FINANCIAL CAPACITY OF LICENSEES

This note should be read as a general guideline to DECC policy on licensees' financial capacity, not as a set of clockwork rules that would constrain our ability to employ a reasonable approach in each case. Nothing here fetters the Secretary of State's discretion in any way in any particular case.

Background

The financial capacity of companies on the UKCS is becoming more of an issue for DECC as large companies contract to core areas, and are replaced elsewhere by smaller companies - sometimes very small companies.

This is an evolving policy area, but at all times our considerations will be informed by DECC's objective (Obj 4) to ensure the continuity and security of energy supply at affordable prices through competitive markets, whilst minimising environmental impacts and delivering social objectives.

It is an integral part of our work towards this objective to promote worthwhile activity (seismic, drilling and development). It is also essential that we protect the taxpayer from uncovered liabilities.

In this light, a company's financial capacity can be relevant to our work in several ways:

- where DECC expects or desires work to be carried out on a licence, a company's presence may stop that work if it can't afford to pay its share of the bills in good time; and
- in an extreme case, a company could become insolvent and leave liabilities and obligations unpaid.

DECC will not award a licence, nor consent to an assignment of a licence, to a company that cannot demonstrate the financial capacity to meet its expected commitments, liabilities and obligations; or to one that is insolvent or appears to be in danger of becoming so.

Need for financial capacity

Financial capacity becomes especially relevant where there is a clear programme of new work that needs to be funded, such as exploration drilling. In some cases, the work may constitute a commitment to the Secretary of State (e.g. an Initial Term Work Programme, or work designed to end a licence's fallow status). Such work is very important to the achievement of DECC's objectives, and we will want to be satisfied that any new company on a licence can provide its share of the necessary funding in good time, so as not to delay or prevent the work.

In any particular case there may not be any high-priority work of this sort, in which case it's much less likely that the company need demonstrate anything more than its viability.

All other things being equal, DECC would not seek to impose commercial choices on anybody. For example, if a company wanted to join two licences and its capacity was equal to one or the other but not both, we would hope to be able to let the company make up its own mind which licence to join.

DECC's Exploration Unit will be able to discuss Initial Term Work Programmes and Fallow Acreage. The relevant Field Team will be able to discuss its expectation of new work on existing fields.

Level of financial capacity

The capacity that must be demonstrated is the ability to meet in timely fashion the actual costs that may reasonably be expected to arise.

Decommissioning

The obligation to pay decommissioning costs is a very important issue, but DECC handles it separately and it is not part of any of the procedures described here.

We expect the company to provide reasonable and realistic estimates of those costs, including contingencies (for example, including the cost of a sidetrack when drilling a well). Where an estimate looks unrealistically low, we may want to see evidence that it can be achieved (for example, a signed agreement with a drilling company).

Ultimately, we will use our own estimates and assumptions if we are unconvinced by those provided by the company.

Acceptable financial arrangements

It's understandable that companies want to know which financial arrangements will be acceptable to DECC. But DECC prefers to be flexible and open to ideas than to be prescriptive. Therefore we do not propose to dictate a range of acceptable options and close the door to any others, and can only give general guidance about the approach we will take.

Here is a link to **DEPARTMENT OF ENERGY AND CLIMATE CHANGE – UK PETROLEUM LICENSING: FINANCIAL GUIDANCE**

Parent companies

DECC requires a Parent Company Guarantee whenever there is a Parent with significant financial capacity. The only exception would be the case where the parent has no significant assets of its own, so that a Parent Company Guarantee would be redundant. DECC has produced two standard forms of words, which should be printed under the company letterhead and signed on the company's behalf.

Our preferred parent company guarantee is designed to cover the licensee's existing licence interests and those it may be awarded or assigned in the future. Administratively, this form of parent company guarantee would be more efficient but we recognise that companies may prefer to provide parent company guarantees on a licence by licence basis. The second form of words remains licence specific and the licensee's corporate parent will be required to provide one in this format for each and every licence interest the licensee is seeking to acquire."