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The New UK Oil and Gas Authority Issues an Urgent Call to Action

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The nascent UK Oil and Gas Authority (“OGA”), has issued an urgent Call to Action report setting out the main risks facing the UK oil and gas industry: insufficient profitability leading to pre-mature asset decommissioning and a failure to commit to critical long-term investment. The Call to Action sets out the priorities for OGA, the UK oil and gas industry and HM Treasury in order to address these risks. It is a measure of how serious the challenges are for the industry that OGA has been tasked with producing the report even as it is being established.

The OGA will officially be established in April 2015 and will be charged - together with the oil and gas industry and HM Treasury - with developing and implementing the UK’s strategy to maximise the economic recovery of oil and gas from the UK Continental Shelf’s (the “UKCS”). In order to implement this strategy (the “MER UK Strategy”), OGA is intended to have certain powers that go beyond those currently held by the Department of Energy and Climate Change (“DECC”).

These include: attending industry meetings; initiating and deciding on dispute resolution procedures; imposing financial sanctions; suspending, revoking or transferring licences; and greater access to data from licence holders. OGA will be partly funded by the UK Government; through charges for its services; and through a levy on licence holders.

Background

In June 2013, DECC requested an independent review of oil and gas recovery in the UKCS. The review, published in February 2014 (the “Wood Review”), recommended that DECC, HM Treasury and the oil and gas industry develop and commit to a new strategy for maximising economic recovery from the UKCS - the MER UK Strategy.

The Infrastructure Act, enacted on 12 February 2015, sets out the objective of maximising the economic recovery of UK petroleum. In order to achieve this, the MER UK Strategy will be developed in consultation with industry, and presented for

Parliamentary approval via a “negative resolution”¹ before coming into force. The UK MER Strategy will set out how to maximise economic recovery from the UKCS through: (i) prolonging infrastructure lifespan; (ii) deploying existing and new technologies effectively; (iii) a low-cost decommissioning strategy; and (iv) increasing exploration in the UKCS. The MER UK Strategy will bind DECC, licence holders, operators, owners of upstream infrastructure and those planning and commissioning upstream infrastructure.

The Oil and Gas Authority

The Wood Review recommended that the stewardship of the UKCS be moved to a new, better resourced, arm’s length body, funded by industry, with additional powers to implement the MER UK Strategy – OGA.

OGA will initially be an Executive Agency of DECC. It will then become a Government Company² by summer 2016 in order to have operational independence from the UK Government. It will be headquartered in Aberdeen and have a presence in London. Andy Samuel, former Managing Director of BG Group’s Exploration and Production in Europe, has been appointed its Chief Executive.

OGA will be an independent arm’s length body, accountable to DECC Secretary of State. DECC will set the strategic and operating framework and the objectives of OGA, however OGA will have the necessary independence to develop its own strategies and plans and be able to carry out its day-to-day operations in line with its agreed objectives.

The Oil and Gas Authority’s Call to Action

OGA’s urgent Call to Action outlined the main risks currently facing the UK oil and gas industry. Declining oil prices risk rendering producing fields insufficiently profitable, thereby leading to the premature decommissioning of key assets. This risks having a “domino effect” whereby further key assets are also prematurely shut down, as shared infrastructure costs are allocated across fewer platforms thereby increasing unit operating costs. The Call to Action also warned that confidence in the future potential of the UKCS could continue to decline resulting in the failure to secure critical long-term investment.

In order to address these risks, OGA’s Call to Action sets out priority actions for itself, the industry and HM Treasury. These include:

▪ **Protecting Critical Infrastructure**

Encouraging operators to invest in new projects could have the opposite result of the “domino effect” by lowering unit operating costs, thereby attracting further investment. To facilitate this, OGA will prepare Regional Development Plans for critical regions of the North Sea and complete economic assessments of key production hubs by the end of 2015.

▪ **Improving Production Efficiency**

Improving production efficiency could also counteract the ‘domino effect’. In light of declining production efficiency, OGA will require the top 20 production operators by volume to present stewardship improvement plans by April 2015.

¹ I.e. The Strategy will come into force if within 40 days if neither House resolves to oppose it.

² I.e. A private company limited by shares under the Companies Act 2006, with the Secretary of State of DECC as the sole shareholder.

▪ **Creating a Competitive Cost Base**

OGA will cooperate with the UK oil and gas industry to prioritise activity and monitor efficiency and is aiming for a 30-40% improvement in efficiency by the end of 2017, in order to counteract the 'domino effect'.

▪ **Revitalising Exploration**

To enable critical long-term investment, OGA will encourage exploration programs in underexplored areas. The OGA will improve on the quantity, timeliness and reliability of data available to it and to the industry.

▪ **Improving Collaboration on Decommissioning**

To further encourage critical long-term investment, OGA will oversee planning for future decommissioning of the UKCS in line with the MER UK Strategy. It expects the UK oil and gas industry to establish a single forum to drive innovation and efficiency in decommissioning by September 2015.

▪ **Driving Investment**

OGA has expressed its support for HM Treasury's fiscal reform plans, which OGA considers will encourage critical long-term investment. It has stated it will assist HM Treasury with these measures which include: (i) an immediate reduction of the Supplementary Charge rate from 32 to 30%; (ii) the introduction of a basin-wide Investment Allowance; (iii) an immediate extension of the ring-fence expenditure supplement from six to ten years; (iv) a commitment in the 2015 Budget to financially support seismic surveys in under explored areas; (v) incentivising exploration through the tax system; (vi) improving access to decommissioning tax relief; (vii) considering reducing the Petroleum Revenue Tax rate when fiscal conditions allow; and (viii) considering reforming the fiscal treatment of infrastructure after consultation with industry in 2015. It supports HM Treasury's view that the overall tax burden will need to fall as the basin matures.

▪ **Supporting the Supply Chain and Developing and Retaining Skills**

OGA will support the work of the Oil and Gas Industry Council and ensure that it is aligned with the MER UK Strategy. OGA will also support the Technology Leadership Board in developing a strategy on technology development by the end of 2015. OGA will, on an on-going basis, encourage companies to retain apprenticeships, trainee and graduate schemes and to consider alternatives to redundancy during downturns to avoid losing capability in the UK.

▪ **Integrating Plans and Delivery**

OGA will hold individuals and groups to account for the delivery of agreed projects and initiatives and will coordinate meetings with the Oil and Gas Industrial Council. OGA will also align existing initiatives such as PILOT (the UK Government and oil and gas industry forum) with the MER UK Strategy and integrate the Fiscal Forum³ by June 2015. It will work to integrate and reduce the overall number of groups and initiatives across the sector by September 2015.

OGA will also take over DECC's Licensing Exploration and Development responsibilities. These include:

- awarding petroleum licences and issuing consents for related activity;
- regulating third-party access to upstream petroleum infrastructure;

³ The Fiscal forum was established by HM Treasury in September 2011 to discuss with oil and gas tax regime with the UK oil and gas industry.

- promoting sound commercial behaviour and efficient use of infrastructure, information and technology;
- developing with industry upstream emergency plans for the security of supply; and
- providing input for long-term plans for gas storage and carbon capture.

The Oil and Gas Authority's Powers

OGA will likely receive additional powers, including the following:

▪ **The Power to Attend Industry Meetings**

It will be allowed to attend as an observer in key meetings where licence obligations, the MER UK Strategy, or matters for which it is providing (or may provide) dispute resolution services are to be discussed. OGA will be allowed to attend meetings between JV parties or where one company is operating alone. OGA would be allowed to pose and answer questions but would have no voting rights. This would keep it informed and help it cooperate with industry. Companies would be obliged to inform OGA in advance of key meetings and provide it with agendas and papers. Failure to do so could result in sanctions. It will be for OGA to prioritise which meetings to attend.

▪ **The Power to Access Data from License Holders**

DECC already has the power to require access to any data pertinent to the terms of a licence and is considering requiring licensees to submit data relevant to licence terms to OGA more regularly on a monthly basis. Licensees may be required to provide seismic data on a yearly basis rather than on a three or four year basis, as is currently the case. DECC is also considering an IT portal allowing licence holders to upload discussion documents before and during licence rounds as well as a publically available website with accessible data and information. Individuals and companies refusing to give access to data, in breach of their licences and the MER UK Strategy, may be subject to sanctions.

▪ **Dispute Resolution**

DECC has indicated that the dispute resolution scheme (including its scope, referral requirements, time limits, OGA's information gathering powers and sanctions) will be defined by legislation. OGA will likely be able to define the detailed process by which it will determine disputes, including the use of independent assessors, similar to Ofcom's dispute resolution scheme. The UK Government has said it believes that OGA should have the ability to require parties to enter dispute resolution and to instruct experts or require parties to undertake studies where necessary.

The UK Government is currently considering interested parties' views on who else should be able to initiate the dispute resolution process, the timeframes for the process, whether to impose sanctions for non-compliance with the process and what (if any) additional powers OGA should have in the dispute resolution process.

The Wood Review suggested that if industry is unable to provide a satisfactory framework within which to simplify and reduce the time required for UKCS commercial and legal negotiations, OGA should impose its own recommendations. The UK Government is considering interested parties' views on the specific difficulties in legal and commercial negotiations and on how OGA can address them.

The Oil and Gas Authority's Sanctions

DECC envisages providing OGA with a wider, more graduated set of sanctions, as is available for example to Ofgem, Ofwat or the FCA. The sanctions currently available such as licence revocation are extreme, making their use often difficult and disproportionate.

DECC envisages OGA imposing sanctions on licence holders or operators in breach of the MER UK Strategy. Any formal sanction would be preceded by a discussion between the companies involved and OGA, followed by an informal, private notification indicating the time period in which the issue should be resolved. If the issue is not resolved by then, the finding of a breach will be made public and a formal Improvement Notice will be issued. The Improvement Notice would set out how the company should improve its performance. If these steps prove insufficient, OGA may make use of financial sanctions. These would grant OGA flexibility to apply the appropriate sanction to each breach. The penalty amounts will be determined, among other things, by the nature of the breach, including the company's intent or recklessness, the impact of the breach and the affordability of the penalty amount. The financial penalties will be capped at a ceiling set at a level so as to retain a deterrent effect while not driving business away from the UKCS. If financial penalties are insufficient, OGA may suspend, transfer or revoke a licence.

The Oil and Gas Authority's Funding by Industry

The UK Government is planning to contribute £3 million annually towards OGA from 2016-17 for a period of five years. It intends to introduce a cost-recovery mechanism, including charges for services such as issuing licence consents and permits.

The UK Government also intends to introduce a new levy, beginning from October 2015, on licence holders in order to cover OGA's remaining costs, such as those associated with developing and implementing the MER UK Strategy, preparing future license rounds, supporting the supply chain, research and development work and data collection and dissemination. The charges will not exceed OGA's best costs estimates. They will be subject to Parliamentary scrutiny and will be set annually. Licence holders will pay their portion of the levy annually in single payments in advance at the beginning of the financial year. Subject to DECC's approval and Parliamentary scrutiny, OGA will have the authority to adjust levy rates upwards or downwards within the year, should unforeseen circumstances significantly change expected costs.

The levy is proposed to be apportioned based on the acreage of the licence holder, with different rates based on licence type, licence terms or licence age. Pre-production licences will have a lower rate per acre. The UK Government will consult with interested parties on the rates to be applied to each type of licence.

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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