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Foresight

A new ownership model for North Sea infrastructure?

The recent announcement of Total's sale of interests in the St Fergus gas terminal and in the FUKA and SIRGE gas pipelines to North Sea Midstream Partners (an affiliate of Arclight, the private equity investor) continues the relatively recent trend of independent oil company disposing of midstream assets in the North Sea to private equity and infrastructure funds. This follows NSMP's own purchase of the Teesside Gas Processing Plant (TGPP), an onshore gas processing terminal, in 2012 and other similar recent transactions such as the April 2015 announcement by BP of a sale of its 36% operated stake in the CATS pipeline system to Antin Infrastructure Partners, and BG's own disposal of its 63% CATS interest to Antin in 2014.

Midstream infrastructure is crucial to the longevity of the North Sea and it is likely that the independent ownership of such infrastructure can help maximise the ultimate economic recovery of the UKCS's oil and gas reserves, consistent with the findings of the Wood Review and the consequent focus on maximising economic recovery (MER) in the UK North Sea. Low commodity prices are forcing companies to reduce costs and offload assets to offset weaker revenues and we can expect to see further North Sea midstream infrastructure divestments over the coming months and years.

Oil company ownership of midstream infrastructure was developed at a time when the industry was booming and when large-scale fields were being developed. The ownership of infrastructure by E&P companies ensured a low-cost and secure transportation route to shore for their own oil and gas, while they also benefited from transportation tariffs from other oil companies requesting spare capacity in their pipeline(s). As many of these original fields mature and move towards decommissioning, those E&P companies now holding the field interest have little to gain from owning the infrastructure but not using the capacity themselves. While many E&P companies welcome third party business which provides additional income and investment that often extends the life of existing fields, as a standalone business, infrastructure ownership does not provide the profit margin that such companies (and more importantly their shareholders) expect and may be viewed by some as an unwelcome distraction from their core business. So, in spite of the Infrastructure Code of Practice (which seeks to facilitate fair access to offshore infrastructure), this dichotomy often creates conflicts of interest and, in some cases, a lack of drive on the part of oil company infrastructure owners to take-on new transportation business or to be flexible in respect of the terms. By contrast, infrastructure funds are set-up to do business on lower returns.

Such infrastructure investments are attractive to investment funds as they can provide guaranteed inflation-linked income, with relatively low running costs. Decommissioning costs are often not a major concern as pipelines may often be trenched and buried in situ rather than having to be removed like offshore platforms. Moreover, the regulatory burden imposed on owners of pipelines is lower than that for production licences and the related platforms and wells. In Norway, returns from gas transportation infrastructure are regulated by the government and are designed to keep major profits with the fields, while allowing a reasonable rate of return on the infrastructure owner's investment.

However, there are challenges to be overcome in transferring pipelines into the hands of infrastructure funds.

The main challenge in the North Sea is that unlike the assets mentioned in the NSMP and Antin transactions above which involved infrastructure assets held under an infrastructure-specific joint venture, much of the offshore pipeline and infrastructure network in the UK is more closely integrated and owned in common with existing E&P infrastructure (platforms, wells and the like) and a key consideration for an owner seeking to sell its stake in a pipeline will be how to delink it from existing E&P infrastructure while protecting the hydrocarbon evacuation route. From a legal perspective the wells, platform and pipeline evacuation route all typically constitute "joint property" under the joint operating agreement. A separate joint venture would therefore require to be set up to manage the infrastructure and an interest in that joint venture then sold to the buyer. Save in the case of 100% owned assets, this "split" will require the consent of co-venturers which may or may not be forthcoming (unless a similar deal is offered to them which they are willing to accept). Although in some cases a trust or synthetic/transfers of income related agreements may be possible in order to pass a "beneficial" type of interest to a fund where the legal interest cannot be transferred without co-venturer consent, this is unattractive to a fund from the perspective of it seeking true ownership of, and thereby security over, the asset.

A further challenge in these transactions is that infrastructure funds are, for structural reasons, special purpose investment entities often unable to give guarantees from parent or affiliate entities, or to obtain letters of credit or the like from financial instructions, meaning that innovative legal and commercial approaches require to be taken in terms of satisfying co-venturers' financial capability concerns and related decommissioning security requirements, through placing monies in trust and ensuring adequate insurances are in place, for example.

I will end with a cautionary tale from Norway where four of the infrastructure fund investors in the Gassled joint venture have taken the Norwegian government to court over the passing of legislation restricting tariff levels which they say will reduce the returns of the Gassled owners by €4.4 billion. While the UK Government does not currently regulate the rate of return for UKCS infrastructure owners, it is interesting to note that none of the traditional E&P companies have joined the proceedings. This may be because they gain more from the tariff reductions in their capacities as shippers then they lose as transporters. Whatever the reason for their absence, what is true is that while the infrastructure funds owners will be more minded to aggressively market for third party business, with lower margins available on their investment and no field interests of their own to protect, they might also be more likely to vigorously defend their bottom line.

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Key contact

Norman Wisely
Partner
T +44 (0)1224 622 002
E norman.wisely@cms-cmck.com

Further information, including a list of our offices, can be found at **www.cms-cmck.com**
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