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The Energy Act 2016 - An Independent Regulator Gets Its Teeth

In our December update, following publication of the draft strategy for the UK Oil and Gas Authority ("OGA"), we noted that a consultation on the merits of maximisation of economic recovery (known as "MER UK") was a welcome development, but that further guidance and detail was needed as to how the strategy would be implemented. The next step in this process took place on 12 May 2016, with the granting of Royal Assent to the Energy Act 2016 (the "Act").

The Act furthers the recommendations of the Wood Review, and establishes the OGA as the independent regulator for the UK oil and gas sector by transitioning it from an Executive Agency of the Department of Energy and Climate Change ("DECC") to a company incorporated under the Companies Act 2006. Substantial changes for the UK oil and gas landscape[1] are set out in the body of the Act addressing the core functions of the OGA, the resolution of disputes in the sector, information gathering powers of the OGA, sanctions and charges, and access to infrastructure and decommissioning. This note summarises the impact of the Act on each of those topics.

The OGA, Its Functions and Powers

From its establishment as an Executive Agency of the DECC, the OGA was given "*sufficient operational independence to be effective from day one*"[2] and the responsibility for a range of functions of the Licensing Exploration and Development unit,[3] including exercising certain statutory functions on behalf of the Secretary of State. Prior to Royal Assent being given to the Act, this was broadly managed pursuant to a Framework Document[4] clarifying the OGA's operation and governance, and the exercise of rights, influence and control by the Secretary of State while the OGA remained an Executive Agency.[5] These arrangements were designed to be, to the extent possible, consistent with the intended OGA operation and governance arrangements, post-transition to a private company.

1 The Act also addresses certain issues concerning the engagement of communities in connection with planning applications for onshore wind farms in the UK, but this note does not discuss this further and will instead focus on the implications for the oil and gas industry in the UK.

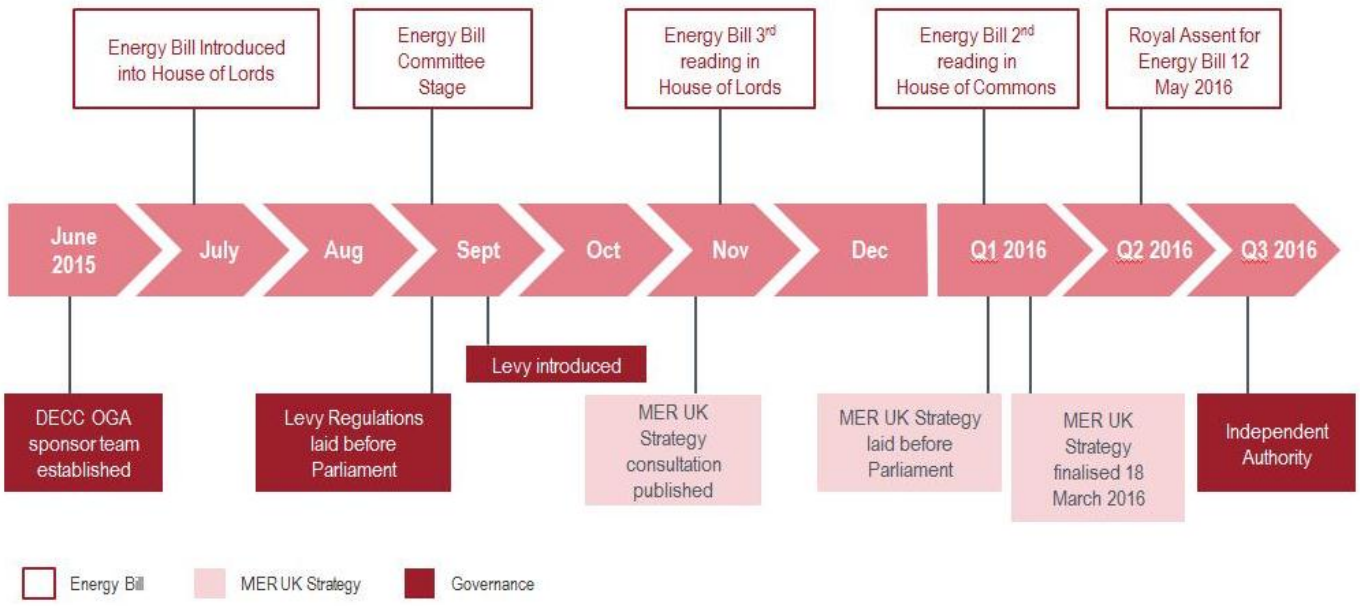
2 The Oil and Gas Authority Framework Document, April 2015, Statement of Intent.

3 The "LED" unit within the DECC had responsibility for the oversight and administration of the regulatory regime established under the Petroleum Act 1998 and associated legislation.

4 The Oil and Gas Authority Framework Document, April 2015.

5 There are a number of formal differences between an Executive Agency and a GovCo, which will make it necessary for a new Framework Document to be entered into when the OGA becomes a private company.

A timeline of the OGA's transition to independence:



The Act now advances the transition of the OGA to an independent authority, giving effect to the next stage of the transition by renaming the Oil and Gas Authority Limited as the Oil and Gas Authority,[6] clarifying its relationship with the Crown[7] and formally transferring to it certain functions of the Secretary of State for Energy and Climate Change.[8] The Secretary of State is also given the power[9] to transfer property, rights and liabilities arising in connection with functions which were functions of a Minister of the Crown and, as a result of the Act, have, or are to, become functions of the OGA. Staff are also transferred[10] to the new corporate entity and arrangements are made in relation to staff pensions.[11]

While initially very little might change in the operations of the OGA, its transition from Executive Agency to independent Government company sets the platform from which long-term decisions for the industry can now be taken. A supplementary Framework Document reflecting the new arrangements is expected in Q3 2016 to clarify the nature of the relationship between the DECC and the OGA further, but it is expected that the following day to day functions of the DECC will continue to be managed independently by the OGA:[12]

- **Licensing**—issuing and amending onshore and offshore petroleum licences

6 S.1(1) of the Act.

7 S.1(2) of the Act.

8 S.2 of the Act.

9 S.3 of the Act.

10 S.4 of the Act.

11 S.6 of the Act.

12 These responsibilities were transferred to the OGA in their entirety at the time of the OGA's establishment as an Executive Agency.

- **Licensing Strategy & Policy**—managing policy issues surrounding licensing (exploration and development) and helping implement the processes of change, introducing new licences and managing new developments and briefing the DECC for information requests regarding the UK's offshore oil and gas sector
- **Exploration**—managing technical assessment of exploration, development and production licenses, conducting licence rounds for all open acreage, both offshore and onshore, operating fallow acreage reviews, providing data collection and release for seismic and well data, along with collating and releasing relinquishment reports and producing maps to support the website, and ensure that data is available both for OGA, Government and industry use
- **Decommissioning**—ensuring decommissioning is planned and carried out in the most cost-effective manner, without prejudice to other obligations such as environmental and safety concerns
- **Field/Area Strategies**—reviewing development plans submitted by oil and gas companies, with specific analysis of company finances and adherence to relevant regulations such as environmental controls and consenting to plans, conducting the 'Stewardship Process' to maximise output and scrutinising decommissioning plans to ensure they are MER UK compliant
- **Infrastructure**—resolving upstream commercial disputes relating to infrastructure
- **Consents**—preparing documentation for new offshore oil and gas development proposals and regulating onshore production, flare and vent consents, and onshore terminal flare and vent consents
- **Metering**—ensuring all petroleum is measured in accordance with good oilfield practices and performing metering inspections to ensure Measurement Guidelines are being followed
- **Supply Chain**—promoting growth across entire oil and gas supply chain
- **Commercial**—managing existing commercial relationships and developing opportunities to facilitate MER UK by supervising new contract negotiation and renegotiation of existing commercial relationships
- **IT**—managing the UK Energy Portal[13] and associated applications

Certain of these responsibilities have been supplemented or developed further by the Act, as described in the remainder of this note.

Dealing with Disputes

It is widely accepted that the UKCS is a challenging jurisdiction in which to operate. It is a mature basin, with ageing infrastructure and increasingly diverse operators. Add high operating costs, limited access to funding and a change in approach to regulation to achieve MER UK and then it is not surprising that the Act also provides the OGA with the powers necessary to resolve certain disputes. The OGA has said that it "*will use the new regulatory powers …*

[13] The UK Oil Portal allows the industry to apply for and receive consent or direction electronically on a wide range of activities relating to hydrocarbon exploration, production, development, decommissioning and the protection of the environment - https://itportal.decc.gov.uk/eng/fox/live/PORTAL_LOGIN/login.

such as those relating to dispute resolution and sanctions, prudently to improve UKCS operating performance in line with MER UK."[14]

So what are these new powers and to what disputes are they applied?

The Act gives the OGA power to consider and make recommendations to resolve "qualifying disputes."[15] These are disputes which involve issues that are relevant to the fulfilment of the MER UK or that relate to activities carried out under an offshore licence, and are not the subject of a section 82 application.[16] An application to the OGA to make a recommendation must be made by a "relevant party" (a party to the dispute who has a relevant purpose and is either a holder of a petroleum licence, an operator under petroleum licence, an owner of upstream petroleum infrastructure or planning and carrying out the commissioning of upstream petroleum infrastructure[17]). The reference is to be "made in such manner as the OGA may require" and the Act permits the OGA to make different provisions for different cases.[18]

Once a qualifying dispute is referred, the OGA can either accept it, adjourn it for further negotiation between the parties or reject it.[19] It must inform the parties about its decision and the grounds on which it has made its decision about the reference (which must be detailed and which may include the grounds that a dispute is "not sufficiently material to the fulfilment of the principal objective to warrant, in the circumstances, its consideration by the OGA"). It is required to issue guidance about the matters to which it will have regard when making a decision about a dispute reference. It is also given the power to decide, on its own initiative, to consider a qualifying dispute.[20]

Once a dispute is accepted, the OGA can follow the procedure which it considers to be "most appropriate" although it must draw up a timetable for its resolution and give directions to the relevant parties. It must eventually make a recommendation 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."[21] As part of the process, the OGA may acquire information and require individuals to attend meetings. A decision of the OGA to either accept, adjourn or refuse a dispute can be appealed to a

14 OGA Corporate Plan, 2016-2021.

15 S.19 of the Act.

16 Section 82 applications concern the acquisition of rights to use upstream petroleum infrastructure under the Energy Act 2011. See also, "Access to Infrastructure," below. If the applicant and the owner do not reach agreement on the access application, the applicant may apply to the Secretary of State for a notice under subsection (11) which would secure to the applicant the right sought in the access application.

17 S.9A(1)(b) of the Petroleum Act 1998, as amended by the Act.

18 S.20 of the Act.

19 S.21 of the Act.

20 S.22 of the Act.

21 S.23 of the Act.

Tribunal[22] but only on limited grounds. A Tribunal may affirm, vary or quash the decision under appeal, remit it to the OGA with directions or substitute its own decision, as it sees fit.[23]

It will be interesting to see how these powers are exercised, and the practical effect that they have on parties operating in the sector.

Information Gathering by the OGA

The OGA's role as a primary regulatory body is reinforced by its power to request from industry participants, by notice in writing, a wide range of petroleum-related information and samples, provided that such information and samples are acquired in relation to fulfilment of the principal objective of MER UK or in the course of licensed activities.[24] To carry out these obligations in practice, each relevant person should appoint an information and samples coordinator who shall closely monitor compliance with the information requirements.[25]

While such provisions arguably give the OGA access to a broad range of information, an affected party has limited appeal rights in front of a Tribunal. A relevant person can appeal a decision either on the ground that it is not within the OGA's powers or by arguing that the plan or the length of time given to comply with the notice are unreasonable.[26] A certain degree of comfort is offered by the strict safeguards for any obtained information where the OGA is only allowed to disclose such information to other branches of government and regulators and only to the extent such disclosure is relevant to their functions.

Sanctions and Charges

The Act establishes a comprehensive sanctions regime to allow the OGA to target and sanction different categories of non-compliance. The OGA's power to levy these sanctions is triggered by breach by industry participants of a "petroleum-related requirement" which captures: (i) a duty to act in accordance with the MER UK; (ii) compliance with the terms or conditions of an offshore licence; or (iii) any requirement imposed by the Act which is itself sanctionable, for instance a failure to comply with an OGA information request.[27]

Prior to levying a sanction, the OGA must inform the relevant person of the alleged breach by giving a warning notice. The actual sanctions are imposed through four gradated types of notices, as follows:

- **Enforcement**. The OGA can require compliance with a petroleum-related requirement within a specified period and stipulate directions and measures to be taken for the purposes of compliance;

22 The Tribunal means a First-tier tribunal.

23 S.26 of the Act.

24 S.34 of the Act.

25 S.35(1) of the Act.

26 S.36 of the Act.

27 S.42(3) of the Act.

- **Financial Penalty**. As a step further to an enforcement notice, the OGA can impose a financial penalty on a sanctioned person. The penalty shall not exceed £1 million per occurrence but the maximum penalty amount can be raised up to £5 million by regulation of the Secretary of State;
- **Revocation**. For non-compliance by licensees, an existing petroleum license can be revoked after a 28-day period from issue of a revocation notice; and
- **Operator Removal**. An operator can be removed where he has failed to comply with a petroleum-related requirement after a 28-day period from issue of a removal notice.[28]

It should be noted that the Act provides for the publication of guidance upon the circumstances in which the OGA will consider issue of a financial penalty[29] but no equivalent requirement is included in relation to licence revocation and operator removal notices. Any sanctions notice can be appealed within 28 days of issue.

The Act enables the OGA to charge fees in connection with certain services it provides to the oil and gas industry. These services include determination of an oil and gas field, consideration of an application for a license to explore for petroleum, issue of consents in relation to the disposal of natural gas by flaring and venting, and storage by the OGA of samples or information in accordance with information and actions plan. The fee amount and relevant payee of the fee are to be determined in accordance with regulations made by the Secretary of State, in consultation with the OGA.[30]

Access to Infrastructure

Third parties who are seeking to access upstream infrastructure, but are unable to agree satisfactory terms of access with the owner, can make an application to the OGA to require access to be granted and to determine the terms on which it is to be granted—a so-called "section 82 application."[31] The Act amends the Energy Act 2011 to allow for an application to access to be assigned to another party.[32] Similarly, the Act introduces an element of continuity where the ownership of infrastructure that is the subject of an application has been transferred, by allowing all things done by the person to whom the application was made to be treated as done by its new owner.[33] Any information provided by the third party applicant to the OGA may be disclosed to the assignee of the application or to the new owner of the related infrastructure asset, provided that anything which might affect the commercial interests of the person providing the information has been removed. Continuity in information flows and process should speed up applications for access, and it is hoped, efficiencies in line with the principal objective of MER UK.

28 See SS.43 to 48 of the Act.

29 S.45(2) of the Act.

30 S.12 of the Act

31 S.82 of the Energy Act 2011. See also "Dealing with Disputes," above.

32 S.89A of the Act.

33 S.89B of the Act.

Decommissioning and Abandonment

With several fields in the UK North Sea coming closer to their end of life, there is naturally a great deal of focus on how the MER UK will interact with operators' decommissioning plans, whether or not submitted in connection with a section 29 notice.[34] The Act creates a new section 28A to the Petroleum Act 1998 which expressly prevents abandonment or decommissioning of an offshore installation or submarine pipeline unless an appropriate programme has been approved by the Secretary of State. It is an offence to start decommissioning without this approval.[35]

It is worth noting that the powers of approval over decommissioning remain with the Secretary of State, and have not moved to the OGA. However, the role of the OGA in decommissioning is now entrenched in the Petroleum Act through a formal consultation process by both operator and the Secretary of State. Any person who receives a section 29 notice must consult with the OGA before submitting an abandonment programme, and the OGA is then under a statutory duty to consider and advise on alternatives to decommissioning or abandonment, including options such as re-using or preserving assets. A concern that we raised at the time of the November/December 2015 consultation was whether the OGA could be given powers to force a sale of assets that were being considered for decommissioning, thereby extending their life. Although there is no reference to forced sale in the Act, that could be a secondary consequence of a forced preservation. Similarly, the Secretary of State is required to consult with the OGA on the same matters once it has received a decommissioning plan for review.

The Act places an emphasis on keeping costs low in any decommissioning programme. Recipients of a section 29 notice are placed under a statutory obligation to frame any plan in such a way as to allow decommissioning to be carried out at the lowest practicable cost, be reasonably practical in the circumstances, and without prejudice to existing obligations under primary and secondary legislation, such as in relation to environment or health and safety. Where an abandonment programme is to be prepared[36] or revised by the Secretary of State, the same costs considerations must be taken into account. How this is to be measured or demonstrated is not clear; presumably whoever prepares the plan will be required to set out a verifiable basis for its costing of the abandonment programme, but this implies that a detailed level of oversight will be required from the OGA.

There is also a new duty on owners of offshore installations to act in accordance with the MER UK strategy when planning and carrying out the activities of an owner, or decommissioning an installation or infrastructure[37]. The Act clarifies that this includes consideration of preservation or re-use and other uses than that for which the infrastructure was originally created. However, the Act remains light on specifics as to how such actions should be carried out beyond this general obligation.

[34] I.e. a decommissioning plan submitted to the Secretary of State following a request made by the operator under s.29(1) of the Petroleum Act 1998.

[35] S.28(2) of the Act.

[36] For instance, following a failure by a s.29 recipient to submit a programme.

[37] S.73 of the Act, amending Part 1A of the Petroleum Act 1998 with a duty under a new s.9C(5).

Conclusions

In our December 2015 note[37], we commended the approach of the reforms that might be described as "guidance before intervention." The Act has continued to entrench this approach, which is to be welcomed. Nowhere is this better articulated than in the required consultation with the OGA over decommissioning and abandonment plans; a process that needs to be conducted by both licence holder and the Secretary of State. In this and many other respects, the OGA will act as a guiding hand to the industry, providing direction that is in the best interests of MER UK, which we see as a sensible development.

However, we have also questioned whether the brevity of the Strategy remains the right approach, and the fact remains that until the OGA has had time to build up a body of decisions and precedent, there will be uncertainty as to just what is required to demonstrate that licence holder plans are cost-efficient, or are indeed maximising economic recovery. At a time when upstream operators are required to tighten their belts, it might seem counter intuitive to require them to spend additional funds in justifying their own interpretations of where lies the tipping point in value of a field. It also remains to be seen whether the OGA will be sufficiently well funded and structured to provide meaningful stress-testing of licence holder plans; if it is not, and serves instead as a bottle neck or ineffective guide, then this will have been an opportunity lost. We hope that, with the forthcoming Framework Document for the OGA (expected July 2016), there will be further guidance on the measures that the OGA wishes for North Sea operators to take. There is clearly change in the North Sea air, and we look forward to working with the industry to make the most of it.

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[37] Shearman & Sterling LLP Client Publication, "DECC Consultation on Strategy for Maximising Economic Recovery of Offshore UK Petroleum," December 2015 - http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/12/Client-Briefing--DECC-Consultation-on-MER-Strategy.pdf.

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