DEPARTMENT OF ENERGY AND CLIMATE CHANGE – UK PETROLEUM LICENSING: FINANCIAL GUIDANCE

DECC has two distinct types of financial criterion: Financial Viability and Financial Capacity. Financial Viability refers to a company's ability to remain solvent and Financial Capacity refers to its ability to meet specific costs. When considering any given type of transaction, DECC may apply both criteria or just one.

FINANCIAL VIABILITY

1. DECC must be confident that any company that receives a licence will continue in sound financial health for the foreseeable future. Each company (even if it is applying for a Promote licence) must therefore demonstrate its basic Financial Viability.

2. Each company must provide a copy of its most recent published accounts or, if these are not available, a pro-forma balance sheet which has been certified by a director and is sufficiently detailed to enable the Financial Viability Assessment to be undertaken.

3. A company that meets the following criteria will be deemed to be financially viable:
   - positive Total Net Assets (Shareholders' Funds);
   - a Current Ratio of 1.00 or better; and
   - Net Gearing of 75% or less.

   For the purposes of this process:

   Current Ratio = Current Assets/Liabilities Falling Due in Less Than 12 Months

   Net Gearing = Total Debt Less Cash and Bank Balances/Shareholders Funds (expressed as a percentage)

4. A company with a deficit of Total Net Assets (Shareholders' Funds) must demonstrate that the deficit is fully funded (e.g. by a corporate parent, directors' or shareholders' loans, commercial debt or other lines of credit), and must produce evidence of the funding.

5. A company with a Current Ratio less than 1.00 must demonstrate that its working capital requirements are financed by adequate short term funding arrangements (e.g. by a corporate parent, bank overdrafts, directors loans etc), and must produce evidence of the funding. Arrangements with trade or other creditors are not acceptable because they often imply that a company is in financial difficulty.

6. A company with net gearing above 75% must demonstrate it will be able to service the debt; i.e. that it can meet the interest payments and any agreed capital repayment schedule. We expect this to be demonstrated by the provision of a debt repayment schedule and a cash flow forecast. If the loans have no fixed redemption date, as is often the case with loans provided by a corporate parent or company directors, we can accept a written statement to this effect.

FINANCIAL CAPACITY – Licence Award

7. For all kinds of licence other than Offshore Promote, each company must demonstrate that it has access to sufficient funds to pay for its share of all the elements of the proposed Work Programme (whether those elements are Firm, Contingent or "Drill-or-Drop" commitments).

The Criterion

8. DECC requires that each company must demonstrate adequate Financial Capacity to cover its share of the proposed Work Programme as well as all of its existing commitments (including overseas commitments). DECC will take into account contingent commitments and drill-or-drop wells as well as firm commitments.

9. DECC requires evidence of 100% funding cover for all FDP, Firm and Contingent Commitments. However we recognise that not all Drill or Drop Work Programmes result in the drilling of a well and that it is not possible to determine which will be drilled at the time of application. We do not therefore require 100% funding cover for most Drill or Drop wells in a portfolio; instead a company must demonstrate 100% funding capacity for the single most expensive net well cost exposure, plus 50% of the cost of the others. This includes existing Drill-or-Drop work programme commitments as well as those being applied for. Some existing licences have multi-well Drill-or-Drop Work Programmes; in such cases, DECC will usually consider only the cost of a single well.

The Calculation

Net Worth

10. The way in which a company can demonstrate its capacity will vary from one case to the next, depending especially on the Company's size:

11. Many oil companies have a net worth that is so much greater than the cost of a Work Programme that this alone is enough to assure us that they will be able to raise funding where necessary, or will be able to fund the work from their own internal resources. So DECC will generally be satisfied by evidence that the Company's Net Worth is significantly greater than the sum of estimated costs and existing commitments, and will not need to consider specific funding arrangements.

12. A company whose Net Worth is not significantly larger than the sum of estimated costs and existing commitments will have to prove its capacity by reference to specific funding arrangements.

13. For the purposes of this assessment Net Worth is defined as Shareholders' Equity less Intangible Fixed Assets

Funding Arrangements

14. DECC recognises the flexibility and variety of funding arrangements and we do not want to be prescriptive in this respect. However, some of the ways funding deficits can be met include:

    - **Issue of additional share capital:** Provide details of the proposed share issue, together with documentary evidence that (a) the funds are available and have been irrevocably committed to the share issue by the investor(s), or (b) the share issue has been guaranteed/underwritten by a recognised financial institution or stock brokerage (future share issues will not be acceptable without such evidence). **Arrangements with financial institutions or stock brokerage firms whereby they undertake to raise equity on a "best efforts" basis will not be considered as adequate evidence of funding.**
    - **Parent company loan/guarantee:** the guarantee should be provided on the parent company's corporate stationery and use one of two prescribed forms of words which can be found on DECC's Oil & Gas website at Financial Capacity of Licensees Where an applicant seeks to satisfy DECC of its Financial Capacity in this way, besides requiring an parent company guarantee, DECC will apply its financial criteria to the parent instead.

- **Directors' loans** must be confirmed in writing and the Company must also satisfy DECC about the directors' ability to make such loans from their private resources.
- **Loans from banks or other financial institutions** if evidenced by a loan agreement signed by all parties. Loan agreements that have been made conditional upon the award of licence are acceptable but letters of intent from a bank or other financial institution are not. If a company will be relying on commercial debt to meet its existing and/or proposed licence commitments, or is a subsidiary of a corporate group which is reliant on commercial debt, DECC will need assurances that the funding arrangements will remain in place long enough to fund the Work Programme and that the company and, if applicable, the corporate group to which it belongs can meet the interest payments and agreed capital repayment obligations. A debt repayment schedule for the applicant company and, if applicable, for the corporate group should therefore be provided along with summary cash flow projections clearly showing interest charges and capital repayments. If the debt repayment schedule shows any significant redemption of debt within the next 12 months which cannot be met from operational cash flow, details of how the redemption will be funded should also be provided.
- **Future cash flows** from existing assets where those assets have proven reserves and are in production, or where production is imminent. DECC will require detailed financial projections for a period of not less than 5 years. As a minimum, these projections should comprise cash flow forecasts for both the Applicant Company and consolidated cash flow forecasts for any corporate group to which the Applicant Company may belong. Any assumptions made in the compilation of these forecasts should also be provided. Speculative cash flows, for example where assets are not in production and where production is not considered imminent, are not acceptable.

15. A company must demonstrate adequate Financial Capacity for each application at the time it is made. DECC will **<u>not</u>** defer the Financial Capacity assessment to give the Applicant additional time to put adequate funding arrangements in place once the application has been made. **<u>Companies should not knowingly make more applications than they can comfortably demonstrate funding for.</u>**

16. Note that, where funding is to be supplied by somebody other than the Applicant (e.g. by a parent company), the burden of proving Financial Capacity is logically shifted to that other party. In such a case, DECC cannot consider an application if that other party refuses to divulge the financial information that DECC requires.

17. **'Promote Applicants'** need not meet DECC's Financial Capacity criteria before Licence award. However, we will apply our financial criteria to the Licence Group as it stands at the second anniversary of a Promote Licence, and the Licence will automatically expire at that time unless DECC is satisfied – the effect is only to defer financial checks, not waive them altogether. The financial checks will be those in force for new applications at the time.

FINANCIAL CAPACITY - ASSIGNMENTS

PROMOTE LICENCES

18. DECC's policy requirement in this regard is to ensure that a Promote Licence is only assigned to financially viable companies.

19. DECC will apply the same Financial Viability criteria to the assignment of Promote Licences as it does for the award of new Licences in a Licensing Round.

20. In the period up to the Secretary of State's decision to continue the Promote Licence, which is expressed to happen after two years though the licensee may elect to request it earlier, DECC will not apply any Financial Capacity criteria to assignees.

ALL OTHER LICENCES EXCEPT PROMOTE LICENCES

21. DECC's policy requirement in this regard is to ensure that Production Licences are held by companies who are both financially viable and able to meet all their liabilities and obligations under the Licence, and who have the Financial Capacity to undertake whatever work programme may be agreed. To achieve this, DECC requires that each company must satisfy DECC's Financial Viability criteria and demonstrate it has the Financial Capacity to fund its share of costs of any agreed Work Programme as well as all of its existing commitments (including overseas commitments). For these purposes "Work Programme" means the Initial Term Work Programme, any Programme agreed with DECC under the Fallow Initiative, any Related Work Elements on a Prospective Area or any other commitments that the Licensee may have made to DECC.

22. DECC will apply the same Financial Viability and Financial Capacity criteria to licence assignments as it does for the award of the same type of licence in a Licensing Round.

23. If there is no agreed or assumed work programme or pending FDP, the assignee will not be subject to any Financial Capacity checks but will need to demonstrate financial viability.

INFORMATION AND DOCUMENTATION REQUIREMENTS

24. In some cases, for example following a Licensing Round or earlier licence assignment, DECC may already hold sufficient information for it to be able to assess the assignee's Financial Viability and Financial Capacity. In such cases there is no requirement for the assignee to provide any accounting or other financial information. DECC will be able to advise whether this is the case.

25. Where DECC does not have access to sufficient information to enable it to make a judgement as to the assignee's financial position, it will send a formal request to the assignee asking for such information as it needs to enable such a judgement to be made. This request may include but not be limited to the following:

    - An estimate of the assignee's share of any work programme costs
    - Full disclosure of the assignee's existing UK and non-UK commitments and associated costs
    - If the burden of proving adequate Financial Capacity has been shifted to a corporate parent, the corporate parent must also provide a full disclosure of the Group's UK and non-UK commitments and associated costs.
    - One copy of the assignee's recent accounts or financial statements.
    - One copy of the most recent group (consolidated) accounts of any body-corporate having ultimate control of the assignee.
    - Evidence of adequate Financial Capacity.
    - If a company will be relying on the financial support of a corporate parent, a parent company guarantee will be required which must be on the corporate

stationery of the guarantor and in the prescribed format. (Please note: corporate parents may already have provided a parent company guarantee in favour of the assignee in our preferred, multi-licence format. If this is the case DECC does not require a new parent company guarantee as the existing guarantee will cover the new licence obligations.)

- If a company will be relying upon commercial debt to meet its existing and/pr proposed licence commitments, or is a subsidiary of a corporate group which is reliant upon commercial debt, DECC will need assurances that the funding arrangements will remain in place for the foreseeable future and that the company and, if applicable, the corporate group to which it belongs can meet the interest payments and any agreed capital repayment schedule. A debt repayment schedule for the applicant company and, if applicable, for the corporate group should be provided along with summary cash flow projections clearly showing interest charges and capital repayments. If the debt repayment schedule shows any significant redemption of debt within the next 12 months which cannot be met from cash flow, details of how the redemption will be funded should also be provided.

26. DECC aims to turnaround assignment requests within 10 working days of receipt. However, this timescale may not be achieved if we need to request additional financial information. We are unable to issue consent for any assignment until the appropriate financial checks have been performed. To expedite matters, assignees may, if they so wish, send the required financial information in advance of receiving a formal request for the same from DECC.

27. The requested information may be submitted in hardcopy, on a single CD-ROM or as PDF documents by email to:

Nic Rogers
Accountancy Adviser
Department of Energy and Climate Change
Oil & Gas Licensing
V2133
1 Victoria Street
London SW1H 0ET

E-mail: Nicholas.Rogers@decc.gsi.gov.uk

FINANCIAL CAPACITY - Well Consent: Exploration and Appraisal Wells

28. DECC's policy requirement is to ensure that no well consents are issued unless we are satisfied that the licensee(s) has(have) access to sufficient funds to meet its share of the actual drilling costs and the plugging and abandonment of the well if it is proven to be "dry" or otherwise non-viable. The sum of all these is referred to hereafter as the "Well Costs". Although DECC does not specify the level of contingency to be included in the well costings, we will assess the extent to which a licensee is able to finance any cost overruns.

29. Additionally, S75 of the Energy Act 2008 added a provision to the Petroleum Act 1998 that grants to the Secretary of State the power to require financial information and documents from a company that has drilled, or started to drill, a well. DECC will analyse that information and decide whether or not it is satisfied that the company will later be able to plug and abandon the well. Where DECC is not sufficiently confident of this, DECC is empowered to require the company to take further action that will bring the necessary level of confidence, and while the action is not specified it might include the creation of financial security such as a Letter of Credit for the required amount under DECC's control.

30. DECC will routinely check the applicant's financial capacity in the context of considering a well consent, and if we are not satisfied of the applicant's financial capacity we can either refuse the Secretary of State's consent, or give consent whilst making clear that we will invoke the Secretary of State's powers from the Petroleum Act if the applicant chooses to drill.

31. This power applies equally to all wells, whether onshore or offshore, drilled under a Petroleum Act licence or a Gas Storage Licence.

32. DECC's Financial Capacity criteria for well consents are more onerous than those applied by DECC at licence award or licence assignment in that each licensee has to demonstrate actual availability of cash resources to meet its share of the Well Costs, not merely the capacity to raise the necessary cash.

33. For example a company may have been awarded a licence on the basis that its Net Worth was significantly in excess of its total potential licence commitments so DECC was satisfied that it will be able to raise money to cover drilling costs when necessary. However when that company comes to seek a well consent, it will have to satisfy DECC that it has actually raised the money, whether from internal cash and bank balances or from external sources of cash.

INFORMATION AND EVIDENCE REQUIREMENTS

34. Each company participating in a well should provide a detailed estimate of its share of the Well Costs as defined in paragraph 1 above, and evidence of the availability of cash resources to pay for its share of the Well Costs.

35. Acceptable evidence of cash resources include, but are not limited to, bank statements, Parent Company funding and operating cash flows from producing assets.

36. If the evidence provided by any company shows a deficit of liquid cash resources to meet its share of the Well Costs, it should also provide additional evidence of the availability of third party funding upon which it can draw in order to meet its licence obligations. DECC does not wish to be too prescriptive in this respect but sources of third party funding would include:

- **Parent company funding:** DECC would expect the corporate parent to provide evidence of the availability of sufficient liquid cash resources to provide sufficient funds to its subsidiary to enable it to meet its share of the Well Costs. DECC would also expect the provision of parent company funding to be formalised, for example by the provision of a parent company guarantee (if not previously provided) or inter-company loan agreement. Any parent company guarantee should be provided on the parent company's corporate stationery and use one of the two prescribed forms of words which can be found on DECC's Oil & Gas website at http://og.decc.gov.uk/en/olgs/cms/licences/licensing_guid/suitability_of/fincaplic/fincaplic.aspx.

- **Directors' or Shareholders' loans:** these must be confirmed in writing and the company must provide adequate evidence that the directors and/or shareholders have access to sufficient liquid cash resources to provide the necessary funds to the licensee.
- **Loans from banks or other financial institutions:** These must be evidenced by a copy of the executed loan agreement signed by all parties. **Undertakings by a bank or other financial institution to provide loans or letters of intent are not acceptable**.
- **Future cash flows:** from existing assets where those assets have proven reserves and are in production. The licensee must demonstrate that the cash flows are sufficient to enable it to meet its share of the Well Costs.

37. If a company will be relying upon commercial debt to fund its share of the Costs, or is a subsidiary of a corporate group which is reliant upon commercial debt to provide its subsidiary with the necessary funds, DECC will need assurances that the funding arrangements will remain in place for the duration of the work programme and that the company and, if applicable, the corporate group to which it belongs can meet the interest payments and agreed capital repayment obligations.

DOCUMENTATION REQUIREMENTS

38. The information required under "Information and Evidence Requirements" may be uploaded to WONS as PDF documents or be sent separately to:

Nic Rogers
Senior Accountancy Adviser
Department of Energy and Climate Change
Oil & Gas Licensing
Area B, 3rd Floor
3 Whitehall Place

London SW1A 2AW
Tel: 202 7215 5728
E-mail: Nicholas.Rogers@decc.gsi.gov.uk

39. DECC's policy requirement in this regard is that before it grants FDP consent the licensee, or each company in a licence group that has an interest in the FDP, has to demonstrate access to sufficient funds to meet its share of the actual FDP costs. Although DECC does not specify the level, we would expect FDP costings to include a reasonable contingency. In any event DECC will assess the extent to which licensees are able to finance cost overruns and other contingencies.

40. The FDP Costs do not include future decommissioning as this is covered by separate guidance issued by DECC's Decommissioning Unit based in Aberdeen.

41. DECC's Financial Capacity criteria for FDPs is stricter than those applied at licence award or licence assignment in that each licensee has to demonstrate actual availability of cash resources to meet its share of the FDP Costs, not merely the capacity to raise the necessary cash.

42. An FDP will include both a detailed breakdown of the FDP Costs and, where there are multiple licensees, the licence equity split. Unless otherwise informed, DECC will assume FDP Costs for each licensee will be in accordance with their equity stake.

43. The licensee, or each company within the licence group that has an interest in the FDP, should individually provide evidence of the availability of cash resources to pay for its share of the FDP Costs.

44. Acceptable evidence of cash resources include, but are not limited to, bank statements, Parent Company funding and operating cash flows from producing assets.

45. If a company's evidence shows a deficit of liquid cash resources to meet its share of the FDP Costs, it should also provide additional evidence of the availability of third party funding upon which it can draw in order to meet its licence obligations. DECC does not wish to be too prescriptive in this respect but sources of third party funding could include:

    - **Parent company funding:** DECC would expect the corporate parent to provide evidence of the availability of sufficient liquid cash resources to provide sufficient funds to its subsidiary to enable it to meet its share of the FDP Costs. DECC would also expect the provision of parent company funding to be formalised, for example by the provision of a parent company guarantee (if not previously provided) or inter-company loan agreement. Any parent company guarantee should be provided on the parent company's corporate stationery and use one of the two prescribed forms of words which can be found on DECC's Oil & Gas website at http://og.decc.gov.uk/en/olgs/cms/licences/licensing_guid/suitability_of/fincaplic/fincaplic.aspx
    - **Directors' or Shareholders' loans:** these must be confirmed in writing and the company must provide adequate evidence that the directors and/or shareholders have access to sufficient liquid cash resources to provide the necessary funds to the licensee.
    - **Loans from banks or other financial institutions:** These must be evidenced by a copy of the executed loan agreement signed by all parties. **<u>Undertakings by a bank or other financial institution to provide loans or letters of intent are not acceptable</u>**.
    - **Future cash flows:** from existing assets where those assets have proven reserves and are in production. The licensee must demonstrate that the cash flows are sufficient to enable it to meet its share of the FDP Costs as they fall due.

46. If a company will be relying upon commercial debt to fund its share of the Costs, or is a subsidiary of a corporate group which is reliant upon commercial debt to provide its subsidiary with the necessary funds, DECC will need assurances that the funding arrangements will remain in place for the duration of the Field Development and that the company and, if applicable, the corporate group to which it belongs can meet the interest payments and any

agreed capital repayment schedule. A debt repayment schedule for the applicant company and, if applicable, for the corporate group should be provided along with summary cash flow projections clearly showing interest charges and capital repayments. If the debt repayment schedule shows any significant redemption of debt within the next 12 months which cannot be met from cash flow, details of how the redemption will be funded should also be provided.

47. If the Applicant Company, or the corporate group to which it belongs, intends to fund the Field Development from cash flows from assets that are currently in production, DECC will require detailed financial projections covering at least the period of development. These projections should comprise cash flow forecasts for both the Applicant Company and consolidated cash flow forecasts for any corporate group to which the Applicant Company may belong. Any assumptions made in the compilation of these forecasts should also be provided.

48. DOCUMENTATION REQUIREMENTS

49. The information required under "Information and Evidence Requirements" may be provided in hardcopy, on a single CD-ROM or as PDF documents by e-mail.

50. The financial information may be provided with the application for FDP consent or it may be sent separately to:

Nic Rogers
Senior Accountancy Adviser
EDU
Dept of Energy and Climate Change
Area B
3rd Floor
3 Whitehall Place
London SW1A 2AW

Tel: 0300 068 6049

email: Nicholas.Rogers@decc.gsi.gov.uk