

## **NOW YOU'VE GOT IT HOW ARE YOU GOING TO GET IT SOMEWHERE USEFUL? – TRANSPORTATION, ACCESS AND USE OF INFRASTRUCTURE FOR NEW FIELDS**

I am going to speak to you about what I consider to be the interesting subject of transportation arrangements but which subject I was surprised to find now has a patent pending as an insomnia cure for those not in the industry.

I long ago came to the conclusion that all of us involved in the oil and gas business must have some character defect and are probably this century's answer to the old gold pan miners in the U.S. We might have sophisticated methods of exploration and drilling and complex commercial and legal arrangements, but ultimately we are involved in one of the costliest and riskiest industries and one without which most of the world would grind to a halt. Many of you present are involved on the exploration side of the industry and you know the power you can exert in persuading what are now known as stakeholders to invest millions in drilling and the despair and embarrassment when yet another salt water find is confirmed. At the risk of depressing and embarrassing several of those present, it used to be a standing joke at Amoco that if the U.S. government was serious about their space programme and wanted to find water on the moon they should send over our explorers to look for oil. However, today we will assume that Christmas has arrived early and that commercially viable oil and/or gas has been discovered in the North Sea and that, joy of joys, funding is available to develop the field and reap long term rewards on that gamble to enter the energy market,

The problem then is how to get it somewhere useful. Once a viable discovery has been made there are a number of development options and these are:

- A stand-alone development – historically this was the model used for development in the North Sea and if you cast your mind back 20 or 30 years a discovery had to be large enough for what was then Big Oil to make the decision that they would build stand-alone off take structures to bring their

products to shore either at existing facilities, or at other infrastructure facilities which had to be built for access into the general distribution systems. These projects required a long lead time, huge investment and the economics were generally done on the back of the projections of the field life. Thus, if there were known reserves but they would not pass the economic hurdles of building a standalone pipeline to shore, those fields were not developed. There were many such examples, particularly for many years in the Central North Sea, for example, Everest and Lomond. Everyone knew that the gas was there but there was no way to bring it to shore economically on a standalone pipeline basis.

- Another development option is where a satellite field is found to be commercially viable and it can tie in to the existing structure of the field already in production. This is probably one of the easiest options, particularly if the ownership groups of the field and infrastructure are similar. It is likely the satellite may not be far from the main field so time and cost are substantially reduced and access to the infrastructure is eased. Indeed there are examples of a number of fields in proximate locality and with differing ownerships who have managed to unite to share facilities and negotiate transportation and processing rights, for example ETAP.
- The third option is possibly the most relevant to the development of the North Sea through Promote Licences and this is the use of proximate third party infrastructure. In other words it is gaining access and use of infrastructure which is near the discovery and requires a tie-in to bring the product to shore,

In the time available I am going to concentrate on this third option as it is particularly relevant in the mature basins of the Southern North Sea where there is a well-developed infrastructure system and much of it with excess capacity. Further North the same rules apply but often with less capacity available. I shall also generally be discussing gas as there are, obviously, other options for oil such as offshore loading.

Historically access to other parties' infrastructure was difficult and often involved very lengthy negotiations. It would be nothing for a transportation agreement to take over a year to negotiate. Further the pipelines were often owned by large companies with an interest in keeping the infrastructure for themselves and charging whatever they could get away with for excess ullage. They would also try to give preference to their own product so that if there were any pipeline use restrictions the third party would be the first to have their transportation curtailed. Obviously this was not helpful to smaller fields who needed to fulfill their contractual obligations and could not afford to be at the mercy of Big Oil choosing to increase their nominations if, for example, there was a surge in prices or restrictions on the line.

At this point I am afraid I shall get a little nostalgic from my days as the CATS lawyer when the whole concept for that pipeline was as a standalone business venture where all gas transported was subject to the same rules (other than the Enron designated part of the capacity). CATS was built on the back of the Everest/Lomond project, but those fields could not economically support a pipeline on their own. CATS was, therefore, deliberately over-sized to encourage the development of other gas finds which were known to exist in the Central North Sea but had no infrastructure to get them to shore. With the development of CATS and the on-shore processing and power plants at Teesside suddenly the Central North Sea became an economically viable proposition. There was, however, still a certain amount of secrecy about obtaining transportation and all negotiations were on a one off basis with little transparency from the perspective of the user.

Times have now moved on, and as the North Sea has opened up to smaller companies and barriers to development have been identified and addressed, so indeed has access to infrastructure become easier. You will have heard Paul Dymond from UKOOA yesterday talk about the infrastructure code of practice ("ICOP") its history, and the benefits it is hoped it will achieve.

The scope of ICOP needs to be understood, it applies to all U.K. oil and gas infrastructure from wellhead to receiving terminals and initial on-shore processing facilities. It does not apply to the NTS, interconnectors or to LNG import terminals. As

you know there are separate rules, statutes and regulations governing access to the NTS and again differing arrangements for existing and proposed interconnectors. With regard to LNG import terminals, when these are built I am sure that the law will evolve over time but with the initial investment required for these projects it will probably be some time before these fall into the scope of a code such as ICOP.

I think at this point it is worth emphasising the purpose of ICOP which, to reiterate, is "to facilitate the utilisation of infrastructure for the development of remaining UKCS reserves through timely agreements for access on fair and reasonable terms, where risks taken are reflected by rewards".

It is also worth pointing out that the code is entirely voluntary and it is for negotiated access. The question, of course, arises as to what is meant by "voluntary". I think what is meant is that there is no statute backing up the procedures but if a party has signed up to UKOOA then it is expected to comply with the code and, as we all know, no-one wishes to get on the wrong side of the DTI. Indeed in practice the DTI is likely to ask new licensees if they are willing to sign up to the code for the future and comply with it so that those who may be unwilling are less likely to have licences granted. I suspect the 'voluntary' aspect may have some similarities to the Mafia asking if you want protection.

Again although the invocation of the code is voluntary once parties have agreed to be bound by it there is an automatic referral for unresolved negotiations to the DTI at the end of what will generally be a six month time period. This provides an incentive to both parties to reach a fair agreement as the DTI would then have power to apply for a notice from the Secretary of State to secure access to the infrastructure in question. The terms of such access might not be as attractive as those negotiated. There are, of course, various procedures for application through the DTI to the Secretary of State including earlier applications if it is felt the infrastructure owner is being obstructive. Generally, however, the automatic referral to the DTI occurs at the end of six months unless the "bona fide enquirer" informs the DTI that access has been agreed or is no longer required. It is also worth noting that no such referral or action by the Secretary

of State has yet been required, but the existence of the procedure is intended to expedite negotiations.

Another major aspect of the code is that it seeks to minimize conflicts of interest. The North Sea has always been rife with incestuous relationships and frequently one company can find itself with different interests on both sides of the commercial arrangements. This often causes friction and delay. Indeed, I recall one situation when after very extensive negotiations one of my coventurers, who was both a field owner and infrastructure owner, decided two days before the signing ceremony that it would sign as an infrastructure owner but not as a field owner! You can imagine the reactions of all parties but fortunately pressure was brought to bear and the signing ceremony went ahead as planned with no blanks in the signature page. Now, however, if a party could sit on either side of the fence, both as an infrastructure owner and what is known as "bona fide enquirer", it will be expected to elect at the outset on which side it will sit. However, the other parties must recognise that this does not constitute a waiver of rights in relation to that Party's approval of the proposed agreement. The party sitting out will be entitled to receive and make comments on the issues, and exercise its rights with regard to approval, but not to participate actively on both sides of the negotiations.

Another important aspect is that access should be non-discriminatory and that "infrastructure owners should consider all bona fide requests for services and negotiate and offer terms to third parties in good faith, without favour to any particular group, company or any group of companies". This basically means that priority cannot be given to favoured applicants, or to keep competitors out, although it is worth noting that owners of infrastructure are entitled to "make reasonable provision of capacity for their own future use (including use by their affiliates)". The key here is reasonableness so that if access was refused to deny market to a competitor this would be unreasonable, but if the owners knew another well in their own field was about to go into production and needed the capacity for this then this might be considered reasonable. Again, it will be a question of fact.

Another principle of the code is that the tariff and terms should be "fair and reasonable where risks taken are reflected by rewards". This, in fact, gives both parties a substantial amount of leeway in the negotiating process. At the outset, through its own enquiries through DEAL, etc. the bona fide enquirer will know if capacity is available, the range of specifications required and much of the other technical information about the use of the infrastructure. As this information is available via the internet much of the preliminary investigation and dancing around the handbags will already have taken place by the time the infrastructure owner is contacted by the bona fide enquirer. Infrastructure owners are encouraged to and should publish short summaries of key commercial terms. This means that the parties can become thoroughly engaged in the negotiation practice a lot quicker than used to be the case. For example, a party will know if blending is required prior to negotiation. This is obviously an add on service that can be charged for in the negotiations. It will be part of the risk and reward.

As a lawyer of course, one of the most hotly contested areas of any negotiation is the liabilities and indemnities which, of course, tie into the risk and reward. At this point I shall embark on my favourite mantra that the job of a commercial lawyer is to analyse and identify risk so as to enable his client to manage that risk and thus reap a reward. If an infrastructure owner is only making a relatively low return on its investment then it would be unreasonable and, indeed, it would be unusual for it to accept a high level of liability should a loss occur. All the Agreements are likely to exclude consequential and indirect losses. As you know, most agreements for oil and gas take this view as the consequential losses can be so enormous that to try to cover them would be impossible and probably only be to the benefit of insurance companies.

Obviously there will also be numerous other agreements required to deal with, e.g. co-mingling, common stream, and allocation and attribution agreements. The latter should take into account the varying quality of the differing streams which pass through the infrastructure and can be extremely complicated with provisions for ensuring that when a product is put into a co-mingled stream the same energy value is received by its owner at the other end. Indeed, again, in the U.S. there have been

expensive and protracted lawsuits with regard to quality, but generally speaking nowadays it is a problem of which everyone is aware and is addressed by agreement at the outset. Each infrastructure owner will have its own specification requirements, and blending abilities, with the right to refuse to accept delivery of any product which falls outside these. The problem, of course, arises if a contaminated product enters the pipeline and then contaminates the rest of the co-mingled stream. Generally speaking the polluter will be responsible but, of course, this can be hard to sort out with the other parties whose product has been contaminated and of course, there will be no claim for the consequential losses. Often the agreements will contain elaborate negotiated provisions for such circumstances. The lawyers tend not to get involved in the technical aspects of blending but these do need to be addressed in the agreements, usually in somewhat complicated schedules full of unintelligible algebraic formulae.

Another provision for negotiation on infrastructure agreements is the Force Majeure clause. Often people think that this is boilerplate and, thus, fairly unimportant. They often do not understand what Force Majeure is really about. Many fortunes have been made and lost on the wording of such clauses. Indeed, in the U.S. when changes were made to the Law with regard to take or pay liability, which permitted take-or-pay to be charged for transportation but not on the corresponding sales contract side, huge litigation ensued as to whether the Change of Law was a Force Majeure event. At the end of the day, those that had "Change of Law" as an identifiable Force Majeure event were successful in having the contracts re-negotiated and those that did not were stuck with the one-sided take-or-pay obligations. Force majeure is about risk – it is allocation of risk. If something unexpected happens which causes a commercial transaction to go awry, who picks up the bill for that unforeseen event? For example, if a pipeline is blown up is this a Force Majeure event? If so, what obligations are suspended? Usually it will be the obligation to provide the service but NOT the obligation to pay for it. Often Force Majeure clauses are intertwined with rights of termination so that if there is an extended Force Majeure event, the parties have the right of termination. This is all very well, but if a major gas pipeline is out of commission it

is unlikely that alternative arrangements could be made to tie into another line in a commercially viable way. Termination may well provide the way out of a take-or-pay liability but will not help the exportation of products from a field tied into the inoperable infrastructure.

Therefore, to summarise, no discovery is of any use until infrastructure is available to capitalise on the discovery and over recent years the availability of and access to infrastructure has been revolutionised and made easier. This is particularly so with the introduction of the new Infrastructure Code of Practice which expedites the process and provides for much technical information to be readily available. It does not, however, take the place of negotiated commercial agreements which should be carefully drafted by both sides, and with legal representation, to ensure that they have covered their own particular risks so as to maximize their reward.

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