

# DECOMMISSIONING OBLIGATIONS: THE WAY FORWARD

18 November 2020 | London  
Legal Briefings – By **Irina Atkenjeva and Susan Field**

---

## PODCAST

[Herbert Smith Freehills Podcasts · Navigating the low oil price environment: EP7](#)

This post focuses on decommissioning obligations, in particular on the impact of the current low oil prices on decommissioning.

Decommissioning is the process of removing and disposing of production facilities and installations at the end of field life. This process, in particular the planning, budgeting and preparation, begins long before production eases, and involves substantial costs.

Decommissioning was already an important topic before the oil price crash, with an increasing number of assets around the world expected to enter the decommissioning phase in the next few years. Low oil prices have amplified some of the challenges faced by operators with regard to their decommissioning liabilities and may also drive change in the regulatory space.

## DECOMMISSIONING IN THE NEXT DECADE

A wave of decommissioning is expected over the next few years, with a significant number of assets around the world reaching the end of their useful life phase. The global offshore decommissioning market is predicted to grow by \$1.77 billion during 2020-2024, and decommissioning costs are predicted to overtake capital expenditures as soon as 2025.

Decommissioning will affect different regions at varying degrees. In the Gulf of Mexico, and to a lesser degree the UK, the practice is already well-developed and supported by robust regulation, while in Asia and the Far East, the decommissioning industry is still evolving. It is projected that over the next 30 to 40 years, as many as 470 installations will require decommissioning in the North Sea. Similarly, in Southeast Asia, an estimated 200 offshore fields are likely to stop producing by 2030, comprising of more than 1,500 platforms and over 7,000 wells.

# DECOMMISSIONING REGULATION ACROSS REGIONS

While there is an international framework regulating decommissioning (UNCLOS and IMO Guidelines), national legislation is required to enforce decommissioning obligations. The comprehensiveness of national regulatory regime varies significantly across countries. The Gulf of Mexico and the North Sea region have a robust framework and have developed substantial expertise, due to having practiced decommissioning for a considerable amount of time. Conversely, the industry in Southeast Asia is at a relatively early stage and legislation remains less developed.

Three key areas of difference in regulation around the world are:

1. **Manner of decommissioning obligations:** Southeast Asian countries tend to provide for flexible obligations in respect of the way in which decommissioning work must be undertaken, requiring assets to be decommissioned in a manner acceptable to the national oil company (e.g. Malaysia, Indonesia) or agreed by the relevant subdivision of the Ministry of Energy (e.g. Thailand). While this does provide operators with room to negotiate, it creates uncertainty which renders the exercise of anticipating decommissioning works and preparing decommissioning cost estimates more difficult. On the other hand, the UK and US legislative regimes provide for stricter obligations with clear and prescriptive requirements.
2. **Clean exit:** In Southeast Asia, companies can usually offload liability for decommissioning upon transfer of their interest to a third party. In the UK, the approach is stricter; there is no discharge of liability on disposal of an interest and previous titleholders retain contingent liability.
3. **Funding of decommissioning costs:** The UK also has strict requirements in relation to decommissioning funding. For instance, the Secretary of State has powers to demand security, and criminal sanctions exist for non-compliance with decommissioning obligations. In Southeast Asia, with the exception of Thailand, requirements are more flexible. For instance, in Malaysia and Indonesia, operators contribute to a fund over the course of the operating life of the asset, with the aim of building up sufficient funds over the course of an asset's life to cover decommissioning costs. However, the ability for the regulators to pursue operators (or their parent companies) if the funds are insufficient may be limited.

# THE IMPACT OF LOW OIL PRICES ON DECOMMISSIONING

## Early decommissioning

Plummeting oil prices are likely to bring decommissioning dates forward as mature fields are no longer considered economically viable. This will not only bring costs forward and force operators to come up with liquid funding on shorter notice than anticipated, but it may also increase costs, by increasing demand for scarce specialist resources. Costs may also have been estimated on the basis of assumptions that no longer hold true.

Early decommissioning can also bring about a domino effect. As more platforms and fields cease to operate, terminal and pipeline costs for neighbouring fields in the same chain are expected to rise. This is of particular concern in the North Sea, where fields are interconnected and share resources such as electricity. As such, wells that would not otherwise be ready for decommissioning may be decommissioned early, at the same time as the supporting infrastructure. This is less common in Southeast Asia, where fields are generally developed on a stand-alone basis.

## Increased regulation?

The economic impact of low oil prices on the oil and gas industry may drive governments to adopt stricter decommissioning regulation to avoid being left with liabilities when companies cannot afford to bear the decommissioning costs of a platform that is no longer economically viable. In Southeast Asia, in particular, where regulation is sparser, regulators may decide to implement legislation similar to that in the North Sea region.

However, governments should tread carefully. In Southeast Asia, oil and gas exploration and production is usually undertaken through contracts with state entities (e.g. Production Sharing Agreements or Concession agreements), which tend to contain robust stabilisation provisions. Consequently, rapid regulatory changes may lead to disputes as operators seek to enforce stabilisation provisions. Additionally, it may not be the right time to bring into force such regulatory changes (which will no doubt have significant economic consequences) at a time when companies are already encountering financial distress due to current low oil prices. Given the current financial situation, and the knock-on effect that this may have on decommissioning, there may equally be a willingness to support operators and assist in finding practical solutions to decommissioning challenges.

## Driving change

Sustained low oil prices also have the potential to accelerate change in the decommissioning industry. For instance, in the implementation of Rigs to Reefs programmes, which is gaining traction as an alternative approach to decommissioning in Southeast Asia. Rigs to Reefs is a practice by which infrastructure is left in place as an artificial reef, rather than disturbing marine life further by removing the entire structure. This can reduce the scope (and cost) of decommissioning. Another area which is being considered seriously in a number of jurisdictions in Southeast Asia is the development of local hubs for decommissioning, which would allow contractors to tow rigs to a nearby country rather than all the way to North Asia, the UK or the US. This also has the potential to lower decommissioning costs, by reducing time, transportation costs, as well as carbon footprints.

Low oil prices have heightened what were already challenging times in the oil and gas industry. However, the pressure of the current low oil prices may also drive innovation and collaboration to find ways to reduce decommissioning costs. As many assets enter the end of life phase around the world, it will be interesting to see how governments and operators, as well joint ventures and contractors, respond to these challenges.

[Navigating the low price oil environment](#)

## KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



**IRINA AKENTJEVA**

OF COUNSEL,  
SINGAPORE

+65 6868 8039

Irina.Akentjeva@hsf.com



**SUSAN FIELD**

SENIOR ASSOCIATE,  
LONDON

+44 20 7466 2818

Susan.Field@hsf.com

---

## LEGAL NOTICE

The contents of this publication are for reference purposes only and may not be current as at the date of accessing this publication. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on this publication.

© Herbert Smith Freehills 2021

---

**SUBSCRIBE TO STAY UP-TO-DATE WITH LATEST THINKING, BLOGS, EVENTS, AND MORE**

Close

© HERBERT SMITH FREEHILLS LLP 2021