the release of funds. It also described the role government envisaged for an economic regulator to assess the performance of the funds over time, and to make the necessary interventions to ensure the fund would reach its target value on schedule.

Responses to this consultation predominantly came from industry and trade associations and were broadly supportive of government's proposals. Government took on board suggestions where those suggestions were advanced by a majority of the respondents and where those suggestions supported or enhanced the design of the funded decommissioning regime. These details were set out in the government response to the consultation, published in January 2022².

This update builds on the government response, and is envisaged to be read as an accompaniment to that publication. In particular it provides clarity on some aspects of the decommissioning regime that have not been previously addressed and which were raised by respondents to the consultation. This includes describing the methodology for evaluating the decommissioning estimate, providing clarity on the management of onshore decommissioning funds and how decommissioning funds for shared infrastructure will be handled. This update also provides more detailed information about aspects of the decommissioning regime that have emerged as other policy positions have matured and settled. This includes information about the role investment funds can play to support decommissioning funds, where the risk of a shortfall or a windfall in the funds should be allocated in different scenario, and the treatment of re-purposed assets in scenarios where Change of Use Relief is not sought.

All the policy positions and proposals set out in this update document, alongside those previously outlined in the consultation and government response, are subject to the Energy Bill

^{1, 2} <https://www.gov.uk/government/consultations/carbon-capture-usage-and-storage-ccus-offshore-decommissioning-regime-for-co2-transport-and-storage>

2022³ being passed by Parliament and the requisite secondary legislation that will sit under this.

As set out in the original consultation, the policy positions and proposals set out in this update will apply UK-wide. However, the government will work with the relevant devolved administrations to ensure that these take account of devolved responsibilities and policies across the UK.

³ [Energy Bill 2022](#)

Chapter 1: Scope of a funded decommissioning regime

Background

As outlined in the government's consultation and response, the decommissioning funds will accrue for the expected offshore decommissioning and post-closure costs associated with the CCUS networks. The consultation made clear that this included three categories of obligations:

- The decommissioning of infrastructure and plugging and abandoning of wells.
- The post-decommissioning monitoring obligations.
- The contribution to the government for ongoing monitoring as part of the licence termination process.

The elements of the decommissioning funds that relate to the Petroleum Act 1998 (as amended) will be supervised by OPRED. The elements of the fund that meet requirements under the Storage of Carbon Dioxide (Licensing etc.) Regulations 2010 and the Storage of Carbon Dioxide (Termination of Licenses) Regulations 2011 will be supervised by the NSTA. However, both regulators will work closely with each other to ensure the funds accrue appropriately and efficiently.

The decommissioning funds will not accrue to cover unexpected costs, for example remediation costs due to a leakage event. There was strong agreement with this position, and this was confirmed as part of the government's response. These costs are expected to be covered through other means, such as commercial insurance.

Additional elements of the decommissioning funds

As part of the ongoing development of the wider T&S business model, the government has identified two further categories of expected costs which it deems sensible to include within the decommissioning funds. These are as follows:

- Post-closure financial security costs – the costs associated with taking financial security (for example commercial insurance premiums) against the impact of events that might occur in the post-operational phase, such as a leakage event.
- Supplementary Compensation Agreement (SCA) charges – charges for access to the SCA during the post-operational phase. The SCA will likely mirror commercial insurance coverage and is there to cover the risk of Leakage of CO₂, where the T&SCo or a post-operations successor entity, is unable to bear costs associated with Leakage of CO₂.

The government judges the inclusion of these two additional buckets of costs to be right because such costs will be incurred by the T&SCo after revenue has ceased to be generated.

Their inclusion within the decommissioning fund, to be accrued over the operational period of the network, places these costs on a secure footing and better ensures money will be available at the time they are required. Reference to the decommissioning funds throughout the rest of this document include these additional elements. Appropriate accounting separation will be expected in order to differentiate these different elements within the accruing decommissioning funds.

The government's response also outlined that it would continue to examine the treatment of onshore decommissioning to ensure clarity and coherence with the rest of the regulated regime. After careful consideration, the government has decided that the decommissioning funds will also accrue for decommissioning costs associated with onshore infrastructure. However, given the different regulatory landscape onshore, the accrual of money to cover onshore decommissioning liabilities will operate somewhat differently to offshore. This is outlined in greater detail in Chapter 7.

Chapter 2: Estimating the decommissioning liability

Background

As outlined in the government's consultation, the obligation to decommission, and the associated costs of this activity, are the responsibility of the T&SCo. This is established in law, for example under the Petroleum Act 1998 (PA 1998), and the Energy Act 2008 which set out that Part IV of the Petroleum Act 1998 applies to offshore carbon storage installations.

The CCUS decommissioning regime is designed to ensure that CCUS operators fulfil their decommissioning obligations and to protect the taxpayer from the risk that any of the liabilities are passed on to them. OPRED will help achieve this by supporting the operators in the preparation of proposals for the necessary decommissioning activities and approving their decommissioning programmes.

Process

To help inform OPRED of the decommissioning costs, T&SCos will be expected to provide a detailed Work Breakdown Structure (WBS) that will entail breakdown of decommissioning activities and the associated costs for each activity. As much as possible, OPRED will look to replicate the existing standard WBS template which is currently used in the oil and gas (O&G) industry. OPRED has initiated engagement with industry and is looking forward to developing a suitable template with them.

The process of agreeing the decommissioning cost estimates would involve OPRED liaising with the T&SCo and working closely with NSTA. This will better ensure the resulting costs estimates are robust, efficient, and fair. The government also envisions that, where helpful, OPRED may engage third party expertise to further bolster this outcome. This is the same procedure which OPRED currently uses when assessing decommissioning cost estimates for O&G projects.

In addition to the estimates for decommissioning and post-closure monitoring costs, the estimated costs of the charges for post-closure financial security and the SCA will be benchmarked off initial policies by DESNZ and the regulators, which will then be reviewed over time.

Once the decommissioning cost estimates are agreed, this will form the target which the decommissioning funds will need to accrue over the operational life of the CCUS network. As outlined in the consultation, a contingency will then be added to the estimate as is standard practice. This is to account for unpredictable conditions at the time decommissioning activities are due to take place which might significantly impact the cost of performing those activities,

for example oil prices. To be clear, this contingency will not cover other unexpected items of cost, as outlined in Chapter 1. The government will continue to work through what an appropriate level of contingency to expect, building on OPRED's existing policy and balancing the desire to adequately cover unpredictable events with the desire to maintain efficient costs for emitters.

Once a T&SCo has verified their decommissioning cost estimates with OPRED, the T&SCo will then pass the estimates on to Ofgem. It will then be included in the calculation of the decommissioning building block, which in turn will form part of the allowed revenue calculation. It is through this mechanism that emitters will contribute towards the decommissioning costs of the network, and the decommissioning funds will accrue over time. Where re-purposed assets are incorporated in the CCUS network, there will also be a requirement for an upfront top-up into the fund, discussed further in Chapter 9.

Role of the periodic reviews

As outlined in the consultation, OPRED will carry out periodic assessments of the decommissioning costs to ensure the cost figures remain appropriate and reasonable. The government judges these to be necessary in order to ensure the decommissioning funds continue to accrue sufficient capital at the rate expected to cover the decommissioning liability, and that it will continue to do so over the next review period. The assessment of the accrual rate will also need to take into account the performance of the approved investment strategy. This is discussed in further detail in Chapter 4. Finally, these periodic reviews will also cover the estimated costs associated with the post-closure financial security and SCA charges, which could vary over time as the market develops.

But these reviews will also enable additional information to be included in the assessments, particularly as the time to decommissioning will reduce, improving the availability of data and accuracy of forecasting. OPRED will also continue to have its financial assessment and assurance process to determine the need for any additional financial security that may be required, in the same way it currently does for O&G decommissioning. This is separate to any financial security required by the NSTA under the storage licence. Both OPRED and the NSTA will have regard for the decommissioning funds when making their assessments.

Chapter 3: Accrual metric for decommissioning funds

Background

The consultation set out the government's proposal that the decommissioning funds would accrue on a straight-line basis as the default mechanism (excluding any initial top-ups which might be required for re-purposed assets, discussed further in Chapter 9). The rationale was that it struck a good balance between fairness to users and offering simplicity and certainty in the expected growth of the fund. However, the consultation recognised that there may be scope to adapt this profile to better match the characteristics of the store or the nature of the T&SCo's plans, such as reflecting the expected ramp-up to throughput.

Responses to the consultation were broadly in agreement with the government's proposal. However, there were a number of respondents who highlighted concerns that straight-line accrual would disproportionately impact early users, and therefore not be fair. These respondents generally believed that a metric which linked to stored volumes of CO₂ would be a better approach. The government's response recognised these views and committed to consider the issue further.

Analysis

To consider this further, the government has looked at three different metrics that might be used and assessed the different implications these might have. These metrics include:

- Volumetric (flow) – the decommissioning funds would accrue based on the forecast volumes of CO₂ expected to be transported and stored in a given period (e.g. each year). This would therefore change to reflect ramp-up of transport capacity and usage over the network's life. Users would then be charged a rate per MtCO₂ transported.
- Capacity (system or booked) – the decommissioning funds would accrue based on the expected injection capacity per year or the expected booked injection capacity per year. The required funding will then be apportioned to users based on connection size or booked capacity.
- Time-based / straight-line – as per the consultation proposal, the total decommissioning costs would be averaged out over the expected operational life of the network (or potentially a shorter period to allow for a safety tail, though in practice this would be the same as adding a contingency to the estimated cost). The required accrual will then be charged proportionately on each user in that given period (e.g. each year) based on booked capacity or connection size.

The work found that the volumetric approach best tracks the activity of the users, and therefore would deliver a more precise outcome in terms of charges over time. To a lesser extent, this is

also true of the capacity options. Of the two capacity options themselves, booked capacity is likely to be higher than the amount of CO₂ captured by each user, as actual volumes are likely to fluctuate, particularly for power emitters. However, it could be argued that this is the emitters' own anticipated requirement, and therefore a fairer way of charging each one for the decommissioning costs of the network.

The analysis demonstrated that the drawback to all of these options is their complexity and their reliance on forecasting. The volumetric approach requires estimating the total volumes expected to be captured and stored over the network's operational life in order to average out costs per given tonne. If a network fails to capture and store the expected volumes of CO₂ over its operational life then there will be a shortfall in the accrual of the decommissioning fund unless the operational life of the network is extended, which in turn hinges on the expectation that emitters will be readily available in the longer-term. Corrections to the accrual at review periods will help account for this, though not in the final period, where the contingency in the fund would need to step in. But this would leave the decommissioning funds susceptible to shortfall risk post-injection.

Similarly, capacity would require confidence in both the expected injection capacity and the total volume it is expected the store to be able to hold, in order to then determine cost per tonne of capacity. If it transpires that a store has a different capacity than originally expected there will need to be an adjustment in the accrual rate. An overestimation would result in upward revision, disproportionately impacting later users. An underestimation would result in a downward revision disproportionately impacting earlier users.

As outlined, a straight-line accrual would carry a disproportionate effect for early users. Taking a scenario of £150m decommissioning costs, straight-line over 25 years, and for an infrastructure asset that will take four years to reach operational capacity, decommissioning costs would be £6m every year with straight-line accrual. This compares to a ramping to c.£6.5m through to 2030 under a volumetric approach (e.g. £1m, £2m, £4.5m, and then £6.5m p/a thereafter). This clearly demonstrates the disproportionate impact that respondents highlighted.

However, it is worth noting that under the proposed charging methodology, users will be protected from excess charges through the proposed mutualisation cap, following which any shortfall remaining between allowed revenue and mutualised charges will be addressed by Revenue Support. Mutualisation, a common practice in networks such as these, will see a reasonable socialisation of costs in excess of a user's proportionate use of system charges up to the UK carbon price. Under this approach, users may not bear the full extent of the increased decommissioning cost in the early years. Straight-line accrual would also result in lower costs for later users, as there has been a slight front-loading of the decommissioning funds. Furthermore, this front-loading of the decommissioning funds would also slightly reduce the shortfall risk in the funds, benefitting both the T&SCOs who would hold this risk, and the taxpayer who ultimately act as the decommissioner of last resort.

Importantly, the modelling also demonstrated that a straight-line approach would require less longer-term forecasting and would only depend on the expected operational life of the network.

This would provide greater certainty on the accrual of the decommissioning funds and help simplify this part of the TRI model.

Outcome

Based on the findings of this additional analysis, the government continues to view the straight-line accrual metric as the right approach for the regular, periodic accrual of the decommissioning funds. This is because the greater levels of certainty and simplicity offered by the metric outweigh the higher levels of precision offered by the other options in the early years, particularly as these are only expected to last for a short period. Wider support for CCUS should help mitigate the disproportionate impacts on early emitters, and the slight front-loading of the fund delivered through the straight-line metric mean slightly lower relative costs for emitters over the remainder of the operational period and a slight reduction in shortfall risk in the funds themselves.

Scope of accrual

The work undertaken by government also found a related issue around the scope of what the decommissioning funds would accrue for. Because of the different potential phases of expansion of a network, there is a choice between accruing for the current volume/capacity/liability at any given point, or to accrue for the forecast state of the network assuming its expansions are undertaken as planned.

Accruing decommissioning funds in line with the existing state of the network would arguably be fairer to current users, as they only pay for what they're using. Furthermore, under a straight-line accrual profile, accruing decommissioning funds based on the anticipated state of the network would result in disproportionately higher costs on early users to bring down costs for later users.

Only under a volumetric accrual profile would accruing based on the anticipated state of the network resulted in lower charges for early users of the network. However, this would also increase shortfall risk in the event any of the planned expansions do not go ahead.

Based on the government's decision on taking forward a straight-line accrual profile, and the increased risk of shortfall in the alternative, it is the government's strong view that the accrual of the decommissioning funds should only be based on the existing nature of the networks at any given time. Amendments to the accrual will only be brought in when expansions (or other changes) to the networks occur, likely at review periods.

Chapter 4: Investment of the decommissioning funds

Background

The consultation set out the government's rationale for recommending that capital accrued in a decommissioning fund should be invested to further support the accrual of the fund. This rationale included the need to mitigate the impacts of inflation and to ease the burden on the emitters to contribute towards the total decommissioning liability of the network. The consultation also recognised the inherent risks of investing capital and suggested that this risk could be managed if appropriate conditions were imposed on the sectors and products that were available to invest in.

Respondents to the consultation mostly agreed with the government's outline and stressed the need to minimise the risk to investors. Their responses helped crystallise some key questions which the government committed to addressing. These items are discussed below.

The level of centralisation / localisation for investment funds

The government has considered the benefits and disbenefits of allowing investment funds to pool across a T&SCo's portfolio of decommissioning funds, and again across all decommissioning funds. The key question was to understand if the economies of scale, provided by pooling funds would provide a safer opportunity to secure returns that would benefit the decommissioning funds; and if so, did that opportunity outweigh the disbenefits of pooling risk.

Where funds are pooled, the cost of fund management as a proportion of the assets under management is reduced, leading to improved efficiency of management costs. This is particularly pronounced when funds are relatively new and investing with less capital. However, this benefit is likely to significantly diminish over time as funds grow. Alongside this, there is limited evidence to suggest that pooling of assets into a consolidated fund increases the investment returns available to the fund. Therefore, so long as a fund is large enough to be fully diversified, the pooling of assets would not lead to a better theoretical return than the targeted rate of return.

Where a single T&SCo operates a number of CO₂ stores and has a substantial level of shared assets used to operate the business, then there may be stronger arguments for sharing the costs of decommissioning across the customer base of the T&SCo. However, even this scenario would require additional accounting to establish the entry price of the assets and the proportion of value at a given time. This would require closer oversight and more regular reviews for there to be confidence that the performance of individual decommissioning funds

can be measured fairly, which would increase complexity in the operation and regulation of the funds.

The pooling of decommissioning investment funds requires the pooling of risk. This could enable fund managers to use surplus assets associated with one T&SCo to subsidise shortfalls among other asset bases. This raises a number of challenges to the principles of fair, reasonable and proportionate charges being faced by T&SCo emitters. This, in turn, could lead to further complications including how the cause of funding shortfalls in a particular decommissioning fund are determined, or exposing the emitter base of one T&SCo to the losses driven by the activity of another T&SCo to which they have no connection.

Ultimately, the government takes the view that pooling investment funds across a T&SCo and nationally is likely to substantially increase the complexity of the management of the funds, leading to additional costs and uncertainty. On top of this, pooling funds and risk muddies the process for fairly evaluating the performance of individual funds. It may also complicate future changes in ownership for particular storage sites which the funds support. Therefore, the intention is that individual investment funds are directly affiliated with individual decommissioning funds.

The proportion of funds available for investment

Respondents to the consultation were clear that investment strategies that used capital from a decommissioning fund should seek principally to protect the value that has accrued in the fund. However, the government would prefer to limit additional requirements on investment managers that might constrain the ability of the investment fund to deliver meaningful returns. As such, it is the government's view that the entirety of the decommissioning fund should be made available to investment managers. The government does not judge the risk to be sufficient to curtail the usage of portions of the decommissioning funds as is the case in other decommissioning regimes. This approach will also help maximise the efficient usage of the accrued funds.

Investment framework

Respondents to the consultation showed a strong preference that investment of the decommissioning funds should be seen as a way to mitigate the effects of inflation on the funds' value. There was a clear emphasis that investment strategies should be relatively conservative and risk adverse. Accrual of the decommissioning funds will influence the regulated charges that will be levied onto users of the network. Therefore, it is important that the investment of these funds balances the competing challenges of reducing the cost burden on users, maintaining the real value of the funds over time and reducing the risk of loss of accrued capital.

The government's view is that T&SCos will be required to submit an investment strategy to Ofgem for approval which seeks to achieve this balance of objectives, and outlines how this

investment plan will be executed and managed. Though the requirement to have the decommissioning funds invested in accordance with the approved investment strategy will be the responsibility of the T&SCo, the government is open to considering different models for the development and execution of the investment strategy, including through professional third-party providers, in line with feedback to the consultation.

To support this requirement on T&SCos, the government believes it is right to set out a framework around which the investment strategy will be devised. Such a framework will also help support the regulators assess whether the proposed investment strategy will deliver its objectives. With this in mind, the proposed framework for investment of CCUS decommissioning funds is as follows:

- The investment strategy must cover the network's lifetime, though this will be periodically reviewed alongside other elements of the funded decommissioning regime (for example the cost estimates).
- This investment strategy will need to be approved by Ofgem. The approval framework will acknowledge the inherent uncertainty in setting long term investment plans and will be developed to support flexibility and adaptation to changing circumstances.
- The decommissioning building block of the allowed revenue will be calculated based on the fund accrual profile and the approved investment strategy.
- T&SCo will be required to provide regular updates on the performance of the investment funds and evidence that investments were made in line with the approved investment strategy.
- A shortfall resulting from a lower-than-expected return on investment may be covered by additional allowed revenue if the Economic Regulator is satisfied the agreed investment strategy was followed. It is intended that T&SCo investors will only be exposed to shortfalls due to lower returns where T&SCo is found to have been remiss in undertaking the approved investment strategy.
- Any upside occurring as a result of the investment strategy during the operations period may be used to reduce the future contributions to the decommissioning funds from the user base.
- The investment strategy and the mechanisms put in place for its execution should not undermine ring-fencing and insolvency protection, discussed further in Chapter 5.

This proposed framework would place responsibility for proposal of, and adherence to, a prudent and effective decommissioning strategy on T&SCo, rather than on government or regulators, while affording greater autonomy to T&SCo to achieve the strategy in uncertain and dynamic market conditions.

The government recognises it will need to provide some guiding principles for the development of a prudent investment strategy and clarity on how Ofgem will approve these. The government will provide further guidance on the detail of this framework, the expectations for a prudent investment strategy, the approvals process and where these requirements will sit in due course.

Chapter 5: Holding arrangements for decommissioning funds

Background

The consultation set out the government's proposals for ensuring that the decommissioning funds would be adequately safeguarded and only used for their specific purpose. These proposals were framed around access to the decommissioning funds and conditions on withdrawal, and respondents were predominantly in favour of these.

As part of this, some respondents noted an expectation that a trust or escrow mechanism would be utilised to deliver the desired safeguarding of the decommissioning funds. In response to this, the government has considered further what holding arrangement would be appropriate to provide T&SCos with greater clarity on expectations.

This consideration has included an analysis of the advantages and disadvantages of the outcome provided by each of the options, as judged against a list of criteria the government would expect to be met, for example adequate ringfencing of the decommissioning fund. These options are the decommissioning funds held in trust, held in an escrow account and held in a secured cash account. Some of the primary elements of this are set out below.

Implications of different approaches

There are four main implications identified:

- Burden – The government is seeking to minimise burdens on industry where possible. As such, a trust mechanism may be more burdensome to establish and maintain compared to an escrow account. This is due to the need to find suitable trustees.
- Cost – The government would seek to minimise the cost created by implementation of this funded decommissioning regime. Again, a trust approach may carry a higher administrative cost compared to an escrow approach.
- Insolvency risk – The government requires that decommissioning funds are protected against insolvency risk. This could be delivered through a trust, but the same may not be said for an escrow approach or other secured cash account.
- Consistency – The government requires that the funded decommissioning regime is consistent with the wider design of the Transport and Storage Regulatory Investment (TRI) model. The government would lack a locus upon which to take security on a cash account. Furthermore, doing so would run the risk of being inconsistent with the intended model being devised for the TRI model.

Outcome

As demonstrated above, the analysis undertaken has identified both advantages and disadvantages of the options. However, the government understands that the scale of these advantages and disadvantages may differ between T&SCos. For example, respondents to the consultation noted that some T&SCos may have the expertise to set up decommissioning funds whereas others might not and therefore would need to outsource this function, likely raising costs.

Given this, the government has decided not to dictate one mechanism that should be used for the decommissioning funds. Instead, the government proposes enabling T&SCos to choose for themselves which mechanism they would prefer to utilise for their networks, so long as they can demonstrate to the regulator that a set list of criteria have been met, and the regulator approves the holding arrangements. Further detail on potential fund mechanisms and criteria to be met will be set out in regulations or guidance, but are likely to include:

- Appropriate ringfencing and restricted access
- Facilitation of investment of the decommissioning funds
- Sufficient regulatory oversight and withdrawal approval mechanism
- Adequate protection against insolvency
- Cost efficiency

Despite the desire to keep this aspect of the funded decommissioning regime relatively open, the government recognises that new information may come to light as T&SCos assess the different options. As such, the government will keep this area under review, and reserve the right to require more specific criteria in regulations or guidance.

Chapter 6: Shared infrastructure

Background

The consultation set out that each storage site and associated transport network would have its own decommissioning fund. Where networks are self-contained, covering the full transport and storage chain, this model envisaged a simple arrangement where the storage licence holder of the assets that comprise that network would be responsible for capitalising the associated decommissioning funds.

However, respondents raised the question about how shared infrastructure would be treated in this funding arrangement and the government committed to considering this further.

Shared assets within a T&SCo's network

As each storage site will have its own decommissioning fund, even when owned by the same entity, a shared asset is any that serves multiple storage sites, either in the transportation of CO₂ to those sites, or in some other supportive function. Figure 1 below provides an illustrative example of a trunk line (red) and platform (P) which serve two storage sites and are therefore shared assets of those sites.

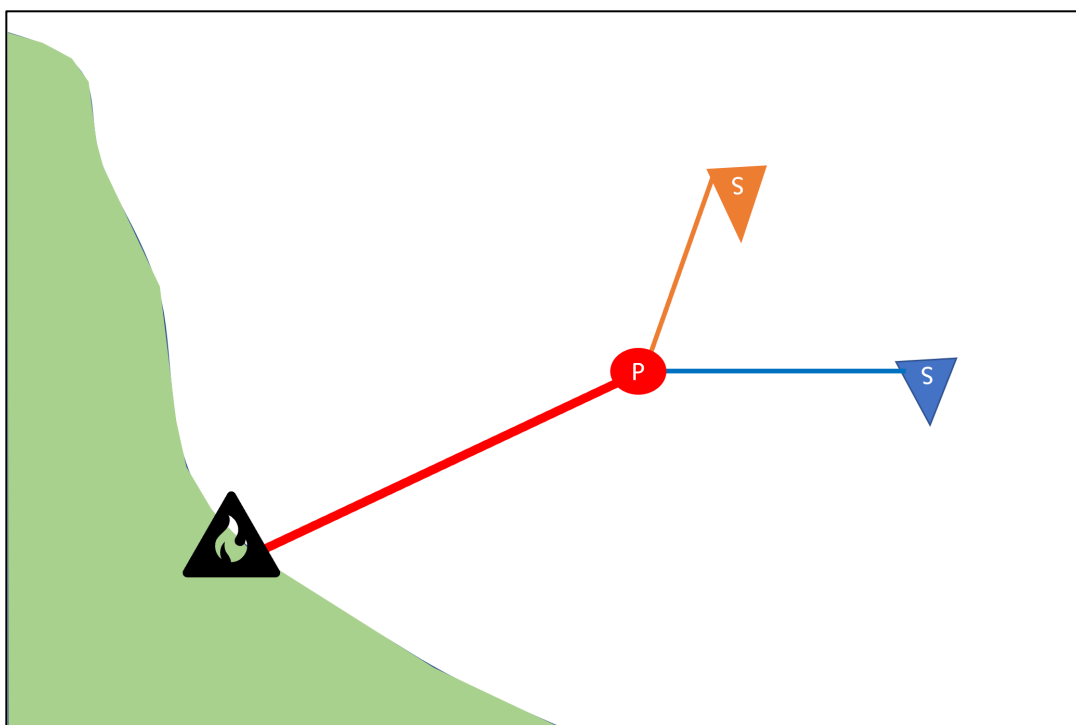


Figure 1: Indicative network comprising a shared trunk pipeline (red) and platform (P) supporting two separate storage sites (S).

In this scenario, both storage sites will have established distinct decommissioning funds to cover the decommissioning costs of their transport and storage infrastructure. The joint asset will serve multiple storage sites, so funds to cover its decommissioning liability can be raised through one of two options.

Under this scenario, the government envisages that the liability for decommissioning the shared asset will be split across the different decommissioning funds. The apportionment of the liability would need to be agreed between the T&SCo and OPRED as part of agreeing the decommissioning estimate and agreeing the liabilities which each fund will aim to accrue. In addition, each decommissioning fund would need to ensure there is appropriate accounting separation to enable identification of the funds associated with the shared asset.

As part of the agreement on apportioning the liability between decommissioning funds, T&SCos and OPRED will need to consider wider implications of sharing an asset. For example, if one of the storage site's operational life is expected to be significantly shorter than the other, both parties will need to agree the timeframe for the decommissioning of the shared assets. This might require the decommissioning funds to remain in place for longer, or for the liability to sit entirely within the fund of the storage site with the longer expected lifetime.

Shared assets for multiple T&SCos

The government foresees the potential for the development of more complex T&S networks in the future than the scenario described above. This will inevitably lead to asset sharing between different T&SCos and also between specialist transport companies (TCos) and storage companies (SCos).

Though these more complex permutations will likely require more complex treatment of the decommissioning liabilities across multiple funds and licence holders, the government recognises that they will also carry wider implications for the T&S business model, for example of the funding flow between companies. As such, the government will consider the decommissioning implications of these other potential network permutations in due course, as part of further work on their implications for the T&S business model as a whole.

Chapter 7: Management of onshore decommissioning liabilities

Background

The consultation highlighted that there are additional regulations underpinning activity relating to decommissioning of onshore infrastructure (e.g. the Town and Country Planning Act 1990). This means that there are clear distinctions between the underlying legislative framework and regulations relating to onshore and offshore decommissioning. There are therefore differences in how the requirements relating to the decommissioning activities are determined for each of these, and hence the government recognised that different provisions might need to be put in place to meet these. As such, the government considered it more appropriate to separate out the treatment of the different sets of decommissioning liabilities.

Though these costs will be treated separately, they will still constitute part of the decommissioning liability associated with the T&S network. As such, they will still be recoverable via the economic model, and specifically through the decommissioning building block of the allowed revenue formula. The only difference would be the flexibility for how this onshore portion would be managed to meet the specific requirements.

Respondents to the consultation were supportive of the proposal that the onshore element should be managed separately to the offshore elements. Respondents sought further clarity on which body would have responsibility for the verification of cost estimates for the decommissioning of onshore infrastructure. The government committed to continue to examine the treatment of onshore CCUS decommissioning to ensure clarity and coherence with the rest of the regulated regime.

Identified issues

Having considered this issue more closely, the government is now of the view that the funding received to cover onshore decommissioning liabilities should be managed through the use of decommissioning funds, in the same way the government expects for the management of offshore liabilities. This is because the government now views there to be an increased risk that a shortfall in the onshore funding may materialise if left to be managed through other means. This is due to a number of reasons, as set out below:

- There is no requirement on the manner in which T&SCo builds up the correct funds to meet the onshore decommissioning liabilities at the end of the asset's life.
- There is no requirement to ensure the funds are appropriately ringfenced and only used for decommissioning activities.
- The setting aside of sufficient capital to cover the onshore decommissioning liabilities could be left to the latter part of the networks' lifetime which may not leave sufficient time to collect the required amount without placing unreasonable costs on emitters.

- There is no requirement to link the accrued capital to the CCUS network / Economic Licence. There is therefore a risk that the licence could move to companies with smaller balance sheets which are unable to cover the full cost of decommissioning.

Differences to the offshore decommissioning regime

As set out above, there are additional regulations underpinning activity relating to decommissioning of onshore infrastructure. The setting of certain requirements relating to the decommissioning of onshore infrastructure sits with the local authorities, and therefore a single T&S network may face varying onshore decommissioning requirements from several local authorities.

There are clear distinctions between the underlying legislative framework and regulations relating to onshore and offshore decommissioning and different requirements relating to the decommissioning activities for each area. These include:

- The lack of an OPRED-equivalent body for overall onshore decommissioning. Instead, the setting of requirements relating to the decommissioning of onshore infrastructure sits with local planning authorities.
- The T&S onshore networks are likely to traverse different local authorities (and potentially different devolved administrations) and therefore different components of the onshore network may face different decommissioning requirements.

The government's revised position

Having considered the issue more closely, the government now proposes that the T&SCo will be required to build up and maintain an onshore decommissioning fund sufficient to cover the onshore decommissioning liabilities. The government envisages that these onshore decommissioning funds will function in the same way and be subject to the same requirements as their offshore equivalents.

Given the absence of an OPRED-equivalent body in the offshore space and differences in onshore and offshore decommissioning requirements, the government will set out a requirement to establish and maintain an onshore decommissioning fund as a condition of the economic licence. This condition will also cover the requirement to establish and maintain the offshore decommissioning funds of the network. Including both onshore and offshore decommissioning funds within this licence condition will ensure better coherence between them and provide an additional layer of regulatory oversight for the offshore funds.

To reflect the existing regulatory landscape, the licence condition will need to recognise that overseeing the requirements relating to decommissioning (as opposed to the requirement to build up and maintain the decommissioning funds) will remain the responsibility of these other bodies. However, in practice we envisage minimal disruption to the existing regulatory landscape for decommissioning obligations, with the onshore requirements remaining with the local planning authorities and the offshore requirements remain with OPRED.

Scope of the onshore decommissioning funds

Given the differences in the onshore and offshore regulated regimes highlighted above, it is not anticipated that onshore decommissioning activities will be followed by a period of monitoring activities. As such, the onshore decommissioning funds are not expected to need to accrue for post-closure monitoring costs, the state hand-back contribution, or the two newer elements of the offshore decommissioning funds set out in Chapter 1; the post-closure financial security costs and the post-closure SCA charges. It is therefore anticipated that the onshore decommissioning costs will only need to accrue for decommissioning activities (e.g. removal of infrastructure), through this would be decided by the relevant local authorities.

Operation of the onshore decommissioning funds

Whilst the absence of an OPRED-equivalent body in the onshore space, and the lack of an existing universal onshore decommissioning regime, presents some challenges, the government views this licenced based approach to best ensure that appropriate funds are ring fenced and accrued to cover the onshore decommissioning liabilities. The government envisages that there would be a number of different elements to the licenced based approach which together would provide the necessary requirements on T&SCo. These are summarised below, and look to mirror as much as possible the offshore decommissioning regime set out in the government's response to the consultation and this update document, alongside the wider economic regime being implemented for the transportation and storage of CO₂.

Licence based requirement

- The economic licensee would be required to establish and then accrue a fund (separate, through accounting separation or otherwise, to the offshore funds) sufficient to cover the costs of onshore decommissioning in accordance with the Economic Licence. This would be funded through an additional component of the allowed revenue. Management of these funds would be the responsibility of the T&SCo. As noted above, the scope of the activities which the onshore decommissioning funds will need to cover are anticipated to be narrower than for the offshore decommissioning funds.
- The requirement would be on the T&SCo to identify and consult upon the estimated costs of onshore decommissioning in full. This estimate would then be provided to the economic regulator, as part of an onshore decommissioning plan, for review and approval. This estimated cost would need to be periodically reviewed.
- The onshore decommissioning funds would accrue in the same manner as their offshore equivalents. This means that they would have the same overall accrual rates (though recognising that there may be differences in the timing of the decommissioning of particular assets) and accrue over the operational life of the onshore network.
- The allocation of risk associated with the onshore decommissioning funds would be the same as for their offshore equivalents. This is discussed further in Chapter 8.

Failure to comply with Licence condition

- Ofgem, as the Economic Regulator, will have the power to take appropriate enforcement action to ensure compliance with licence conditions.

Change of ownership of T&SCo

- As is the case for offshore, it is expected that the licensee would be required to seek consent from Ofgem to onshore decommissioning arrangements that will be in place following any transfer of the licence to a new operator. Ofgem consent would also likely be required even when there is a change at the shareholder level (T&SCo remains the licensee but the owner would change via share sale). This is to ensure that all components of the onshore decommissioning fund existing prior to the transfer either remain or are adequately substituted as part of the transfer.

Chapter 8: Allocation of shortfall and windfall risk

Background

In the consultation the government noted the potential for there to be a difference between the amount of money accrued in the fund and the realised decommissioning costs that the fund was required to meet. This discrepancy could be either positive (resulting in an upside or windfall outcome) or negative (resulting in a downside or shortfall outcome). The government noted that a difference could arise due to a number of scenarios and potentially at different points in the lifetime of the network.

The consultation outlined the government's position that the T&SCo will be expected to hold both the upside and downside risk associated with decommissioning under all scenarios. This was based on the precedent established over many years by the O&G sector. This was also supported by the government's view that this would best ensure the polluter pays principle is sufficiently delivered.

Respondents to the consultation were generally supportive of these proposals, and in particular that the T&SCo hold the shortfall and windfall risk, so long as the T&SCo was involved in the processes that might affect the target value of the decommissioning fund. However, respondents noted that they should not carry a risk which they do not have any realistic control over, with the main example provided being a lack of demand for the network resulting in discontinuation.

The government's response reaffirmed the position that T&SCos would hold upside and downside risk under all scenarios. However, this would be kept under review pending wider development of the T&S business model.

Updated position for managing shortfall risk

In recognition of the responses to the consultation, and continued engagement on the development of the business model since the publication of the government's response to the consultation, the government has reconsidered its position on where the shortfall risk for the decommissioning funds will sit. Further consideration has focused on key issues such as who is best placed to manage the risk, value for money considerations, the applicability of the polluter pays principle, as well as the wider landscape.

This new position is that T&SCos will continue to manage the shortfall risk under the majority of potential scenarios. In some of these scenarios, if a shortfall is identified prior to the final review period, the T&SCo will be able to pass the risk on to its emitter base. These scenarios are described below in more detail.

Revisions in the decommissioning liability

This is the risk that the estimated decommissioning liability is recalculated during the operational phase of the project. In practice, this means that if the revision occurs prior to the final review period of the network, then the risk will be carried by the emitter base through revisions to their fees. It is only if the change to the liability is calculated after this final review period that the risk will sit directly with the T&SCo.

Investment performance

This is the risk that an investment strategy does not meet performance expectations. This risk will sit either with the T&SCo or the emitter base. If an investment strategy underperforms against expected returns, the shortfall may be covered by additional allowed revenue, if the Economic Regulator is satisfied that the agreed investment plan was followed. T&SCo investors will only be exposed to shortfalls due to lower returns where the approved investment strategy has not been undertaken as agreed.

Unanticipated external market conditions

This is the risk that unexpected volatile market conditions (for example period of high inflation) create an adverse impact on the value accruing in the fund. As with revisions to the decommissioning liability estimate, this risk will in practice sit with the emitter base up until the final review period. Thereafter the risk will sit directly with the T&SCo.

Discrepancy between forecasted and actual cost

This is the risk that outturn decommissioning costs are different to anticipated costs. As this risk is most likely to materialise after the final review period, it will sit directly with the T&SCo.

Efficient or inefficient decommissioning activity

This is the risk around performance of decommissioning activities. This risk will sit directly with T&SCos.

Early closure prior to full accrual due to a transportation or storage issue

This is the risk that the store must be abandoned earlier than forecast because of an issue or concerns about the transportation of CO₂ to that store or the integrity of the store itself. The T&SCo is the entity who had responsibility for characterising the store, ensuring it could contain the injected CO₂. It is also responsible for developing the transport infrastructure to support transportation of CO₂ to the store. It is therefore the T&SCo's risk that the transportation infrastructure and store perform to the levels anticipated, and as such, an early closure of the network due to such performance issues leading to a shortfall in the decommissioning fund will need to be covered by the T&SCo.

OPRED will continue to have its financial risk assessment process in place, and may therefore seek to take financial security if necessary. However, the government will expect T&SCos to adequately demonstrate how they intend to manage the shortfall under each of these

scenarios. To support this, the government would encourage T&SCos to explore, in particular, what role the commercial insurance market could play in this regard.

Discontinuation of the network due to underutilisation

As highlighted above, the government has further considered its position on shortfall risk reflecting on the key issues of who is best placed to manage the risk, value for money considerations, the applicability of the polluter pays principle, as well as the wider landscape. Having considered these issues, the government has decided that it is prepared to hold the specific risk of a decommissioning shortfall caused by a lack of demand from users of the T&S network. This will be managed via any Discontinuation Agreement arrangements in place to support the deployment of the CCUS T&S infrastructure as part of a proposed Government Support Package.

The government's rationale for this decision is that CCUS is a new industry to the UK, and as a result, the Track 1 T&S projects are first of a kind in nature. This means that certain risks, such as a decommissioning fund shortfall caused by a lack of demand from users of the T&S network are likely to be best managed in a bespoke way. T&S networks will be subject to economic regulation and therefore it is appropriate for the risks to be shared and allocated to those who are best placed to manage them.

Ultimately T&SCos will have limited control over the business decisions taken by users that connect to the network and so any loss of demand leading to discontinuation of the network is a cross chain risk that is difficult for T&SCo to efficiently manage. The government recognises these challenges and is committed to the development of appropriate risk sharing mechanisms to facilitate private investment into T&S infrastructure enabling the deployment of a range of other technologies, which are necessary to support net zero. As such, the government accepts that this risk is likely to be more efficiently held by itself.

This is the sole scenario under which the government will hold any shortfall risk in the decommissioning funds. As stated above, the government expects T&SCos to manage the decommissioning shortfall risk resulting under all other scenarios. Such an approach is designed to help realise the initial CCUS networks and the government expects such a risk to be managed on a commercial basis in the future. For the avoidance of doubt, this approach is not intended to act as a precedent for the management of decommissioning liabilities in any other sector.

Though this is a risk the government has decided it will hold, the government still expects T&SCos to explore the potential role the market can play in managing shortfall risk under this specific scenario. This is with a view to CCUS operating on a more merchant basis in the future and encouraging the market to develop suitable commercial products to support this.

Windfall

In light of the government's decision to hold the shortfall risk in the decommissioning funds under the scenario of a lack of demand for the network resulting in discontinuation, the government has also decided that it will now retain any windfall in the decommissioning funds once all decommissioning and post-closure obligations have been met. This is in keeping with the principle of utilising a risk sharing model to facilitate the deployment of CCUS in the UK, and the expectation that any windfall remaining after such obligations have been met is likely to be marginal.

Importantly, this position will simplify the treatment of contingency in the decommissioning estimates. Allowing the contingency to be part of any windfall that might be available to the T&SCos has the potential to create perverse incentives at the emitters' expense. Removing this risk better enables an appropriate level of contingency to be calculated on a simpler basis, without concern that T&SCos might be exposed to disproportionate upside risk.

Chapter 9: Re-purposing of assets

Background

CCUS has the potential to utilise re-purposed O&G assets as part of its deployment. Examples of assets which can be re-purposed include subsea pipelines and offshore platforms. Re-purposing such assets has the potential benefit of accelerating the deployment of CCUS through reduced construction time and upfront capital expenditure, while also improving the resource efficiency of the industry and minimising the impact on the local environment.

The regulated model for deployment of CCUS in the UK means that T&SCos will receive a regulated return for their operation of CCUS networks. This return will be based, in part, on the capital required to build the network (its upfront value), and the expected decommissioning costs of the network's infrastructure.

In the majority of cases, assets with the potential to be re-purposed were not originally designed with this outcome in mind. They were originally envisaged to be used and ultimately decommissioned by the O&G industry. This means their value would have depreciated over their lives as O&G assets and they will have a decommissioning liability associated with them on the assumption they would be decommissioned at the end of their O&G lives.

As such, for their transfer into the CCUS regulated regime, a new 'asset value' (AV) will need to be determined, in order for this to be included as part of the transfer value of the asset and added to the T&SCo's Regulated Asset Value. Alongside this, an agreement will be required on how the decommissioning liability will be apportioned between the original O&G operator and the T&SCo. Both of these elements, the AV and the decommissioning liability transfer, will need to be taken into account in the calculation of the agreed revenue in the economic licence as well as considered in the wider set of contractual arrangements with the government required to support the establishment of initial clusters. For the initial T&SCos the economic licences will be negotiated and granted by DESNZ. Future licence awards, and the modification of licences including initial licences, will be the responsibility of Ofgem, as the economic regulator of the carbon dioxide transportation and storage networks.

Existing government position

Sections 30A⁴ and 30B⁵ of the Energy Act 2008 (as planned to be amended through the current Energy Bill 2022⁶) set out that Change of Use Relief (CoUR) can be issued for certain re-purposed assets. As set out in the government's consultation⁷, this relief would mean that

⁴ [30A of the Energy Act 2008](#)

⁵ [30B of the Energy Act 2008](#)

⁶ [Energy Bill 2022](#)

⁷ [Carbon capture, usage and storage \(CCUS\): offshore decommissioning regime for CO₂ transport and storage](#)

an individual previously issued with a notice under Section 29 of Part IV⁸ of the Petroleum Act 1998 could not be issued with a new Section 29 notice in respect of that asset (or the elements which are to be re-purposed) if that person was not involved in the CCUS development, nor could a decommissioning liability be imposed under Section 34 of Part IV⁹ of the Petroleum Act 1998 once an abandonment programme for that asset had been approved. This has the effect that the decommissioning liability could not revert back to any owners or operators of the asset prior to its re-purposing. The availability of CoUR was requested by industry for instances where existing owners of an asset with re-purposing potential were reluctant to sell the asset for use in a CCUS network given the risk of being called upon to contribute to future decommissioning liabilities and the uncertainty around these costs.

The government's consultation and subsequent response¹⁰ on establishing a funded CCUS decommissioning regime set out that CoUR could be issued on the condition that the CCUS decommissioning fund for that asset was 'topped up' by an amount reflective of the existing decommissioning liability associated with that asset. Before CoUR could be granted, the appropriate top-up amount would need to be paid into the decommissioning fund for the re-purposed CCUS asset. There would also need to be a section 29 notice in place in respect of the decommissioning of the CCUS asset. The conditionality of the issuance of CoUR seeks to mitigate the risk to the taxpayer that the government is required to step in as decommissioner of last resort of the re-purposed asset.

Given the conditionality on the issuance of CoUR, any scenario where the relief is sought would therefore have a defined outcome for the transfer of decommissioning liabilities associated with the re-purposed asset (i.e. the existing decommissioning liability would need to be paid in full). As such, the financial negotiation relating to the transfer of the asset into the CCUS regulated regime would likely focus on the AV of that asset.

However, it may be that O&G operators do not seek CoUR, as the application of Sections 29 and 34 are less relevant to their circumstances. In such scenarios consideration could be given to determining what level of decommissioning liability is provided by the previous owners of the asset and how much is provided by T&SCo.

The government's consideration and rationale for the treatment of re-purposed assets

As with all policy development, the government has sought to apply a principled approach for determining its position on any re-purposed assets for which CoUR is not sought. Some of the principles and arguments which were used in its consideration are set out below to provide greater clarity and transparency on the underlying rationale. However, this is not an exhaustive list.

⁸ [Section 29 of Part IV of the Petroleum Act 1998](#)

⁹ [Section 34 of Part IV of the Petroleum Act 1998](#)

¹⁰ [Carbon capture, usage and storage \(CCUS\): offshore decommissioning regime for CO₂ transport and storage](#)

As highlighted above, re-purposing has the potential to reduce upfront capital costs of CCUS deployment. As such, the cost of the re-purposed asset would be expected to be lower than the cost of building the asset new. Building on this, the transaction would also be expected to demonstrate that it offers a better value for money outcome for the purchasing party compared to potential alternative forms of ownership (e.g. a leasing model).

The government has been clear that it does not want to create any barriers to re-purposing, given the potential benefits it can deliver. However, the government is also clear that CCUS should not be used as a means for the O&G industry to avoid its obligations. The government also wants to maximise the economic use of the North Sea and therefore does not want to create an environment where viable O&G projects are prematurely ended to exploit such opportunities. Furthermore, the agreed outcomes should not create any perverse incentives with regard to their interaction with the regulated regime.

With the complexity of the wider business model and the scale of different elements which must be agreed, there is a desire to simplify the government's negotiations with industry where possible. The conditionality on CoUR provides such a scenario, as the decommissioning liability transfer be determined through agreement with OPRED. All that is left to agree is the AV of the asset.

Alongside a desire to simplify the negotiation, the government would also seek to create a regime which has greater coherence across the whole sector. This consistency would provide greater certainty for prospective T&SCos and for taxpayers in terms of the risk they are exposed to through the government's role as decommissioner of last resort. It would also mitigate the risk that particular T&SCos are able to achieve a 'better' outcome than others, which in turn mitigates the risk that re-purposing could inadvertently lead to instances of perceived favouritism.

Greater consistency will also create a more identifiable policy framework for the way in which assets are transferred into the CCUS regime, underpinned by a clearer set of desired outcomes and overarching rationale. This provides further clarity as to the government's position and in turn places the overall policy on a more robust footing.

The government's position for the approach to negotiations on re-purposed assets

With this in mind, this section looks to set out the government's vision for how re-purposed assets will be transferred into the CCUS regulated regime for all scenarios, including where CoUR is sought and where it is not sought. This includes how agreement will be reached on the treatment of existing decommissioning liabilities and on the asset's value.

Firstly, the government will seek to simplify the negotiations on re-purposed assets to only one of the two elements. The conditionality on the issuance of CoUR provides a helpful precedent for the treatment of existing decommissioning liabilities, and one which the government has a

strong preference to see extended to all re-purposing scenarios, providing consistency across the sector.

Consequently, in scenarios where CoUR is not sought, the government will expect T&SCos to contribute an upfront top-up to the CCUS decommissioning fund, reflecting the full decommissioning liability of the re-purposed asset. Agreement of the amount of money that would be expected to be transferred up front into the CCUS decommissioning funds would follow the approach set out for CoUR, and in effect become a non-negotiable element for the transfer of the asset, beyond establishing the exact scale of the liability itself. This means that for all re-purposed assets, regardless of whether CoUR is sought or not, the government will expect an upfront top-up into the CCUS decommissioning funds which reflects the full decommissioning liability of that asset. This would mean that the negotiation only focuses on the AV of the asset.

For consistency, this approach will also be the expectation for the treatment of re-purposed assets that are located onshore. These are not subject to the same decommissioning regulations as offshore infrastructure. But there is an equal need to determine the AV and the treatment of existing decommissioning liabilities as they are incorporated into the CCUS regulated regime.

Subject to Parliamentary agreement on the passage of the Energy Bill 2022, the government will set out this requirement for a top-up to the decommissioning funds in all re-purposing scenarios in regulations and guidance.

In reaching agreement on the AV of a re-purposed asset, the negotiation will need to take in certain considerations stemming from the nature of re-purposing an existing asset. For example, this might include the assets' integrity, the age and historic usage of the asset, the relatively higher operational expenditure and potential future capital expenditure which might arise through its re-purposing. Such considerations will help reach an outcome which delivers greater value for money. However, the government would not expect any loss of potential earnings which the seller may have received if it continued to operate the asset to be included in the assessment. This will prevent any circumstances of premature re-purposing.

Alongside this, the government judges that the AV would need to be a non-zero value. This is to reflect the expectation of the selling party, particularly given the government's position for the treatment of the decommissioning liability, and the minimum value they would have reasonably expected to receive from the asset even if they had decommissioned it, for example through scrappage. In addition, a non-zero value would also mitigate any risk of creating perverse incentives for the purchasing party in terms of translating that value onto the regulated asset base for the CCUS network, for example through early replacement of assets.

Separately, the government must also have regard of the public interest in ensuring that the O&G sector cannot use CCUS as a means of minimising or avoiding existing obligations, or extracting further value from their activities at the expense of a new and taxpayer-supported industry. As such, the government does not see any reasonable case under which the agreed

AV exceeds the amount paid into the associated CCUS decommissioning fund to reflect the existing decommissioning liability.

Taking the minimum value the seller would have reasonably expected to receive if it had decommissioned the asset and the effective cap set at the money paid into the CCUS decommissioning fund provides a reasonable range within which the parties can agree the AV for the asset and delivers on the government's objectives and expectations.

Next steps

The position set out in this update, and those it follows in the government response, are dependent on securing the necessary legislation. The Energy Bill 2022¹¹ is currently progressing through Parliament and includes the legislation that will underpin the implementation of T&S business model and the establishment of the role of the Economic Regulator in overseeing this. The Bill also includes the power for the Secretary of State to issue regulations as to the provision of financial security relating to the decommissioning and post-closure costs associated with CCUS. Subject to Parliamentary approval on the passage of this Bill, the government will then put in place the necessary regulations that will set out the requirements relating to the proposed CCUS funded decommissioning regime set out in this document and those preceding it.

The government will continue to engage industry closely in the implementation of the funded decommissioning regime. The government will also work closely with industry to help support their delivery, including support in understanding and fulfilling their decommissioning and post-closure obligations. This will include establishment of the decommissioning funds and their management, how liabilities will be estimated and feed through to the allowed revenue calculation, and how appropriate mechanisms are in place to manage any risks.

¹¹ [Energy Bill 2022](#)

This publication is available from: www.gov.uk/government/consultations/carbon-capture-usage-and-storage-ccus-offshore-decommissioning-regime-for-co2-transport-and-storage

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