

Rule amendments to give effect to changes to the financial security regime in Marine Protection Rules Part 102: Certificates of Insurance – Invitation to Comment

July 2017



Invitation to comment

Following public consultation earlier this year on options to improve the financial security regime for offshore installations, the Government intends to introduce the following changes to the financial assurance requirements:

- introducing a financial assurance requirement sufficient to cover the costs of well control;
- introducing a scaled framework for the level of financial assurance required for pollution damage; and
- refining the scope of liabilities under Part 26A of the Maritime Transport Act 1994 (MTA) that the financial assurance must cover.

These changes require amendments to Marine Protection Rule Part 102: Certificates of Insurance (Part 102). Part 102 requires permit holders of offshore installations to provide financial assurance in respect of their potential liability to the Crown and others under Part 26A of the MTA.

Amendments to Part 102 relating to well control require consideration of Oil Spill Contingency Plans under Marine Protection Rule Part 131: Offshore Installations - Oil Spill Contingency Plans & Oil Pollution Prevention Certification (Part 131). Part 131 does not require any amendments.

This invitation to comment is issued to fulfil consultation requirements under section 446 of the MTA. The consultation period will run from 11 July 2017 until 2 August 2017. Following consultation and consideration of submissions, the draft rule will be finalised for the Minister of Transport's signature. The rule is expected to come into force 12 months after signing.

This consultation is restricted to seeking views on the proposed new rule giving effect to the proposed changes outlined above. It is not intended to seek views on the underlying policy for the regulation of offshore petroleum activities. Those views were considered following the previous public consultation, which ended on 20 February 2017.

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

The draft amendments will ensure that financial assurance provided by permit holders is more aligned with the risk associated with their activity. This will provide a level of financial protection to the Crown and the public that better reflects the level of costs likely to be incurred in the event of a significant oil spill.

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

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

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

The Crown will benefit from the proposals. One of the key objectives for the proposed changes is to increase protection to the Crown against the costs of oil spill prevention, containment, control and clean up measures in the event of a major incident involving an offshore installation. The existing assurance requirement is not sufficient to cover a permit holder's liability in such an event, thus exposing the Crown to the response, clean up and pollution damage costs if the permit holder refuses, or does not have the financial resources, to meet its statutory liability for those costs. The proposed changes aim to reduce the Crown's exposure to this risk.

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

Because existing offshore installations are located in the Taranaki region, it is this region that is immediately affected. However, the proposals anticipate offshore petroleum activities occurring in other areas, hence the amendments may in the future become directly relevant to other regions.

Summary of submissions on previous consultation

Formal consultation on options to improve the financial security regime was held from 19 December 2016 until 20 February 2017. Five submissions were received from the oil and gas industry and one from an insurance company.

Submissions were generally supportive of the update of the regime and an increase in assurance requirements, but they did raise some issues with the proposed changes.

Clarity of coverage

Submitters noted that activities may have different associated risks and therefore should be treated differently by the financial security regime. For example, they stated there needs to be differentiation between drilling, a well work-over¹ or a well in a stable producing state. In a given period, permit holders may be carrying out some activities and not others. It is therefore important that the regime is clear about how it applies to the various activities and well types.

Officials have received advice on the risks associated with different activities and well types. This showed that there is a risk of a significant spill from wells that are currently being drilled, wells undergoing work-overs and wells that are in a stable producing state. All of these activities will therefore be included under the financial assurance requirements. The only exception will be for installations that depend on the use of artificial lift technologies for production.

¹ The process of performing invasive intervention, maintenance or remedial treatments on an oil or gas well.

Clarity of terminology

Submissions emphasised the need for the legislation to be clear, for ease of understanding and implementation. For example, the use of the words 'owner', 'operator', and 'permit holder' should align with other legislation and commonly used terminology.

Officials have aligned terminology with common usage as much as possible in the attached documents. There is an issue of differing terminology between the MTA and the Crown Minerals Act 1991 (CMA). The MTA uses the term "owner" but the CMA refers to "permit holders" as holding responsibility. This difference in terminology cannot be addressed in a new rule without first amending the primary legislation. However, the guidelines to accompany the amended offshore financial assurance regime will clarify the relationship between the owners' and permit holders' responsibilities.

General legislation issues

Some submitters expressed concern with the structure of the current legislative regime for financial assurance under the MTA and Part 102. They expressed concerns that the proposed changes work around this rather than fixing it.

Officials consider that the Minister of Transport's existing rule-making powers under the MTA provide the authority to make a marine protection rule to give effect to any of the options proposed in the discussion paper. Changes to the MTA are therefore unnecessary. Any legislative change to directly address submitters' concerns would substantially increase the time required to amend the financial assurance requirements.

Financial assurance for well containment

Submitters supported introducing a financial assurance requirement for well containment, but had some concerns with the proposed formula for calculating the costs. Officials have proposed introducing an assurance requirement sufficient to cover the costs of well containment. A permit holder's Oil Spill Contingency Plan, required under Part 131, will be referenced in the rule as a factor to be considered by the regulator when considering the level of financial assurance required by the permit holder under Part 102. Officials intend to finalise the required cost calculation after the Part 102 rule amendment is finalised, with the requirements to be detailed in supporting guidance.

Level of financial assurance for clean up and compensation

Submitters supported two options: raising the current level of assurance required; and, introducing a scaled framework for identifying the appropriate level of assurance. While the scaled framework is more complex in terms of identifying the level required, it means that the financial assurance requirement better reflects the risk associated with a particular installation. The Government decided to introduce the scaled framework.

Coverage issues with conventional insurance policies

Submitters supported refining the scope of assurance required, and removing a requirement for assurance to cover liabilities for third party loss of profit from impairment of the environment. Submitters noted that New Zealand's assurance requirements need to be compatible with conventional insurance products, and small or domestic companies may find

it particularly difficult to provide assurance otherwise. Officials have proposed to amend the assurance required, to exclude liability for third party loss of profit from impairment of the environment. However, this does not limit permit holders' liabilities as provided in the MTA.

Summary of proposed amendments

The proposed amendments address the three issues for the financial assurance requirements raised in the review.

Financial assurance for well containment

The draft rule amendment would require permit holders to hold a level of financial assurance sufficient to cover the costs of well containment, should such costs be incurred by the Crown or Maritime NZ as part of the response to a pollution incident.

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

Level of financial assurance for clean up and compensation

The draft rule amendment refers to a scaled framework for identifying a permit holder's assurance requirement for clean up and compensation.

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

- hydrocarbon type;
- length of shoreline oiled; and
- volume of oil reaching shore.

Under the new rule, permit holders will be expected to undertake modelling of a reasonable worst-case scenario. This modelling would identify the possible length of shoreline oiled and the volume of oil reaching the shore. Points would be allocated according to the three criteria, which will identify the appropriate band (and the level of financial assurance required) for clean up and compensation, in addition to the required assurance for well containment.

A banding table has been drafted, based on the framework proposed in previous consultation on options to improve the financial assurance requirements, and is included in this Invitation to Comment as part of information to be included in proposed guidance. Officials welcome comments on whether the banding table be included in the rule.

Further detail on requirements for modelling by permit holders, definitions and thresholds relating to the variables will be finalised as part of supporting guidance.

Coverage issues with conventional insurance policies

The financial assurance requirements under the draft rule amendment do not include third party loss of profit from impairment of the environment. However, this does not affect a permit holder's liability under Part 26A of the MTA for such losses.

Supporting guidance to be finalised following the rule amendment will include information on acceptable insurance policies.

Proposed supporting guidance

After the rule is finalised, officials will develop supporting guidelines, in consultation with industry. We propose that the guidelines would provide guidance on:

- the requirements of permit holders in undertaking modelling of a worst case scenario;
- how to apply the required modelling to the scaled framework, including what factors must be identified for calculating the required financial assurance band;
- the calculations required for identifying the cost of well containment;
- acceptable insurance policies for obtaining a certificate of insurance; and
- clarification of terminology (e.g. permit holder, operator, owner).

Further detail for a proposed guideline is provided in Appendix 2. Included in this appendix is an outline of what information could be covered in the guideline, as well as the process by which applicants and the regulator assess their assurance requirement within the banding framework.

Officials are exploring the possibility of having guidance for identifying assurance requirements based on location, with mapping of areas based on their level of risk. If successful, this would reduce or eliminate the need for modelling of individual installations, as this information would be used to identify the required band for an installation, instead of the points allocation currently proposed.

Officials welcome comments on the usefulness of the proposed guideline detailed in Appendix 2, as well as the potential utility of guidance based on a mapping of locations.

Officials also welcome comments on the banding table provided in Appendix 2, and whether the table should be included in the rule or in a supporting guideline.

Making submissions

The deadline for making submissions on the draft amendments to Part 102 is **2 August 2017**. You may make comments by:

- Email: info@transport.govt.nz
- Post:
Ministry of Transport
PO Box 3175
WELLINGTON 6140

Submissions are public information

Your submission may be the subject of a request under the Official Information Act 1982, which could result in its publication. The withholding of particular submissions for any reason will be determined in accordance with the Official Information Act. If you feel that any part of your submission should be properly withheld under the Official Information Act, you should indicate this clearly. Further information about the Official Information Act is available at: <http://www.legislation.govt.nz>.

Appendix 1: Draft rule amendments to Marine Protection Rule Part 102: Certificates of Insurance

Amendments to Marine Protection Rule Part 102

1. Insert after rule 102.8(1)(b):

- (c) accompanied by such information as may be reasonably required by the Director to assess the level of financial assurance required under this Part in respect of the offshore installation or installations for which the certificate of assurance is to be issued including, but not limited to:
 - i. the applicant's planned work programme during the period to which the certificate of insurance will apply
 - ii. the location of the installation or installations to be covered by the certificate of insurance
 - iii. the nature of the hydrocarbon being prospected for, explored, or mined
 - iv. the total volume of hydrocarbon likely to be released in the event of a spill
 - v. the potential impact of hydrocarbon on the shoreline in the event of a spill
 - vi. the applicant's oil spill contingency plan under Marine Protection Rules Part 131.

2. Revoke rule 102.8(2)(b) and replace it with the following:

- (b) the contract of insurance or other financial security in respect of the regulated offshore installation provides public liability coverage for an amount not less than that determined by the Director under rule 102.8(2A) and of a kind and scope suitable to meet the owner's potential liability under Part 26A of the Act for:
 - i. costs of dealing with pollution under section 385B of the Act
 - ii. pollution damage to property and costs of reasonable preventive measures under section 385C of the Act; and

3. Insert a new rule 102.8(2A) as follows:

- (2A)(1) The Director will determine the sums required under rule 102.8(2)(b), using the scaled framework required by rule (2A)(2), taking into account:
 - a. the information provided by the applicant in accordance with rule 102.8(1)(c); and
 - b. any further technical information, data, advice and guidance relevant for the purposes of the Director's determination.

- (2A)(2) The Director must establish a scaled framework for determining financial assurance requirements, up to a maximum of NZ\$600 million, based on:
- i. the nature of the hydrocarbon being prospected for, explored, or mined
 - ii. the location of the prospecting, exploration or mining activity
 - iii. the total volume of hydrocarbon likely to be released in the event of a spill
 - iv. the potential impact of hydrocarbon on the shoreline in the event of a spill
 - v. relevant technical information, data, advice and guidance

Appendix 2: Indicative draft guidance to support amendments to Marine Protection Rule Part 102

This appendix sets out the information that would be included in a guideline to support the amended Marine Protection Rule Part 102 (Part 102), including:

- a proposed outline of a guideline, to indicate the likely information to be included;
- a flow diagram indicating the process by which an applicant's assurance requirements for clean-up and compensation are identified;
- the proposed banding system, unchanged from that provided during public consultation over December 2016 to February 2017; and
- information on calculating well containment costs, unchanged from that provided during previous public consultation.

Officials welcome any comments from submitters on the usefulness of a guideline, and the information to be provided.

Proposed outline of guideline

1. Background and purpose of regime
 - a) Legislative links and requirements
 - b) Required timeline for rule to take effect
 - c) Requirements for review of regime (in particular bands)
 - d) Clarification of liability
2. Definitions
 - a) Clarification of terminology – permit holder, installation
 - b) Abbreviations and glossary
3. Overview of the regime
 - a) What costs are covered and what can be excluded
 - b) A diagram of requirements
 - c) Relationship with well control contingency plan and existing spill modelling (also referred to under the well containment and clean-up sections)
 - d) Guidance on acceptable insurance policies
 - i. Requirements for specific inclusion
 - ii. Acceptable exclusions
 - e) Guidance on other acceptable forms of assurance
 - f) Guidance on activities to be covered and activities or scenarios to be excluded
 - i. Drilling, well interventions, producing wells
 - ii. Nature, pressure and volume of hydrocarbon
 - iii. Artificial lift
 - iv. Slow seepage
 - v. Offshore wellhead
 - g) Guidance on how Floating Production Storage and Offloading vessels (FPSOs) should be treated

- h) Guidance on how vessels should be treated when outside permit areas or when not engaged on exploration or mining activities
- i) Guidance on how joint ventures and companies with ownership of multiple installations should be treated
- j) Guidance on interaction with other parts of the New Zealand regime

4. Application Process

- a) Roles, responsibilities, contacts – industry, regulator, third party
 - i. responsibilities, process and requirements to manage change, if work programmes change
- b) Required process and timeline for applications
- c) Information to be included with an application
- d) Certificate and what it will allow and what information it will include

5. Well containment costs

- a) Method of calculation (formula or alignment with Well Control Contingency Plan (WCCP))
- b) Assumptions or minimum values (e.g. mobilisation times)
- c) What needs to be included and what type of estimate to use
- d) Requirement for third party verification

6. Clean-up and remediation costs

- a) Method of deciding worst case spill scenario
- b) Method of deciding values for pressure and volume of hydrocarbon, to be used for modelling
- c) Method of confirming environmental conditions
- d) Method of confirming nature of hydrocarbon
- e) Requirements for modelling (e.g. assumptions, number of runs, required abilities)
- f) Treatment of dry gas wells
- g) Treatment of wells with zero shoreline impact
- h) Requirement for third party verification
- i) Limits for shoreline impact, length etc
- j) Scaled framework points and bands

7. Forms

- a) Application
- b) Certificate of Insurance template
- c) Form for parent company undertaking

Proposed banding table for scaled framework

Officials developed a proposed framework for identifying financial assurance requirements for clean-up and compensation for public consultation alongside options to improve the financial assurance regime.²

The framework provided in this document is similar to the framework consulted on previously. The key difference is that the maximum level has been amended to NZ\$600 million, which is closer to the Australian requirements.

The framework for setting the scaled financial assurance requirement is predominantly based on the length of coastline impacted and the volume of oil reaching shore. Hydrocarbon type is also included, to recognise the lower clean-up costs associated with a dry gas release as a worst-case scenario, compared to that of an oil spill.

Officials anticipate that oil spill trajectory modelling, required as part of a permit holder's well control contingency plan, will be used to provide relevant information for the scaled assurance requirements.

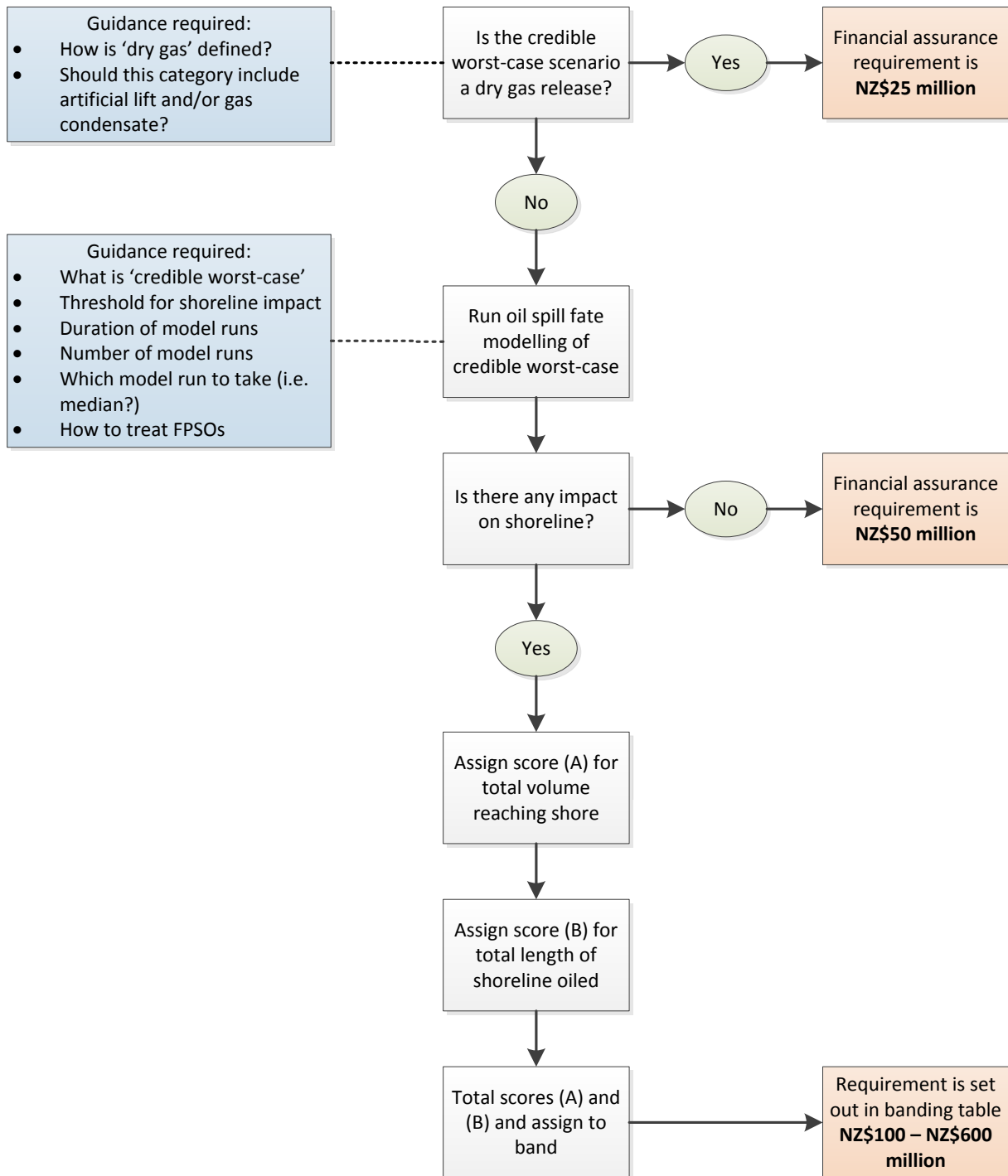
Table 1: proposed banding system

Score A: Hydrocarbon type							
Dry gas				Other			
0 points				1 point			
Score B: Total length of shoreline oiled							
0km	1 to 200 km	200 to 400km	400 to 600 km	600 to 800 km	Over 800 km		
0 points	1 point	2 points	3 points	4 points	5 points		
Score C: Total volume reaching shore							
0 bbls	1 to 5,000 bbls	5,000 to 40,000 bbls	40,000 to 80,000 bbls	80,000 to 120,000 bbls	120,000 to 160,000 bbls	160,000 to 200,000 bbls	Over 200,000 bbls
0 points	1 point	2 points	3 points	4 points	5 points	6 points	7 points
Total Score							
Score (total A + B + C)		Band		Financial Assurance Requirement			
0		0 (Dry gas)		NZ\$25 million			
1		1 (No shoreline impact)		NZ\$50 million			
2-3		2		NZ\$100 million			
4-5		3		NZ\$200 million			
6-7		4		NZ\$300 million			
8-9		5		NZ\$450 million			
10-13		6		NZ\$600 million			

A summary of the process for identifying assurance required for clean-up and compensation is provided on the next page.

² Consultation occurred from December 2016 to February 2017, documents can be found on the Ministry of Transport's website: <http://www.transport.govt.nz/sea/financial-security-regime-for-offshore-installations/>

Financial assurance calculation process



Calculation of well containment costs

One of the amendments proposed to Part 102 is to introduce a financial assurance requirement sufficient to cover the costs of well containment. To support this, it is proposed that the guideline contain information on the calculation of this cost.

In the proposals for previous public consultation, two formulas were proposed:

1. Cost of well control = (2 x Estimated cost of drilling activity) + Cost of capping stack
2. Cost of well control = (Estimated daily rig cost x time to achieve well kill) + Cost of capping stack³

These formulas are based on those used in Australia and the UK. Officials proposed that where sufficient information is available for both methods, the method with the higher result is used.

Officials anticipate that calculation of well containment costs will be informed by information provided by permit holders as part of the Well Control Contingency Plans, required under Marine Protection Rule Part 131.

³ In the absence of an operator's estimate, the default cost of a capping stack in New Zealand is NZ\$60 million and the time to achieve kill well is 120 days.