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Maximising economic recovery from the United Kingdom Continental Shelf: An update



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In July this year the new UK Energy Bill started its passage through Parliament, beginning in the House of Lords. The Bill represents the second stage of the implementation of the Wood Review recommendations that a new strategy for maximising economic recovery from the UKCS be developed and a new regulator be created with additional powers to facilitate the execution of that strategy. The first stage of that implementation was the establishment of the Oil and Gas Authority (OGA) as an executive agency of DECC and the passing of the Infrastructure Act 2015.

Once passed, the Bill will, together with the amendments to the Petroleum Act 1998 which were made by the Infrastructure Act, provide the framework for the OGA's operation and the transfer to it of DECC's oil and gas regulatory functions, and the additional powers that the Wood Review recommended it should have.

The changes to the regulatory landscape in the UKCS as a result of the Bill will be significant for industry participants. In particular, the establishment of the OGA as a more active regulator, with a new mandate to maximise economic recovery from the UKCS as a whole, is likely to mean that industry participants will wish to consider how they interact with it more closely than was previously the case.

The purpose of this note is to provide an overview of the provisions of the Bill and changes to the regulatory landscape that it will bring.

MER UK

A key theme of the Wood Review recommendations was that the pursuit of individual commercial interests by UKCS licence holders, operators and infrastructure owners is likely to result in a failure to maximise economic

recovery from the UKCS for the benefit of the UK.

The objective to maximise recovery from the UKCS as a whole (MER UK) has therefore been placed at the heart of the new regulatory framework. It is referred to in the Petroleum Act and the Bill as the "principal objective". It is required to be achieved in particular through:

- development, construction, deployment and use of equipment in the petroleum industry; and
- collaboration among holders and operators of petroleum licences, owners of upstream infrastructure and persons planning and carrying out the commissioning of upstream infrastructure (UKCS stakeholders).

A more detailed strategy for enabling MER UK to be achieved is required to be put in place by April 2016. DECC is responsible for producing and consulting on the initial MER strategy and the OGA will be required to review and (if necessary) update it every four years.

MER UK and the MER UK strategy are therefore fundamental to the new regulatory structure, not least because, as explained in more detail below, both the OGA and UKCS stakeholders will be under a statutory



duty to comply with the MER UK strategy and the OGA will be able to require compliance with it and impose sanctions for failures to do so.

DECC included a high level illustrative MER UK strategy in its call for evidence on the implementation of the Wood Review in November 2014. The initial feedback it received is summarised in its response to that **call for evidence** and it is currently carrying out additional consultation with industry stakeholders.

Given the focus of MER UK, there is significant scope for misalignment between the OGA's views on how the MER UK strategy should be implemented in any particular circumstance and the individual commercial interests of the relevant industry stakeholders. The way in which the final MER UK strategy recognises the importance of those interests, and the extent of the emphasis that it places on them, will therefore be of central importance to stakeholders.

The Wood Review stated that MER UK should not be used to require stakeholders to invest, and DECC's response to its call for evidence stated that a key theme to emerge from its initial consultation was that it was important that the MER UK strategy recognised the need to offer internationally competitive and fair returns (and that MER UK should not inhibit freedom to make investment decisions and should aim to create an attractive investment environment). In addition (as mentioned below) the OGA is required to have regard for the need to encourage investment in exercising its functions. However, the nature of MER UK means that there will almost certainly be circumstances where the views of the OGA and individual stakeholders in relation to a particular matter cannot be reconciled, and this will almost certainly have cost implications for the stakeholders concerned.

Transfer of regulatory functions

As mentioned above, certain oil and gas regulatory functions of the Secretary of State for Energy and Climate Change (SoS) are to be transferred to the OGA under the Bill.

In addition, the Bill allows the SoS to transfer additional functions to the OGA. These include petroleum licencing functions under the Petroleum Act that the Bill does not directly transfer, licencing functions in relation to the gas and carbon dioxide storage under the Energy Act 2011 and functions under the Energy Act 2008 in relation to the resolution of disputes in connection with access to upstream infrastructure. The OGA may amend licences and other authorisations to give effect to such a transfer.

As currently drafted the Bill does not provide for the

transfer of the SoS's powers under Part 4 of the Petroleum Act to give s.29 notices requiring licence holders to prepare decommissioning plans. However, DECC have indicated that the Bill will be amended during the parliamentary process to include additional (more technical) provisions in relation to decommissioning and it may be that these powers will also be transferred.

The OGA's functions will apply both onshore and offshore. Certain onshore functions in respect of Scotland and Wales are to be devolved to the Scottish and Welsh Governments, but may be transferred to the OGA for an interim period until those functions are devolved.

In exercising its functions, the OGA is to have regard to the following:

- The need to minimise public expenditure.
- The need for the security of supply.
- The need for the OGA to work collaboratively with Government and industry participants.
- The need to encourage innovation in technology and working practices.
- The need to maintain a stable and predictable regulatory system which encourages investment.

Additional powers

Overview

The Wood Review recommended that the OGA be given powers in addition to those which the SoS has under the terms of existing licences and the current regulatory regime. These powers will be restricted to offshore licences and activities.

Disputes

The Wood Review considered that a lack of collaboration and overzealous legal and commercial behaviour between operators and other industry participants has resulted in disputes and led to increased costs, delays in projects, stranded assets and increased costs on the UKCS. To address this, it recommended that the OGA be given the ability to make non-binding recommendations as to how disputes between stakeholders should be resolved.

The Bill implements those recommendations. The dispute resolution provisions apply to any dispute between UKCS stakeholders which are either relevant to the fulfilment of MER UK or relate to activities carried out under an offshore licence may be resolved under the provisions. In practice this is likely to cover almost all disputes on the UKCS.

A UKCS stakeholder who is party to dispute can refer



it to the OGA for determination but the OGA may also decide on its own initiative to consider a dispute.

The OGA has extensive procedural powers in connection with the management of the dispute, including the ability to set the timetable for its resolution and to require parties to provide information and attend meetings. Failure to comply with the OGA's directions in relation to these procedural matters are sanctionable under the sanctions regime (on which see below).

The Bill's dispute resolution procedures are not exclusive, so other resolution procedures (including arbitration and litigation) may run in parallel to an OGA dispute resolution procedure. This clearly has potential to result in duplication, although it may in practice be that the parties agree to suspend other resolution procedures and attempt to resolve the dispute through the OGA procedure. The OGA procedure is not available for disputes in relation to third party access to upstream infrastructure under the Energy Act 2011 which have reached the stage of an application for determination by the OGA under that Act and the OGA is considering that application.

Unless the parties resolve the dispute themselves, the outcome of a dispute which is dealt with under the OGA procedure will be a recommendation from the OGA on how it should be resolved. The OGA's recommended resolution must be one which it considers will best contribute to MER UK, having regard for the need to achieve an economically viable position for the parties. There is no further definition of what "economically viable" means.

A recommendation by the OGA will not in itself be legally binding. However, to the extent that failure to comply with that recommendation would result in a party not failing to comply with the MER UK strategy, sanctions under the sanctions regime would be available to the OGA.

Information / samples

The Wood Review recognised that ready access to timely data is necessary for a competitive market in the UKCS.

The model terms of UKCS licences contain extensive provisions in relation to the keeping of records and provision of information to DECC. DECC's **PON 9** sets out its current requirements for the provision and publication of information. In addition, it has agreed guidelines with Oil & Gas UK in relation to the publication of seismic data.

The Bill includes a number of provisions which supplement the licence requirements and which are intended to fulfil any perceived gaps in those provisions.

Information and samples plans

One of those gaps is that the requirement to keep data ceases on a licence transfer. The Bill includes a requirement for a licence holder to produce an "information and samples" plan in connection with a "licence event" (which is broadly a transfer or termination of a licence). The plan must set out what is to happen to the information and samples which the licence holder holds in relation to the relevant licence after the licence event. It must be agreed with the OGA. Failure to comply with it is sanctionable under the sanctions regime.

One point which will need to be considered when agreeing a plan is the extent to which the licence holder is permitted to transfer data (in particular speculative seismic data) and who will be responsible for any additional fees which may be payable as a result of this. Similarly, licence holders will not normally sell or provide their own interpretations of data to a purchaser on a sale or farm in and the extent to which a plan may require them to do so will need to be considered.

Additional powers to require information / samples to be provided

The OGA will be given a new power (in addition to the powers already contained in the licences) to require information and samples which are relevant to the fulfilment of MER UK to be provided to it.

The SoS will have the power to make regulations which may contain additional provisions (in addition to those set out in licences) for the retention of information and samples which are relevant to the fulfilment of MER UK and which allow information provided to the OGA under these provisions to be published or otherwise made available to the public. Depending on the terms of the regulations, this disclosure requirement could result in a change to the current arrangements (in PON 9 and other guidance) for the publication of data.

Meetings

The Wood Review recommended that the OGA should have the right to attend industry meetings as an observer in order to assist its efforts in maintaining oversight of the MER UK strategy.

Under the Bill, the OGA will have the right to be informed of and attend any meeting between representatives of a UKCS stakeholder which is relevant to the fulfilment of MER UK or relates to activities carried out under an offshore licence. Where the OGA does not send a representative to the meeting, the participants must provide it with a written summary of the meeting and the decisions reached at it.



Given the large number of meetings to which these provisions will apply, it is clear that these provisions could be extremely burdensome. However, we understand that the OGA intends to publish guidelines on how it will apply the provisions, which will hopefully assist in reducing that burden.

Sanctions

Under the current regulatory regime, the main sanction which is available to the SoS for breach of licence conditions is the revocation of the licence. This is regarded as the “nuclear option” and, given its severity, as not being as effective a deterrent in ensuring compliance with the relevant requirements as it might be.

The Wood Review recommended a more graduated sanctions regime be put in place, and the Bill contains provisions to implement that regime.

In broad terms, sanctions may be imposed in relation to a breach of a “petroleum related requirement”. There are three such requirements:

- to comply with the MER UK strategy;
- to comply with a term of an offshore licence; and
- to comply with a requirement under the Bill which is stated to be “sanctionable”.

Four sanctions are available to the OGA:

- *Enforcement notices:* These will generally include directions requiring action to be taken to remedy the relevant failure within a specified timescale. A failure to comply with the directions can result in additional sanctions being imposed.
- *Financial penalty notices:* These will impose a financial penalty on the relevant UKCS stakeholder. The penalty may not exceed £1m, although this can be increased to £5m by the SoS.
- *Revocation notices:* These will provide for the termination of the UKCS stakeholder’s interests in the relevant licence.
- *Operator removal notices:* These will require that in respect of an offshore licence resigns (and is removed by the other licence holders) from the relevant licence within a specified period.

Where a licence is held jointly by more than one licence holder, sanctions can be imposed on one or more of those holders.

Any decision of the OGA in connection with the imposition of sanctions or the exercise of a power by the OGA in relation to the procedure for resolving a dispute are subject to appeal to the First Tier Tribunal. This may be a mistake in the drafting of the Bill, as we would have expected appeals to be heard by the Upper Tribunal (which deals with appeals of the decisions of other regulators, such as the Financial Conduct Authority and OFGEM).

The grounds for an appeal are very limited. Essentially, in order to be successful, the UKCS stakeholder will have to prove that the OGA has acted unreasonably, irrationally or outside of its powers. The factors to which the OGA is to have regard in exercising its functions and the MER UK strategy (on which see above) will inform the tribunal’s decision. However, in practice it will be very difficult to successfully challenge a decision of the OGA.

Where the OGA gives a sanction notice in relation to a particular matter, the arbitration provisions in the licence are disapplied in relation to that matter.

Next steps

A House of Lords committee hearing on the Bill will be held on 14 October. After that, the Bill will progress through the final stages of the House of Lords procedure and will then move into the House of Commons.

For further information or advice on any of the issues discussed in this briefing note, please get in touch with your usual Shepherd and Wedderburn contact.