



Oil & Gas
Authority

Case INV-2019-00104 **Recommendation - Summary**
Prioritisation of access to Cygnus capacity
in relation to transportation and processing services for
gas from the Pegasus field

Background

The Cygnus field, operated by Neptune E&P UK Ltd ('Neptune') with its JV partner Spirit Energy North Sea Limited ('Spirit'), commenced production in December 2016. The well performance currently exceeds the export capacity, resulting in a lack of ullage (space for gas from other fields) in the short term.

The Pegasus field owners, Spirit and its JV partner Halo Offshore UK Limited ('Halo'), expressed a wish to tie back to Cygnus for export of their gas. Detailed commercial negotiations took place during 2017, with non-binding heads of terms ('HoT') agreed between the parties in March 2018. The HoT anticipated a commencement window for Pegasus to obtain access to the Cygnus facilities of between October 2021 and December 2023.

However, as detailed engineering work progressed and Neptune also obtained more understanding of the subsurface through production experience, Neptune considered that there were barriers to proceeding with the HoT as previously agreed. Spirit, meanwhile, in its capacities both as Cygnus JV partner and Pegasus owner, considered that the changes identified by Neptune were not material and that the Cygnus JV should honour the HoT. It appeared that the parties could have taken considerable time to resolve this dispute by themselves.

The OGA's Investigation

The OGA, on its own initiative, opened a non-binding dispute resolution investigation under the Energy Act 2016, on 25 June 2019. The scope of the dispute was the prioritisation of access to Cygnus capacity in relation to transportation and processing services for gas from the Pegasus field, taking into account in particular (a) the nature and timing of the various Cygnus resource progression opportunities, (b) the plant operating mode limitations, and (c) the pre-investment made in future facilities at the time of Cygnus FID / FDP consent.

The OGA carried out its investigation in accordance with the procedures set out in its Dispute Resolution Guidance, https://www.ogauthority.co.uk/media/5759/oga_dispute_resolution_guidance-may-2019.pdf, see in particular sections 5 and 6. Information was sought using the OGA's formal information gathering powers, with which all parties complied.

The Parties' positions

In summary, Neptune stated that the HoT were drafted based on the end 2017 reserves for the Cygnus field, and the subsurface performance has been better than expected. At the same time, its ability to export gas had been constrained beyond that originally anticipated, and previously unknown technical limitations and challenges had been discovered during engineering work. Neptune concluded that the HoT as agreed would constrain the production of current and future Cygnus equity gas, inconsistent with both the MER UK Strategy and the Infrastructure Code of Practice ('ICOP').

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Spirit, in its capacity as Cygnus JV partner, stated that there have not been any material changes since the HoT were signed, that would warrant reopening their terms. It stated that the uncertainties around subsurface data and likely field performance, and the technical limitations, were already known previously. It considered that third party business (such as Pegasus) is a mechanism through which potential downside in Cygnus production performance may be mitigated. It was also concerned that there had been a delay in Neptune communicating its revised position effectively.

Pegasus stated that Cygnus should adhere to the HoT which were negotiated over the course of a year, with the uncertainties acknowledged during negotiation. It is not aware of any Cygnus developments that are at the same stage as Pegasus, so that ullage may be sterilised needlessly. Pegasus noted that ICOP requires prospective hosts to “offer terms to parties in good faith” and the Cygnus Owners should comply with the HoT.

Draft Recommendation

Having considered all of the facts and information provided by the parties, the OGA issued a draft recommendation to the parties on 30 July 2019. The parties provided the OGA with representations on the draft recommendation. The OGA, having taken those representations into account, has now issued a final recommendation to the parties.

The OGA’s Final Recommendation – initial points

The OGA’s recommendation must be one which it considers will enable the dispute to be resolved in a way which best contributes to the fulfilment of the principal objective whilst having regard to the need to achieve an economically viable position for the parties to the dispute.

In summary, because of the remaining uncertainties around future production capacity of the Cygnus field, the OGA’s recommendation does not specify a date at which ullage should become available for Pegasus gas to be exported via Cygnus, or indeed whether that would be the best export solution for Pegasus gas.

The OGA also notes that there have been various breakdowns of communication between the parties, including between the companies within the Cygnus JV. Misalignments within JVs have the potential to impact adversely on MER UK and the OGA considered that the Cygnus JV partners should ensure they are operating in accordance with the provisions of their Joint Operating Agreement, and carry out significant work on improving collaborative behaviours within the JV.

As a general rule, the OGA considers that parties should negotiate HoT in good faith, and that they should adhere to non-binding HoT so far as possible (and as a corollary of this, infrastructure owners should ensure that they consider potential outcomes properly before commencing negotiations that may lead to significant expenditure by prospective users), but the OGA notes that there will be situations where the supporting facts change to the extent that renegotiation of some of the terms may be necessary. This would appear from the information before the OGA to be one of those situations.

The OGA’s Final Recommendation

The OGA issued the final Recommendation to the parties on 30 August 2019. It should be noted that the OGA is not suggesting, at this stage, that Cygnus should

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prioritise capacity for Pegasus over its own current (and reasonably forecast future) requirements. However, Cygnus should take the actions set out in Recommendations 1 to 3, and Pegasus should continue to explore alternative export routes in parallel.

Recommendation 1: The Cygnus JV to issue a hub strategy, inclusive of both equity and third-party gas opportunities for the next five years, by end September 2019 at the latest. This should include an agreed list of Cygnus area targets and associated plans to prioritise these opportunities. The Cygnus JV to issue an updated and revised hub strategy by end March 2020 at the latest to take account of the results of the technical work set out in Recommendation 2 below, as well as including a defined and agreed Cygnus view on ranges and profiles for planning purposes and an extension of the agreed list of Cygnus area targets and associated plans to prioritise these opportunities that extends beyond the five-year period.

Recommendation 2: In parallel with Recommendation 1, the Cygnus JV to prioritise work on technical solutions that would remove the current blockers not only to third party business (whether Pegasus or otherwise) but also to infield and near-field developments. Such prioritisation work to include a debottlenecking study and a process simulation model. Monthly progress reports should be delivered to the OGA, and significant progress towards solutions should be made by end February 2020. There should be transparent and timely communication by Cygnus with Pegasus (and any other interested third parties) throughout this process.

Recommendation 3: The Cygnus JV should improve its knowledge of the subsurface and progress its hopper of infield opportunities in a timely manner, with timescales to be agreed by the OGA.

Recommendation 4: Should all of the parties deem it appropriate pursuant to the Strategy for Pegasus to be delivered over Cygnus, the parties should return to the HoT and jointly work through such changes as would be needed to enable agreement to be concluded between them. The OGA considers that to deliver an outcome that is consistent with the Strategy, the parties should ensure that revised, binding fully termed agreements are finalised and signed as soon as reasonably practicable, to give Pegasus the certainty to move forward either on Cygnus or elsewhere. The parties should provide the OGA with monthly reports on progress of the discussions.

Recommendation 5: While there is continued uncertainty over the ability for Cygnus to transport the Pegasus gas volumes, the Pegasus JV should continue its work to identify and evaluate alternative export options.