Global oil & gas
Guide to oil & gas regulation in the UK
If you would like further information on any issue raised in this guide, please contact our oil & gas team at energy@clydeco.com or get in touch with your usual Clyde & Co contact.

Regulation correct as at 1 April 2014

<table>
<thead>
<tr>
<th>Contents</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Background</td>
<td>3</td>
</tr>
<tr>
<td>Regulation</td>
<td>4</td>
</tr>
<tr>
<td>Rights to oil and gas</td>
<td>6</td>
</tr>
<tr>
<td>Health, safety and the environment</td>
<td>14</td>
</tr>
<tr>
<td>Decommissioning</td>
<td>18</td>
</tr>
<tr>
<td>Sale and trade</td>
<td>20</td>
</tr>
<tr>
<td>Enforcement of regulation</td>
<td>22</td>
</tr>
<tr>
<td>Reform</td>
<td>24</td>
</tr>
</tbody>
</table>
The Clyde & Co team of oil & gas specialist lawyers operates across our global network and are recognised as true experts in the oil & gas industry. This core team consists of a group of both transactional and contentious professionals who work full time with the oil & gas industry.

We recognise that due to the pioneering nature of the industry, our oil & gas clients are often working in frontier markets, dealing with complex multi-jurisdictional and cross-border transactions and disputes. They require legal advisors who are not only expert lawyers with a deep understanding of the industry but have a commercial approach and pragmatic mindset assisting clients to achieve their goals cost effectively and with a minimum of risk.

The group specialises in all areas of contentious and noncontentious disciplines in oil & gas exploration and production (E&P), upstream and downstream projects and their related infrastructure.

It is supported by a wider group of lawyers that have extensive experience in the oil & gas sector across corporate, commercial, finance, projects, disputes and international arbitration. This includes specialised areas such as employment, HSE, regulatory and compliance, insurance, trading and derivatives.

**Background**

The UK’s oil and gas industry makes a substantial contribution to the country’s energy security and economy. Oil and gas production from the UK Continental Shelf (UKCS) provided 67% of the oil and 53% of the gas demands of the country in 2012. Despite the UK’s reliance on UKCS oil and gas, production has fallen by approximately 40% between 2010 and 2013.

Gas production from the UKCS began in the late 1960s followed by the production of oil in the mid-1970s. According to reports by the Department of Energy and Climate Change (DECC), 42 billion barrels of oil equivalent (boe) have been produced with an estimated 12 to 14 billion boe reserves remaining.

After the first exploration successes almost 55 million boe have been discovered in more than 400 fields across the UKCS. Presently, nearly 300 fields are in production and approximately 100 fields are yet to be developed. The West of Shetlands region is the latest to be developed. UKCS production peaked at the turn of the 21st century, since when an additional 4.1 billion boe of recoverable reserves have been discovered.

The UK became a net importer of crude oil and petroleum products in 2006 for the first time since the 1980s. Although there have been small changes in trade since then, the UK has remained a net importer.

Consumption of petroleum fell by 29% between 1970 and 2012. Gas consumption in the UK has increased and is around seven times higher than in 1970. Net exports of gas peaked in 2000. Gas production in the UK has declined and by 2011 it was 58% below its 2000 peak. The net result has been a sharp fall in exports and an increase in imports of gas. The main sources of gas imports are the three pipelines to Norway, the pipeline with the Netherlands and LNG. Two LNG terminals opened in 2009 producing 25% of the imports.

**Sector commitment**

Practitioners who are experts in their chosen practice areas and specialise in the oil & gas industry, providing the most commercially valuable solutions to our clients’ needs.

**Trusted advisors**

A focused and enterprising team with the expertise, drive and ingenuity to help clients succeed.

**On the ground where and when we are needed**

A global presence and a continuing ambition to expand into regions that support our oil & gas clients.
Regulation

Regulatory bodies

DECC is responsible for setting energy and climate change mitigation policies, and establishing the framework for achieving the policy goals in those areas. DECC is also responsible for petroleum licensing and regulation of the upstream oil and gas sector, including decommissioning of offshore oil and gas installations and pipelines, as well as enforcing environmental legislation as it applies to upstream oil and gas activities. The Secretary of State for Energy and Climate Change (the Secretary of State) is the minister who is head of DECC. The Secretary of State is responsible for exercising many of the powers under the Petroleum Act and related legislation.

In March 2013, DECC also set up the Office of Unconventional Gas and Oil with the aim of promoting the safe, responsible and environmentally sound recovery of the UK’s unconventional reserves of gas and oil.

The Environment Agency is the environmental regulator for all onshore oil and gas operations, including shale gas, coal bed methane and underground coal gasification in England. In April 2013, Natural Resources Wales, a new body formed by the Welsh Government, took over the functions previously carried out by the Environment Agency in Wales.

The Health and Safety Executive (HSE) is responsible for enforcing health and safety laws. In particular, the HSE’s Offshore Division is responsible for regulating the risks to health and safety arising from work activity in the offshore oil and gas industry on the UKCS. The HSE also has an important role to play in regulating safety in other segments of the oil and gas industry, such as oil and gas pipelines.

The Office of Gas and Electricity Markets (Ofgem) is responsible for regulating the downstream gas market, and in particular the monopoly gas transmission and distribution networks. Ofgem also plays a role in enforcing the third party access regime that applies to downstream gas infrastructure.

The regulatory regime

The Petroleum Act 1998 (the Petroleum Act) establishes the regulatory regime applying to oil and gas exploration and production in the UK (other than onshore in Northern Ireland). The Petroleum Act vests all rights to petroleum in the Crown but permits the Secretary of State to grant licences to search and bore for and get petroleum to such persons as he thinks fit. The Petroleum Act is supplemented by various environmental and health and safety legislative provisions.
Rights to oil and gas

Oil and gas licences

The rights to all oil and gas in the UK and its territorial sea have belonged to the state since the Petroleum (Production) Act 1934. This Act gave the UK Government the exclusive right to grant licences to explore for and exploit these oil and gas resources.

The Continental Shelf Act 1964 extended these licensing powers to the UKCS. The 1934 Act and the 1964 Act are now consolidated in the Petroleum Act. The effect of these Acts is that exploration for and production of petroleum in the UK and on the UKCS can only be undertaken under the terms of licences issued by the Secretary of State. A separate regime applies to onshore oil and gas in Northern Ireland.

DECC issues licences through competitive licensing rounds which generally take place every year. There are three main types of licences:

- Seaward Production Licences, which are granted in relation to offshore fields. They cover the full life of a field, from exploration to production
- Petroleum Exploration and Development Licences (PEDLs), which are granted in relation to onshore fields. These also cover the full life of a field
- Seaward Exploration Licences, which cover offshore exploration activities only. This type of licence is particularly aimed at seismic contractors who wish to gather data to sell rather than exploit geological resources themselves. Such licences are non-exclusive and do not give the right to conduct exclusive exploration

Seaward Production Licences and PEDLs are valid for a sequence of periods, called terms. These are designed to cover the typical life cycle of a field of exploration, appraisal and production. Each licence expires automatically at the end of each term, unless the licensee has sufficiently progressed to warrant a chance to move into the next term.

The initial term is usually an exploration period, usually granted for a period of four years for Seaward Production Licences and for four years for PEDLs. The licence expires at the end of the initial term unless the licensee has completed the work programme. At this stage, the licensee must also relinquish a fixed amount of acreage (usually 50%).

The second term is intended for appraisal and development, usually granted for a period of four years for Seaward Production Licences and of five years for PEDLs. The licence expires at the end of the second term unless the Secretary of State has approved a development plan.

The third term is intended for production, usually granted for 18 years for Seaward Production Licences and for 20 years for PEDLs. The Secretary of State has the discretion to extend the term if production is continuing, but DECC reserves the right to reconsider the provisions of the licence before doing so, especially the acreage and rentals.
In recent years, DECC has recognised that a standard Seaward Production Licence, often referred to as a “Traditional Licence”, may not be appropriate in all cases. For this reason, DECC also issues special types of Seaward Production Licences, being Promote Licences, Frontier Licences and West of Shetland Frontier Licences. The detailed terms and conditions of every licence are prescribed in a series of “Model Clauses”, which are set out in secondary legislation made under the Petroleum Act.

**Licence term**
The earliest Seaward Production Licences were granted in 1964, for a term of 46 years. Licences issued under the current licensing regime are issued for shorter periods. DECC acknowledges that it is not desirable for production to cease simply because the term of the licence has expired, and therefore DECC has a policy of extending licences where the relevant criteria are met. Typically, DECC extends the term of a licence where a field is well-managed and there is continuing production, but in some circumstances DECC also extends the term where production has not yet begun, but a discovery is very close to becoming a producing field when the licence expires.

**Licence fees**
A small annual charge, called a rental, is payable under each licence. Rentals are charged at an escalating rate on each square kilometre the licence covers at that date. This method of calculating the rental provides an incentive to licensees to surrender acreage they do not want to exploit and to focus on acreage they retain.

**Liability under licences**
The regulatory regime aims to maximise exploitation of the UK’s petroleum resources and to protect the state (and taxpayers) from any liability arising from exploration and development activities undertaken by licensees. As such, under the Model Clauses, the licensee indemnifies the Secretary of State against any third party claims arising in relation to the licence or anything done pursuant to it. The Model Clauses do not distinguish between operators and non-operators in relation to their liability. All licensees under the licence are jointly and severally liable for operations conducted under the licence. The Model Clauses are intentionally broad to ensure the widest possible interpretation and recourse by DECC to all of the licensees.

**Award of licences**
DECC issues licences through competitive licensing rounds which generally take place every year. Separate rounds are held for seaward (offshore) licences and landward (onshore) licences. In exceptional circumstances, where there are compelling reasons, DECC may issue a licence outside of a licensing round. DECC can only accept licence applications in response to a formal invitation to apply for a licence, so a company seeking an out-of-round licence must make a case to DECC that out-of-round applications are justified i.e. that there are clear reasons why it should not have to wait for the next opportunity in a licensing round. Before awarding licences (or approving the transfer of a licence), DECC must be satisfied that the applicant meets certain criteria. DECC focuses on financial capacity and technical expertise, and places particular emphasis on the technical capacity of the party who will take on the role of operator.
Tax liability for profits from oil and gas

The taxation regime that applies to profits derived from oil & gas production in the UK and UKCS is made up of three main components:

– Petroleum Revenue Tax (PRT). This is a field based tax charged on the profits arising from oil & gas extraction of individual oil fields and not in relation to the aggregate profits from all oil fields owned by each relevant company. PRT only applies to fields for which development consent was given before 16 March 1993.

– Ring Fence Corporation Tax (RFCT). In contrast to PRT where each individual field is separately ring-fenced on a field by field basis, RFCT includes all oil & gas exploration and production activity carried on by the relevant company. It aims to prevent profits from oil & gas extraction activities and rights in the UK and UKCS being reduced for tax purposes by the setting off of losses from other trading activities or by excessive interest payments and applies regardless of when development consent was granted. The profits from oil & gas extraction activities and rights are “ring fenced” and treated for tax purposes as a separate trade, so that only losses derived from these activities can be set off against profits from these activities. Since 1 April 2008 the rate of RFCT has been fixed at 30% and the UK Government has announced that it will remain at 30% despite the phased reduction in the main rate of Corporation Tax on non-ring fence profits (currently 23%) to 21% from 1 April 2014 and further reduction to 20% from 1 April 2015.

– Supplementary Charge. This is also a tax imposed on profits arising from any ring fenced activities but excludes finance costs. It was originally introduced in 2002 and set at a rate of 10%. In 2011, the UK Government increased the rate of the Supplementary Charge from 1 January 2006 to 20% and increased it further from 24 March 2011 to its current rate of 32%.

The current marginal rates of UK tax in respect of profits from fields subject to PRT, RFCT and the Supplementary Charge is 81%, or 62% for profits from fields subject to RFCT and the Supplementary Charge only.

In order to encourage development of remaining reserves or new marginal fields, field allowances were introduced in 2009 for certain qualifying oil & gas fields to offset against the Supplementary Charge on profits from those qualifying fields. Field allowances recognise that some fields, because of their remoteness, depth, maturity or other characteristics, are more expensive to develop. Qualifying fields are currently small fields, ultra heavy oil fields, ultra high pressure/high temperature fields and remote deep water gas fields.

Transfer of rights

Assignment

Licences cannot be sold, transferred, assigned or otherwise dealt in without the consent of the Secretary of State. If a licence is assigned without obtaining prior consent, this constitutes grounds for revocation of the licence under the Model Clauses.

Change of Control

A change in control of an assignee is also a ground for revocation, but there is no express provision in the Model Clauses or the legislation for the granting of consent by the Secretary of State before the change in control. DECC acknowledges that this can lead to a request for comfort that the Secretary of State will not exercise such power. DECC is generally willing to consider such requests but will not give a formal confirmation. DECC’s policy is that a licensee should be able to demonstrate that a change of control will not prejudice its ability to meet its licence commitments, liabilities and obligations.

Creation of a Charge

The creation of a charge on a licence also requires the consent of the Secretary of State. To facilitate transaction financing and to dispense with the need to obtain prior consent, an “Open Permission”, which is a form of automatic consent, applies to any fixed or floating charge or debenture. It is a condition of the Open Permission that the licensee must give notice to DECC within ten days of creation of the charge.
Transportation by pipeline

Construction and operation of pipelines

A Pipeline Works Authorisation issued by DECC is required for the construction and use of any offshore oil and gas pipeline, while a Pipeline Construction Authorisation is required for onshore pipelines longer than 10 miles. A number of environmental regulations apply to the construction, operation and maintenance of pipelines.

Third party access to pipelines

Access for developers of offshore oil and gas fields to upstream infrastructure for the purpose of transporting and processing hydrocarbons is a key element in maximising the exploitation of the UK’s oil and gas resources. The third party access regime has a voluntary, industry led component, but this is underpinned by a statutory regime.

The Code of Practice on Access to Upstream Oil & gas Infrastructure on the UKCS (ICoP) was launched in 2004, and revised and updated in 2012, to help open up access to infrastructure on the UKCS for new and smaller users so that small adjacent fields could be made economically viable. It provides a framework for oil and gas infrastructure owners and users of the process that should be followed in seeking, offering and negotiating access to oil and gas infrastructure on the UKCS. The ICoP is voluntary and is not legally binding, although DECC does consider whether it has been followed when resolving disputes in respect of third party access.

Owners of upstream infrastructure are required to publish annually their main commercial conditions for access. Third parties wishing to obtain access to such facilities negotiate in good faith directly with the owners in the first instance on the basis of these published commercial terms. Where a party that seeks access to upstream oil and gas infrastructure cannot agree rights of access with the owner, it has the right to apply to the Secretary of State for a notice granting the relevant rights.

A similar regime under the Gas Act 1995 applies to downstream gas processing facilities (for instance, facilities that process gas for the purpose of the gas being put into storage, an LNG import or export facility, a gas interconnector or a distribution system pipeline).
Health and safety regime

In addition to the obligations arising under the general health and safety law, a specific safety case regime applies to offshore oil and gas operations, which was established in response to the Piper Alpha disaster in 1988 which claimed the lives of 167 people, and the official public inquiry which followed. The key aspects of the regime are as follows:

- A regulatory regime (the Offshore Installations (Safety Case) Regulations 2005), which requires written safety cases and risk assessments to be prepared by the operator, and then approved by the HSE for all fixed and mobile offshore installations before such installations are brought into use on the UKCS
- A system of well notification, where the HSE assesses well design and procedures
- A requirement for the design and construction of a well to be examined by an independent specialist
- A scheme of independent verification of offshore safety critical equipment (such as blowout prevention equipment) to ensure they are fit for purpose
- Checks that workers have received suitable information, instruction, training and supervision
- Offshore inspections of well control and integrity arrangements, and related safety issues, by specialist inspectors from HSE’s Offshore Safety Division
- The HSE Offshore Safety Division employs a team of inspectors who are responsible for enforcing both the offshore specific regulations and general safety legislation common to all industries, including the overarching Health and Safety at Work Act 197
- The Maritime and Coastguard Agency also plays a role in enforcing maritime health and safety law, which covers the operation of ships worldwide
Environmental impact assessments (EIAs)

The Offshore Petroleum Production and Pipelines (Assessment of Environmental Effects) Regulations 1999 provide that an operator who wishes to carry out certain upstream activities must first make an assessment of the impact that the activity would have on the environment (that is, an Environmental Impact Assessment (EIA)) and then summarise and present the conclusions of this in an Environmental Statement (ES), which must be submitted to DECC. The activities for which an EIA is required are the:

- Grant and renewal of production consents for field developments
- Drilling of wells (deep boring)
- Construction and installation of production facilities and pipelines

DECC recognises that operators may employ independent specialist consultants to aid in the EIA process and preparation of the ES, but it requires operators to assure the quality of the work being done by third parties on their behalf and ultimately to be responsible for the preparation of the ES and the commitments set out in it.

Environmental permits

The UK has a comprehensive framework for the management of the potential environmental consequences of oil and gas exploration and production, with a large number of different approvals and permits being required for various different aspects of operations, including greenhouse gas emissions, combustion equipment on offshore installations, the use and discharge of chemicals and other waste in relation to oil and gas activities.

Flare and vents

Consent from DECC is required for venting and flaring. DECC's policy is that it is committed to eliminating all unnecessary or wasteful flaring and venting of gas, and therefore operators should seek to minimise this by implementing best practice at an early stage in the design of the development and by continuing to improve on this during the subsequent operational phase.
Decommissioning obligations arise when the Secretary of State serves a section 29 notice under the Petroleum Act 1998 to the operator of the field and each of the licensees, requiring them to submit a decommissioning programme. DECC usually requests the submission of a decommissioning programme three or more years before cessation of production, although on smaller fields DECC may require a programme at the time of approval of the final field development plan.

Once the decommissioning programme is approved, following DECC’s review of the details including the cost estimates, the section 29 notice holders are legally obliged to carry it out on a joint and several liability basis. If a programme is not carried out or its conditions are not complied with, the Secretary of State may, by written notice, require remedial action to be taken. Failure to comply with any such notice is an offence and the Secretary of State can carry out the remedial action and recover the costs from the person to whom the notice was given. Licence holders are also required to post security for the cost of decommissioning. This is usually through letters of credit and facility agreements with third party financiers.

As the objective of the regime is to shield the government from decommissioning costs, DECC may also serve a section 29 notice on a wider group of parties, not just the current licensees, including any person having an ownership interest in the installation or pipeline, a parent or associated company of a licensee or former licensees. The licensee remains liable for decommissioning obligations until the section 29 notice is withdrawn. In most cases, the section 29 notice is withdrawn once DECC is satisfied that adequate financial security arrangements are in place in relation to the decommissioning liabilities.

As decommissioning is an inherent cost of doing business on the UKCS, obtaining tax relief for decommissioning costs is critical in determining whether to invest and a crucial factor in enabling participants to meet the overall cost of decommissioning. Tax relief for such costs is given at the point they are incurred and the decommissioning carried out. Relief is given against RFCT and Supplementary Charge (but capped at 20%) as well as PRT. Typically, the relief will produce losses that can be carried back and set against earlier profits.

The government announced in the Finance Bill 2013 the introduction of bilateral decommissioning relief deeds between a participant and the government which will provide certainty as to the tax relief available.
Gas trading
Traditionally, gas was mainly sold by producers to gas suppliers and large users at the onshore entry points into the National Transmission System (NTS), referred to as the “beach”, under long-term gas supply agreements. While beach trades still take place, increasingly, gas trades are made once the gas enters the NTS, using the National Balancing Point (NBP). The NBP is a virtual trading location created under the Uniform Trading Code, which governs the transport of gas through the NTS. The NBP ’97 contract is a standard contract commonly used for over-the-counter trades on the NBP. Other contracts, such as the ISDA with an NBP annex, are also used. Since 1999, an on-the-day commodity market has also operated. Participants in the gas trading market include not just producers and suppliers, but also institutional investors, commodity traders, and National Grid Gas plc (the Transmission System Operator), who conducts trades on a daily basis to balance the network under the Uniform Network Code.

Oil trading
Oil trading consists of both physical oil trades, as well as futures trading and over-the-counter derivatives. Participants in both the physical and paper crude oil markets include producers, refiners, independent trading houses and, increasingly, the commodity trading arms of investment banks.

Oil and gas prices
Oil and gas prices are not regulated in the UK. However, market regulators such as the Competition Commission, which enforces competition law, play a role in ensuring there are no abuses which could lead to price distortions. For gas, part of Ofgem’s role is to ensure that the wholesale and gas supply markets remain competitive.
Enforcement of regulation

Enforcement powers of DECC

DECC’s Offshore Environmental Inspectorate enforces offshore oil and gas environmental regulations and permit conditions. DECC’s enforcement activity falls into four main categories: letters, enforcement and prohibition notices, permit revocation and prosecution.

Where there has been frequent recurrence of a minor contravention, DECC may write a letter to the relevant permit holders and/or licensed operators confirming the matters requiring attention and specifying the remedial actions to be taken.

DECC may also require permit holders and/or licensed operators to make improvements by issuing them with a notice: either an “Enforcement Notice” which allows time for the recipient to comply with prescribed conditions or a “Prohibition Notice” which prohibits an activity from occurring until remedial action has been taken. The issue of an Enforcement Notice and/or a Prohibition Notice does not prevent other Enforcement Activity, such as prosecution, being progressed if this is deemed appropriate.

DECC may, in exceptional circumstances, give notice of the revocation of a permit where they are of the opinion that:

– Any application or information or statement made in connection with a permit was false or misleading; or
– The permit holders and/or licensed operators have been guilty of a breach of any condition(s) of a permit.

DECC may also bring prosecutions against offshore permit holders and/or licensed operators. In general, DECC will pursue prosecutions where it considers:

– The gravity of the alleged offence, taken together with the seriousness of any actual or potential pollution, justifies this approach;
– The general record and approach of the alleged offender warrants it; or
– There has been a reckless disregard of requirements enforced by the legislation.

Appeals to decisions of DECC

The enforcement regime entitles the permit holder or licensed operator to appeal to the High Court for England, Wales and Northern Ireland, or the Court of Session in Scotland. Any appeal under the Regulations must be made within 28 days of written notification of the decision in question.
In response to declining exploration and production rates from the UKCS, ageing infrastructure and declining production efficiency, the Secretary of State commissioned a review of UK offshore oil and gas recovery, led by Sir Ian Wood.

The Wood Report, delivered in February 2014, identified several key issues to be addressed, including the need for:

- Operators to focus on maximising economic recovery for the UK as well as pursuing their individual commercial objectives;
- Fiscal stability consistent with a mature offshore basin;
- Significantly improved asset stewardship;
- Greater constructive collaboration between operators; and
- A greater resourced and more proactive regulator.

The Wood Report makes four principal recommendations to address these issues:

- Development and implementation of a new strategy for maximising economic recovery from the UKCS;
- Creation of a new arm’s length regulatory body charged with effective stewardship and regulation of UKCS hydrocarbon recovery and maximising collaboration in exploration, development and production across the industry;
- Affording the new regulator additional powers to facilitate the implementation of the new strategy to maximise economic recovery from the UKCS; and
- The development and implementation of key sector strategies.