Oil Regulation

In 28 jurisdictions worldwide

Contributing editor
Bob Palmer

2015

GETTING THE DEAL THROUGH

GETTING THE
DEAL THROUGH

Oil Regulation 2015

Contributing editor
Bob Palmer
CMS Cameron McKenna LLP

Publisher
Gideon Roberton
gideon.roberton@lbresearch.com

Subscriptions
Sophie Pallier
subscriptions@gettingthedealthrough.com

Business development managers
Alan Lee
alan.lee@lbresearch.com

Adam Sargent
adam.sargent@lbresearch.com

Dan White
dan.white@lbresearch.com

Published by
Law Business Research Ltd
87 Lancaster Road
London, W11 1QQ, UK
Tel: +44 20 3708 4199
Fax: +44 20 7229 6910

First published 2003
Twelfth edition
ISSN 1742-4100

Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

CONTENTS

Preface

Oil Regulation 2015

Twelfth edition

Getting the Deal Through is delighted to publish the twelfth edition of *Oil Regulation*, which is available in print, as an e-book, via the GTDT iPad app, and online at www.gettingthedealthrough.com.

Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the 28 jurisdictions featured.

Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com. This title is also available as an e-book and through the GTDT iPad app.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Bob Palmer of CMS Cameron McKenna LLP, for his continued assistance with this volume.

GETTING THE DEAL THROUGH

London
June 2015

United Kingdom

Bob Palmer

CMS Cameron McKenna LLP

General

1 Describe, in general terms, the key commercial aspects of the oil sector in your country.

According to the Department for Energy and Climate Change (DECC), over 3 billion tons of oil have been produced from the UK continental shelf (UKCS) to date. Production from the UKCS peaked in 1999, reaching 137 million tons, although there has been a general decline since, with production falling by 6 per cent per annum on average. Over the past three years, production has fallen by 38 per cent, but with the combination of new field start-ups and fields coming back on-stream, it is expected to begin picking up in 2014. In 2005, the UK became a net importer of crude oil for the first time since the early 1990s. Estimates of the remaining hydrocarbons range from 10 to 24 billion barrels of oil equivalent (boe). In 2014, the industry produced 1.42 million barrels of oil and gas equivalent per day, 1.1 per cent less than in 2013. This represents the best year on year performance in 15 years.

During 2014, 126 development wells were drilled (comparable in number to 2013) together with only 14 exploration and appraisal wells. This represents a significant decline on 2013 during which 44 exploration wells were drilled.

The UK has the fourth-largest total refining capacity in the European Union and some of its six crude oil refineries are among the largest in Europe. The refining business, however, has suffered from disruptions, the sale of three refineries in 2011, the closure of the Coryton refinery in 2012 and the closure of the Milford Haven refinery in late 2014. As a result, refinery production decreased by 5.2 per cent in 2013 and is expected to fall further pending the release of 2014 data.

In 2014, the industry invested £14.8 billion of capital expenditure (greater than anticipated, largely due to cost overruns on large scale projects and the highest rate of investment for more than three decades) and spent a further £9.6 billion on operating costs. The oil and gas industry in the UK paid more than £3.2 billion in corporate production taxes for the 2014 calendar year and supports the employment of around 450,000 people across the UK.

The Cygnus field development is due to come on-stream by the end of 2015. It is the largest UK gas discovery in the past 25 years and once it enters production it will account for approximately 5 per cent of the UK's total gas production.

2 What percentage of your country's energy needs is covered, directly or indirectly, by oil as opposed to gas, electricity, nuclear or non-conventional sources? What percentage of the petroleum product needs of your country is supplied with domestic production? What are your country's energy demand and supply trends, especially as they affect crude oil usage?

According to statistics published by DECC, oil represents 32 per cent of the UK's energy usage, natural gas 36 per cent, coal 22 per cent and electricity 10 per cent (consisting of 7 per cent nuclear, 1 per cent renewables and 2 per cent imports). In 2013, oil consumption fell by 5.3 per cent and gas consumption increased by 2.1 per cent. Total UK indigenous production of oil in 2013 was 8.8 per cent lower than in 2012, with natural gas production 6.2 per cent lower. Although UK imports of oil and oil products decreased by 2.3 per cent in 2013, the UK became a net importer of petroleum products for the first time since 1984 with net imports of 2 million tonnes. In 2012, the UK had a net export of 1.1 million tonnes. In 2013, gross imports of natural gas continued to be greater than gross production and net imports of natural gas were 5.1 per cent higher than in 2012. Gas exports were around 25 per cent lower than in 2012, and demand for gas decreased by 0.8 per cent, with the fall in gas demand for electricity generation being offset by the higher domestic demand. Gas and oil used for electricity generation decreased by 6.8 per cent and 22.6 per cent respectively in 2013, reflecting the higher renewables and nuclear generation as well as higher net imports from France.

In the domestic sector, sales of gas were 2.5 per cent higher, largely as a result of the colder weather in the first part of the year. Dependency on imported oil and gas is estimated to have increased to 47.9 per cent in 2013 (from 26 per cent in 2009) and is expected to rise to 64 per cent by 2025 (assuming production declines at an annual rate of 5 per cent).

3 Does your country have an overarching policy regarding oil-related activities or a general energy policy?

The Energy Act 2010, which became law in April 2010, implements some of the key measures required to deliver DECC's low carbon agenda. It includes provisions for delivering a programme for carbon capture and storage and for implementing mandatory social price support. It also introduces a number of measures aimed at ensuring that the energy markets are working fairly for consumers and are delivering secure and sustainable energy supplies. However, it was the Energy Act 2008 that enshrined the UK's present policy for the energy sector. The primary aim of the government in passing this Act was to tackle climate change, reduce carbon dioxide emissions and ensure secure, clean and affordable energy. The Energy Act 2008 also provided for a regulatory framework for offshore gas storage, introduced changes to the offshore oil and gas decommissioning regime and extended third-party access to upstream oil and gas infrastructure. The government has, over a number of years, encouraged smaller companies to apply for licences in the UKCS and has, through initiatives such as the fallow acreage initiative and the Code of Practice on Access to Upstream Oil and Gas Infrastructure on the UKCS (ICOP), made a concerted effort to maximise recovery of oil from the UKCS. This policy was given further standing when the Energy Act 2011 was enacted, providing for the secretary of state to enforce access to upstream infrastructure on behalf of an applicant. Since the publishing of the Wood Review there has been a further shift in government policy toward maximising the recovery of hydrocarbons from the UKCS through the government entering into consultation with the industry. In addition, the Climate Change Act 2008 introduced the world's first long-term legally binding framework to reduce greenhouse gas emissions and set carbon budgets. Separate additional legislation, the Climate Change (Scotland) Act 2009, is also in place. Also of relevance in terms of greenhouse emissions are the Greenhouse Gas Emissions Trading Scheme Regulations 2012, which implement the EU Emissions Trading Scheme in the UK and the more recently introduced mandatory reporting requirements for quoted companies incorporated within the UK to disclose details of their GHG emissions in their directors' report or in a stand alone strategic review. In addition, the Energy Savings Opportunity Scheme Regulations (ESOS) 2014, which implements article 8 of the Energy Efficiency Directive 2012/27/EU, has been introduced. ESOS requires relevant undertakings (as defined in the legislation) and their corporate groups to undertake mandatory energy assessments by 5 December 2015 and every four years thereafter if they continue to qualify.

4 Is there an official, publicly available register for licences and licensees?

DECC maintains an online register of all existing licences and their respective licensees, which is publicly accessible. However, DECC does not accept any responsibility for the accuracy of the information on its website, and does not accept any liability as a result of reliance upon such information. There is a process of checking the accuracy of the published data upon lodging any assignment on the Oil and Gas Portal.

5 Describe the general legal system in your country.

The legal system in England and Wales, Scotland and Northern Ireland is one of the oldest and most established legal systems in the world. As such, many international agreements are governed by English law. The legal system is based on a well-established common law system that has been developed through the years by the courts and the creation of case law, which sets out tests and interpretative procedures that should be followed when determining the meaning of contracts. There is a well-developed appeals procedure from the High Court, to the Court of Appeal and finally to the Supreme Court, which is also the final appeal court in many other jurisdictions around the world. The judiciary maintains its independence from the government and, as such, is able to uphold the rule of law at all times.

The Bribery Act 2010 came into force on 1 July 2011 and created a number offences including:

- a number of general bribery offences;
- the offence of bribing a foreign public official; and
- the offence of a commercial organisation failing to prevent bribery on its behalf (this applies to any organisation that has business operations in the UK).

Regulation overview

6 Describe the key laws and regulations that make up the principal legal framework regulating oil activities.

The Petroleum Act 1998 governs oil and gas exploration and production activities in the UK. This Act vests ownership of petroleum in the UKCS in the Crown and empowers the Secretary of State for DECC to grant licences for the exclusive right to search for, bore for and extract petroleum in the area covered by the licence. Licences are acquired through competitive licensing rounds held each year by DECC. A company will make (either by itself or as part of a joint venture) an application for a specific area. Licences may also be acquired through asset transfers between companies and the consent of DECC is required prior to any licence assignment. The conditions of a licence (known as 'model clauses') are set out in secondary legislation, which for existing offshore production licences are the Petroleum Licensing (Production) (Seaward Areas) Regulations 2008. The model clauses set out in detail the conditions for the licence, including term, licence surrender, record-keeping, working obligations, appointment of operator, measurements and pollution. In awarding licences, DECC must also comply with the Hydrocarbons Licensing Directive Regulations 1995, which set out additional rules that EU member states must follow when issuing petroleum licences.

In addition to the regulatory requirements, there are a number of voluntary industry-based codes of practice to which many UKCS licensees have signed up to. ICOP is intended to facilitate access by a third party to oil infrastructure in the UKCS such that the parties involved can agree fair and reasonable terms. The fallow acreage initiative places pressure on licensees to deliver activity on old licences where companies have not been active for some time or relinquish licences in order for the acreage to be offered to other companies. With respect to transfers of licences, the Commercial Code of Practice establishes an agreed framework to minimise resources spent on negotiations and promote positive commercial behaviour.

7 Are there any legislative provisions that allow for expropriation of a licensee's interest and, if so, under what conditions?

At present, there are no legislative provisions that allow for expropriation of a licensee's interest, however, as the terms of a licence may be unilaterally altered by the government, any change in the law may allow for expropriation of a licensee's interest.

8 Identify and describe the government regulatory and oversight bodies principally responsible for regulating oil exploration and production activities in your country.

DECC is the government authority primarily responsible for the development and regulation of the oil and gas industry in the UK. DECC was established in October 2008 following a transfer of powers from the Department of Business Enterprise and Regulatory Reform. DECC administers oil and gas regulatory activities, including licensing, development consent, fiscal policy, environmental policy and decommissioning. Other regulatory bodies include the Health and Safety Executive (HSE), which is responsible for health and safety, and includes the Hazardous Installations Directorate, which is responsible for regulating and promoting improvements in health and safety across the offshore oil and gas sector. From 1 April 2015, the Oil and Gas Authority (OGA) became the regulatory authority responsible for licensing in the UK.

9 What government body maintains oil production, export and import statistics?

Responsibility for oil production, export and import statistics is with DECC. The Office for National Statistics is the central data source, where the statistics are produced to a high professional standard.

Natural resources

10 Who holds title over oil reservoirs? To what extent are mineral rights on private and public lands involved? Is there a legal distinction between surface rights and subsurface mineral rights?

The Crown (through the Petroleum Act 1998) holds all title and rights to oil reservoirs within the UK and its territorial waters. DECC (on behalf of the Crown) has the power and discretion to grant licences to persons deemed fit to search for and extract oil and to further distribute and sell such oil in the market.

11 What is the general character of oil exploration and production activity conducted in your country? Are areas off-limits to exploration and production?

UK oil exploration and production activity is predominantly conducted offshore. Such activities are regulated by a licensing regime. Each licence covers a particular area, and there are separate licensing regimes for onshore and offshore exploration and production activities. Such activities (whether onshore or offshore) can be restricted for environmental, conservation or military reasons. DECC is required to carry out a strategic environmental assessment on areas proposed to be licensed to examine the impact of such activities on the environment.

Onshore exploration and production activity is also subject to additional environmental and planning legislation. The planning policy in England and Wales is currently uncertain as to whether certain areas (such as areas of outstanding natural beauty and world heritage sites) will wholly be off-limits.

12 How are rights to explore and produce granted? What is the procedure for applying to the government for such rights?

DECC is the government body responsible for the regulation of oil exploration and production activities in the UK. However from 1 April 2015, many of regulatory functions of DECC were passed to the OGA, a newly created Executive Agency of DECC. This was in line with recommendations made by the Wood Review. Regulation is by a licensing regime rather than a production sharing arrangement. Applications for a licence are made (either individually or through a joint venture) to DECC as part of a formal annual licensing round that is advertised online and in the European Journal. All applications are made in a prescribed form and companies applying for a licence must be registered in the UK, either as a company or as a branch of a foreign company (see question 18).

The timing for the application will vary depending on the size of the licensing round. In the simplest case (out-of-round with no environmental complications) it can take less than three months from the application. However, in a large licensing round with many licences and applicants, some of which are subject to Appropriate Assessment (defined below), it can take up to two years. The 2012 licensing round (27th Seaward Licensing Round) took six months from the application closing date to offer most of the awards and eight months to offer awards for applications subject to Appropriate Assessment.

'Appropriate Assessment' is the additional environmental assessment procedure required under the Offshore Petroleum Activities (Conservation of Habitats) Regulations 2001 (as amended) for licence blocks containing Special Areas of Conservation (SACs) and Special Protection Areas (SPAs). In the 28th Seward Licencing Round (announced November 2014), there are currently 94 blocks that will be subject to further environmental assessments, increasing the time before any offer is made in relation to these blocks.

At present, there are two types of offshore licence awarded by DECC: the 'exploration' licence and the 'production' licence. Under a seaward petroleum exploration licence, seismic surveys and shallow drilling can be performed in acreage not already licensed. Other parties may hold an exploration licence over the same area, and it is therefore a non-exclusive licence. Under a seaward petroleum production licence, the licensee is granted the right to search for, bore for and extract hydrocarbons from the UKCS in the area prescribed under the terms of the licence for the full life of the field from the exploration phase and development to decommissioning.

Three subcategories of production licence exist. The most common of these is the 'traditional licence'. Potential applicants must be able to demonstrate financial, technical and environmental capability in order to be successful. The 'promote' licence (introduced in 2002) is designed to award smaller companies with production rights and allow a two-year period in which to obtain the requisite financial and technical capabilities prior to development. The 'frontier' licence (introduced in 2003) recognises the difficulties in sourcing oil in remote areas of the UKCS (such as the deep waters west of Shetland) and permits screening over a large area to look for a wide range of prospects.

Onshore production is governed by the onshore production and development licence, which follows a similar form to the offshore licences described above.

13 Does the government have any right to participate in a licence? If so, is there a maximum participating interest it can obtain and are there any mandatory carry requirements for its interest? What cost-recovery mechanism is in place to recover such carry? Does the government have any right to participate in the operatorship of a licence?

The government does not have the right to participate and be carried in a licence.

14 If royalties are paid, what are the royalty rates? Are they fixed? Do they differ between onshore and offshore production? Aside from tax, are their any other payments due to the government? Are there any tax stabilisation measures in place?

Royalties are no longer payable under a licence. Licences do carry a small annual charge, known as a 'rental', which is due on each anniversary of the date of the licence.

There are no tax stabilisation measures in place, demonstrated in March 2011 when the budget raised tax on oil and gas output from 20 per cent to 32 per cent overnight and more recently lowered them overnight in the March 2015 budget.

15 What is the customary duration of oil leases, concessions or licences?

As previously stated, from 1 April 2015 many of regulatory functions of DECC were passed to the OGA. It will therefore be the OGA that administers licences.

Offshore licences

There are three types of offshore licence (traditional, frontier and promote), and each licence comprises three terms. A licence will expire automatically at the end of each term, unless certain conditions allowing the licensee to advance to the next term have been fulfilled.

Traditional licences

The duration of a traditional licence is split into successive terms of four, four and 18 years. To progress from the initial to the second term, the licensee must have completed a work programme as approved by DECC and relinquished a minimum of 50 per cent of the acreage under the licence. If, during the second term, DECC has approved the development plan and all of the acreage outside that development has been relinquished, the licence may continue into the third term. DECC may exercise its discretion to extend the third term beyond the prescribed 18-year period if production is ongoing.

Frontier licences

The duration of a frontier licence is split into successive terms of six, six and 18 years. By the end of the third year of the first term, the licensee must have relinquished 75 per cent of the licence area. At the end of the sixth year, the licensee must relinquish a further 50 per cent of the remaining acreage. This equates to a total relinquishment of seven-eighths of the original licence area by the end of the initial term. DECC may, in exceptional circumstances, where prospectivity can be demonstrated over more than 25 per cent of the licence area, allow, at its discretion, a licensee to relinquish only 50 per cent of the acreage by the end of the third year. However, the licensee would still need to relinquish all but one-eighth of the original licence area at the end of the initial term, and must have completed the work programme in order to progress from the initial to the second term.

A new type of frontier licence for the areas west of Scotland was introduced in the 26th licensing round announced in January 2010. The new frontier licence differs from the original frontier licence in that the first of its three terms is three years longer. This is in recognition of the particularly challenging nature of the geographical area where it applies and the relative scarcity of geophysical data.

Promote licences

The duration of a promote licence is split into the same successive periods as a traditional licence. However, the licence will expire at the end of the second year if DECC is not satisfied that the licensee has sufficient financial, technical and environmental capacity to undertake the work programme. At the end of the second year the licensee must also decide whether to 'drill or drop', in essence the licensee must make a firm commitment to DECC to drill a well in order for the licence to continue. Having committed to drilling, the licensee then has until the end of the initial period in which to drill.

Onshore licences

The duration of an onshore exploration and development licence is split into successive periods of six, five and 20 years. The licensee must complete the agreed exploratory work programme in the initial term before advancing to the second term. A development plan must then be approved during the second term before progressing to the third production term.

In addition, the Fallow Initiative may apply to certain blocks and discoveries under an older licence. Blocks and discoveries are considered fallow after three years if there has been no significant activity such as appraisal drilling, dedicated seismic acquisition or extended well testing. Ultimately, fallow blocks and discoveries, if not 'rescued', will be relicensed. Since most blocks under older licences have been reviewed, this initiative may now be at an end.

16 For offshore production, how far seaward does the regulatory regime extend?

The regulatory regime extends to the UK's territorial seas and the UKCS. The UK territorial sea extends from the low water mark (established by the Territorial Waters Order 1964) for 12 nautical miles. The designated area of the UKCS has been redefined over the years through a series of designations under the Continental Shelf Act 1964, following boundary agreements with neighbouring states. The Continental Shelf (Designation of Areas) Order 2013 replaces two previous orders and designates the areas of the continental shelf within which the rights of the United Kingdom with respect to the seabed and subsoil and their natural resources are exercisable. The Order designates the area of the United Kingdom's continental shelf resulting from the treaties with Belgium, Denmark, France, Germany, Ireland, the Netherlands and Norway. The area designated includes the exclusive economic zone, declared around the United Kingdom on 31 March 2014 under the Marine and Costal Access Act 2009 pursuant to the Exclusive Economic Zone Order 2013, together with any areas of continental shelf beyond 200 nautical miles from the United Kingdom's baselines.

17 Is there a difference between the onshore and offshore regimes? Is there a difference between the regimes governing rights to explore for or produce different hydrocarbons?

The onshore and offshore regimes are historically similar, although there are distinctions in the means of designating licence areas. Offshore uses a 'grid system' for the designation (quadrants of 1 degree latitude by 1 degree longitude, split into 'blocks' of 25km by 10km).

Onshore does not use a grid system, because the blocks are not regular and are much smaller than offshore. In addition to the regulatory regime, onshore operations must also adhere to the usual rules of Scots land law in Scotland and English land law in England and Wales (as exemplified by *Bocardo v Star Energy*, where, despite having obtained the licence to get petroleum, nominal damages were awarded against an oil company for its failure to obtain landowner consent to drill diagonally through strata beneath the land). The *Bocardo v Star Energy* case has now largely been circumvented by the Infrastructure Act 2015, which provides a right to drill through deep level land (at least 300 metres below the surface). Crude oil, gas and shale gas all fall under the definition of 'petroleum' in the Petroleum Act 1998 and are, therefore, governed by the same regime.

18 Which entities may perform exploration and production activities? Describe any registration requirements? What criteria and procedures apply in selecting such entities?

Companies may only perform exploration and production activities in the UK under a licence. Applications for a licence are made (either individually or through a joint venture) to DECC as part of a formal annual licensing round.

The licensing round is advertised online and in the European Journal. All applications are made in a prescribed form and companies applying for a licence must be registered in the UK, either as a company or as a branch of a foreign company, the timing of which is not overly onerous. DECC considers each application on a case-by-case basis and will require a company to demonstrate its financial worthiness (that it is able to finance its share of the relevant work programme for the licence in question). With regard to technical capability, non-operators are not required to demonstrate a high level of technical expertise.

Companies wishing to be appointed as operator are considered against additional criteria including previous experience, technical expertise and environmental awareness.

19 What is the legal regime for joint ventures?

Companies generally engage in oil activities through unincorporated joint venture associations. The companies will normally enter into a joint operating agreement (JOA) to govern contractual relations between parties to the joint venture. An industry standard JOA has been produced by Oil & Gas UK (the oil industry representative body), which is often used as a template by parties and then tailored to a specific situation. The JOA will cover such matters as the appointment of the operator, the percentage interests of each of the parties, and govern the day-to-day operational activities carried out by the operator.

20 How does reservoir unitisation apply to domestic and cross-border reservoirs?

Where a field is situated in two or more adjacent blocks that are licensed to different companies, DECC will require, prior to approving a field development programme, that the companies show that recovery of oil will be maximised and that competitive drilling is avoided. In most cases, this will require a unit operating agreement (UOA) to be entered into by the companies. The terms of the UOA will be heavily negotiated, especially provisions relating to the parties' participating interests, the selection of the operator and the ability to require a re-determination of the field. In the case of cross-border unitisation agreements, these issues may be compounded by country differences on matters such as taxation and export preferences. The government has, in the past, been willing to assist licensees with resolving cross-border issues on an intergovernmental level.

21 Is there any limit on a party's liability under a licence, contract or concession?

The liability of a licensee under a UKCS licence is joint and several. It is the joint operating agreement that splits liability between the parties in proportion to their beneficial interest in the licence. There is no limit on liability contained within the relevant statutes. However, any claim for damages must be reasonably foreseeable.

22 Are parental guarantees or other forms of economic support common practice? Are security deposits required in respect of any work commitment or otherwise?

As a general rule, DECC requires a parent company guarantee (PCG) whenever the licensee is dependent upon the financial support of its parent company in order to meet its licence obligations.

A PCG is also required from the new parent company if, prior to the acquisition, sufficient value had been transferred out of the licensee to render it unable to meet its licence obligations without the financial assistance of the new parent.

Whether the parent company is the immediate parent or the ultimate parent company will depend upon where the financial support for the licensee to meet its obligations under the licence comes from. Such liability of the parent company under the PCG will mirror that of the licensee that it is supporting.

No specific security deposits are required in respect of work commitments; however, any PCG provided is likely to cover any work commitment.

Local content requirements

23 Must companies operating in your country prefer, or use a minimum amount of, locally sourced goods, services and capital?

There are no local content requirements in the United Kingdom.

24 Describe any local content requirements likely to apply to oil companies operating in your country.

None.

Transfers to third parties

25 Is government consent required for a company to transfer its interest in a licence, concession or production sharing agreement? Does a change of control require similar approval? What is the process for obtaining approval? Are there any pre-emptive rights reserved for the government?

Government consent is required for assignments of a licence or for a change of control of the licensee. The licensee shall not, except with the consent of DECC and in accordance with the conditions (if any) of the consent, do anything whatsoever whereby any right granted by the licence becomes exercisable by or for the benefit of another person. DECC operates an e-licence administration system (PEARS: the Petroleum E-Licensing Assignments and Relinquishments System) for the submission of licence assignment applications for offshore production licences. The timing for consent depends on such factors as the complexity of the assignment, the quality of information initially provided by the licensee via PEARS and the number of other applications being processed. In addition, as part of a general drive by DECC towards improvement of the quality of records, each application will be checked for consistency between its starting point and the records of the licence's current position. The first time each licence is implicated in a PEARS application, the user will have to confirm this consistency, or notify DECC via the system about any discrepancies and upload supporting documentation for DECC to consider, and, if appropriate, implement a correction, which can also affect timing. DECC generally aims to process a straight-forward case in 10 working days (although this cannot be guaranteed). Production operatorship and financial checks in particular can take longer than this; the overall processing time will increase to 25 to 30 days where (straightforward) financial checks are involved. Once consent is granted the licensee must submit a scanned copy of the implementing agreement.

The model clauses provide that the secretary of state may revoke the licence on a change of control, so obtaining consent is paramount. When considering an application for a change of control, DECC's policy requirement is that the licensee must demonstrate that the change will not prejudice its ability to meet its licence commitments, liabilities and obligations. Where a licensee is dependent upon the financial support of its present corporate parent to enable it to meet its licence obligations and will become reliant upon the financial support of its new corporate parent, DECC will require a parent company guarantee from the new corporate parent to replace any existing parent company guarantee that may have been issued. The existence of this power can result in a request for comfort that the secretary of state will not exercise it. DECC is generally willing to consider such requests.

There are no pre-emptive rights reserved to the government.

26 Is government consent required for a change of operator?

The approval of DECC is required prior to the appointment of an operator to ensure the entity has the financial and technical capability to act as operator. The government does not have the right to participate in the operatorship. Approval is sought by submitting the operator appointment via PEARS.

27 Are there any specific fees or taxes levied by the government on a transfer or change of control?

There are no specific fees or taxes on a transfer or change of control, aside from any land and buildings transaction tax (in Scotland) or stamp duty land tax (in the rest of the UK) that may be payable on an asset transfer that includes facilities situated above the low water mark. Stamp duty will be payable by the purchaser on a transfer of any shares in a company. DECC will charge certain fees to process the relevant application via PEARS.

Decomissioning

28 What laws or regulations govern abandonment and decommissioning of oil and gas facilities and pipelines? In summary, what is the obligation and liability regime for decommissioning? Are there any other relevant issues concerning decommissioning?

The domestic UK legislation has taken on board a number of international and regional treaties, including UNCLOS (Law of the Sea Convention) article 60(3), IMO Guidelines and Standards 1989 and 1992 OSPAR Convention (Recommendation 2006/05 was adopted by the 2006 OSPAR Commission, which introduced a management regime for offshore drill cuttings piles).

Under section 29 of the Petroleum Act 1998, the secretary of state is empowered to serve notice on a wide range of persons indicating that those persons are jointly and severally liable to carry out an approved decommissioning programme. In the first instance this would include parties to joint operating agreements for installations and owners for pipelines. The notice will either specify the date by which a decommissioning programme for each installation or pipeline is to be submitted or, as is more usual, provide for it to be submitted on or before such date as the secretary of state may direct. The primary liability rests on the parties to the asset at the time of decommissioning. The secretary of state may withdraw a section 29 notice, for example, on the sale of an asset; this right used to be automatic, but is now less so. However, the secretary holds a significant 'clawback' power under section 34, whereby the liability net can be expanded to include anyone on whom a section 29 notice could have been served at any time after the first section 29 notice is served (ie, former owners – even those who have previously had the section 29 notice withdrawn – and affiliates of such owners).

Parties agree to provide security for their share of decommissioning liabilities: as part of a sale and purchase, as part of a field agreement with partners or as part of an agreement with DECC/government (relatively rare). The amount of security, which is recalculated each year, is based on an estimate of the decommissioning cost. The usual form of security is a letter of credit, but a suitably rated parent company guarantee can also be provided. The required rating of the relevant parent company or bank is AA-. The proceeds are paid to a trustee if the licensee defaults or is insolvent or does not renew the credit. A fund is therefore available to meet decommissioning costs.

The potential tax relief available for decommissioning is huge. Therefore, in the 2013 budget the chancellor committed to the introduction of decommissioning relief deeds (DRDs). These deeds provide the oil and gas industry with certainty over decommissioning tax relief on the UKCS, which in turn allows a greatly reduced level of security to be put up by companies for decommissioning (as such security will be calculated on a net tax rather than gross tax basis). The Finance Act 2013 is the enabling Act that brought in the DRDs and enables payments to be made under them. DRDs are now final and the first ones were signed in October 2013. Under these deeds, if the tax relief available were to be reduced in the future, the government would make a compensating payment to the oil and gas company affected. In most situations, it is sufficient for one company in a group to have a DRD and then under the Contracts (Rights of Third Parties) Act all group companies will be covered by that DRD. If an affiliate is to be sold to a group without a DRD, then that affiliate may obtain a separate DRD to ensure coverage.

29 Are security deposits required in respect of future decommissioning liabilities? If so, how are such deposits calculated and when does their payment become due?

The amount of security provided by the licensees is recalculated each year and is based on an estimate of the decommissioning costs. The usual form of security is a letter of credit.

If the licensee defaults, becomes insolvent or fails to renew the credit, then the security is paid to a trustee. There is therefore a fund in place to meet decommissioning costs even if not all of the licensees are able to do so.

Transportation

30 How is transportation of crude oil and crude oil products regulated within the country and across national boundaries? Do different government bodies and authorities regulate pipeline, marine vessel and tanker truck transportation?

The Energy Charter Treaty (the ECT) requires the UK to take measures to facilitate oil transit across its national boundaries in a non-discriminatory manner and according to the principles of freedom of transit, namely, without distinction as to the origin, destination or ownership of the oil and on the basis of non-discriminatory pricing. All of the UK's neighbours are parties to the ECT. Offshore pipelines require the approval of DECC (a pipeline works authorisation) before going ahead, and in granting approval DECC will have regard to the interests of other users of the sea for the transport of oil as well as the impact on the environment. Transportation of oil by road and rail is regulated by the Carriage of Dangerous Goods and Use of Transportable Pressure Equipment Regulations 2009 (amended 2011), and is monitored by the Health and Safety Executive. Transportation of oil by sea is regulated by the Merchant Shipping (Prevention of Oil Pollution) Regulations 1996 (amended 2005) and the Merchant Shipping (Dangerous Goods and Marine Pollutant) Regulations 1997. The International Maritime Dangerous Goods Code contains internationally agreed guidelines on the transport of dangerous goods.

31 What are the requisites for obtaining a permit or licence for transporting crude oil and crude oil products?

The consent of DECC is required in order to transport oil by pipeline. Transportation of oil by marine vessel and tanker truck must comply with various domestic health, safety and environmental statutes.

Health, safety and environment

32 What health, safety and environment requirements apply to oil-related facility operations? What government body is responsible for this regulation; what enforcement authority does it wield? Are permits or other approvals required? What kind of record-keeping is required? What are the penalties for non-compliance?

The Health and Safety at Work etc Act 1974 (HSWA) is the principal piece of UK legislation regulating health and safety in the workplace. It applies fully to onshore activities and many of its provisions apply to offshore activities in the UKCS. It is supplemented by a large number of subordinate regulations relating to specific risks, hazards and industries, including a number of offshore-specific regulations, mentioned below. The HSWA imposes a general obligation on employers to ensure, so far as is reasonably practicable, the health, safety and welfare at work of employees and those affected by their undertaking. All employers involved in onshore and offshore work activities, such as third-party contractors, are subject to those general duties and the majority of other health and safety regulations.

The Piper Alpha disaster was seminal in the creation of the present offshore-specific regulatory regime. It is underpinned by the concept of a 'duty holder' (either the owner of a non-production installation or the operator of a production installation) who has overall responsibility for managing risks and hazards on an installation. The cornerstone of this regime is the Offshore Installations (Safety Case) Regulations 2005. It should be noted that as a result of the Offshore Safety Directive (discussed in more detail below), the 2005 Regulations will be replaced in 2015 by the Offshore Installations (Offshore Safety Directive) (Safety Case) Regulations 2015. Slightly confusingly, despite the revocation of the 2005 Regulations, they will continue to apply where provided for by the 2015 Regulations. These Regulations are supplemented by a suite of offshore-specific legislation, which includes:

(i) the Offshore Installations and Pipeline Works (Management and Administration) Regulations 1995;
(ii) the Offshore Installations (Prevention of Fire and Explosion and Emergency Response) Regulations 1995; and
(iii) the Offshore Installations and Wells (Design and Constructions, etc) Regulations 1996.

Amendments to (i) and (ii) will be introduced in 2015 also as a result of the Offshore Safety Directive (OSD).

In terms of formal records and documents, the principal requirement on duty holders is the preparation of a safety case for each installation that must be submitted to, and accepted by, the HSE. In addition, any offshore employer (including operators, owners and contractor companies), or any person in control of work premises, must record and report certain work-related accidents in terms of the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 2013. A number of other formal notifications are required in respect of, for example, dangers to the integrity of installations and work on wells where there is substantial risk of unplanned escape of fluids.

The enforcing authority for offshore health and safety matters in the UK is the HSE, Energy Division. In 2014, the Offshore Safety Directive Regulator (OSDR) was created to oversee industry compliance with the OSD (see below). Non-compliance with either the offshore-specific legislation or the HSWA can result in criminal prosecution (punishable by unlimited fines and imprisonment for the most serious offences) or imposition of prohibition or improvement notices. Each breach of the HSWA or its subordinate regulations is a separate criminal offence. There are many 'strict liability' offences, which means that an offence may be committed even where there is no 'guilty mind'. Companies may also be prosecuted for corporate manslaughter in relation to fatal accidents that occur offshore. Any fatality occurring offshore will also be subject to investigation by the police under the Corporate Manslaughter and Corporate Homicide Act 2007, which may give rise to a prosecution and conviction of the organisation of corporate manslaughter. Such cases are prosecuted in the High Court and carry an unlimited fine.

Developments are expected during the course of 2015 in relation to new sentencing guidelines following closure of the consultation in February 2015, of the 'Health and safety offences, corporate manslaughter and food safety and hygiene offences guidelines'. The guidelines are applicable to England and Wales only, however a similar approach is expected to follow suite in Scotland. The result of the guidelines will be a very significant increase of the level of fines Imposed for breaches of health and safety.

On 18 July 2013, the new EU Directive on the safety of offshore oil and gas operations came into force as a consequence of the Macondo incident in the Gulf of Mexico. Initially, the European Commission published draft proposals for a regulation to harmonise the offshore health and safety regimes across all 27 member states and Norway. While in many respects the proposed regulation mirrored the UK's world-class 'risk-based' regime, there was concern that it may in fact undermine the UK's existing high standards in some areas. Oil & Gas UK opposed the proposal, and subsequently it was decided that a less prescriptive EU directive would be more appropriate. The OSD was published on 28 June 2013 and sets out minimum requirements to ensure prevention of major incidents and provisions to limit adverse environmental and social consequences where incidents have occurred. Some of the requirements of the OSD include:

- only operators with sufficient technical and financial capacities to remedy possible environmental damage will be allowed to explore and produce oil and gas in EU waters;
- an independent third party must verify the technical solutions proposed by the companies prior to and periodically after the infrastructure installation;
- companies will have to prepare a major hazard report for their installation, before the exploration or production begins;
- independent national authorities will inspect the installation, and in the event that an operator does not comply with the minimum standards, the competent authority will take enforcement action or impose penalties, or both;
- comparable information about the standards will be made available to the public;
- companies will prepare emergency response plans based on their rig or platform risk assessments and keep resources at hand to be able to act immediately;
- oil and gas companies will be fully liable for environmental damage caused to protected marine species and natural habitats;
- EU offshore authorities groups will work together to ensure effective sharing; and
- the Commission will support the promotion of the highest safety standards across the world.

The OSD applies to all offshore regions in Europe and European companies operating outside EU regulated waters, and extends the geographical zone for environmental damage to waters (from 22km offshore to 370km offshore). The transposition of the OSD is in stages: by 19 July 2015, member states must bring into force the laws, regulations and administrative provisions necessary to comply with the Directive; by 19 July 2016, laws, regulations and administrative provisions are to be applied to all owners and operators of planned production installations and operators planning or executing well operations; and by 19 July 2018, member states are to apply the laws, regulations and administrative provisions to existing installations. The Environmental Damage (Prevention and Remediation) (England) Regulations 2015 come into force on 19 July 2015. Similar legislation is being introduced in Wales by the same date. These regulations amend the existing Environment Damage Regulations (England)/(Wales) 2009 and implement article 38 of the OSD, extending the scope of the regime to include marine waters. Scotland has produced similar implementing legislation in draft.

The environmental impact of offshore exploration and production activities is clearly considerable. Obligations arising from various international conventions such as the Convention for the Protection of the Marine Environment of North East Atlantic (OSPAR) have culminated in a number of domestic environmental regulations. The Offshore Chemicals (Amendment) Regulations 2011 and Offshore Petroleum Activities (Oil Pollution Prevention and Control) (Amendment) Regulations 2011 amend, respectively, the Offshore Chemicals Regulations 2002 and the Offshore Petroleum Activities (Oil Pollution Prevention and Control) Regulations 2005 for the purpose of making changes to the regulatory framework for offshore chemicals and oil pollution, prevention and control. The key changes are those contained in the Offshore Chemicals (Amendment) Regulations 2011, which ensure that enforcement action can be taken in respect of non-operational emissions of chemicals, such as accidental leaks or spills. Following the 2011 amendments cited above, enforcement action can now be taken against organisations that cause an oil or chemical release outside the terms of the permit, whether or not they are the named operator in terms of the permit. Under the Merchant Shipping (Oil Pollution Preparedness, Response and Co-operation Convention) Regulations 1998, an oil pollution emergency plan (OPEP) must be prepared accordingly and submitted to the DECC for approval. What is required in an OPEP is currently in a state of transition as a result of amendments to the 1998 Regulations to be implemented in July 2015. Among other requirements is the need to provide evidence of financial responsibility. Regulatory approvals and consents are withheld until the OPEP is approved. An oil record book must be maintained at all times.

In addition, the Oil Regulations 2011 extend the scope of the Oil Regulations 2005 so that they cover emissions from pipelines. The Energy Act 2008 (Consequential Modifications) (Offshore Environmental Protection) Order 2010 extended both regimes to installations used for the offshore storage of natural gas, offshore unloading of liquefied natural gas and the offshore storage of carbon dioxide for the purpose of its permanent disposal.

In the event of a significant oil spill the operator, in accordance with its OPEP, would activate its emergency response centre to take appropriate actions to prevent further pollution and implement a response strategy. In the event of an oil leak in UK waters, the liability for all costs lies with the owners of the well. This is an unlimited liability. As a back-up, should the operator default, the Offshore Pollution Liability Association Limited was established to help pay for any clean up and liability costs. The implications of drilling and production-related emissions have seen an increase in regulation in recent years. In particular, since the Gulf of Mexico oil spill, DECC has taken action to double the number of annual environmental inspections of drilling rigs.

There is also a framework of regulations governing offshore atmospheric emissions that relate to the flaring of gas, diesel engines, gas turbines and other 'combustion plant'. A permit is required in order to operate an offshore combustion installation. Subject to transitional provisions, the Offshore Combustion Installations (Pollution Prevention and Control) Regulations 2013 revoke the Offshore Combustion Installations (Prevention and Control of Pollution) Regulations 2001. As the Industrial Emissions Directive (IED) (see question 33) provisions in respect of the offshore sector mirror those of the Integrated Pollution Prevention and Control (IPPC), DECC considers that the new 2013 regulations will not place any additional administrative or compliance burdens on offshore operators and any extra obligations (for example preparation of publicly available inspection reports) will be borne by DECC. The 2013 Regulations transpose the provisions of the IED. On land in England and Wales the environmental permitting regime applies to specified activities including certain oil related activities whereas in Scotland and Northern Ireland the Pollution Prevention Control regime applies.

The main enforcing authorities for environment matters in the UK are DECC, the Environment Agency (the EA) in England, Natural Resources Wales (NRW) in Wales, the Northern Ireland Environment Agency (NIEA) and the Scottish Environmental Protection Agency (SEPA). The Maritime and Coastguard Agency (the MCA) is the competent UK authority in terms of counter-pollution measures and response at sea, and the Joint Nature Conservation Committee (JNCC) and Marine Scotland provide advice on environmental sensitivities that may be affected as a result of any oil spill. Both the MCA and JNCC are consulted as part of the OPEP review and regulatory approval process.

Under the Offshore Petroleum Production and Pipelines (Assessment of Environmental Effects) Regulations 1999, prior to extraction, any operator who wishes to carry out certain upstream activities must undertake an Environmental Impact Assessment (EIA), and present a summary of this EIA (in an environmental statement) to DECC. Relevant activities for the purposes of the regulations includes drilling of wells, construction and installation of production facilities and pipelines in the United Kingdom Territorial Sea and on the United Kingdom Continental Shelf.

Developing areas

The Climate Change Act 2008 (CCA) sets targets for the reduction of greenhouse gases (GHGs) for the UK. The provisions of the CCA relating to emissions of GHGs apply to emissions from sources or other matters occurring in, above or below the UK sector of the continental shelf, as they apply to emissions from sources or matters occurring in the UK. Developments may be expected in this area.

The Marine Strategy Framework Directive, implemented in the UK by the Marine Strategy Regulations 2010, requires each member state to develop a marine strategy. This includes steps to protect and preserve the marine environment, prevent its deterioration and prevent and reduce effects in the marine environment. The UK Marine Strategy Part I was published in December 2012. Part II was published in August 2014 and described the UK's marine monitoring programmes to support the targets and indicators for good environmental status. In January this year, Defra published a consultation on proposals for a UK programme of measures to maintain or achieve good environmental status in UK seas by 2020. The government aims to adopt the programme of measures by the end of 2015.

The Marine and Coastal Access Act 2009 provides for greater protection of the marine area and process to designate marine conservation zones. It divides the UK marine areas into marine planning regions with an associated plan authority who prepares a marine plan for the area. It also establishes a Marine Management Organisation for the waters around England and the UK offshore area. The Marine (Scotland) Act 2010 establishes a similar organisation, Marine Scotland, in Scottish waters. As part of the marine strategy, different plans are in the process of being created, which will identify how oil and gas activities are to be dealt with in the appropriate area. Potential risks identified for oil and gas, both now and under future climates, is how infrastructure is sited and designed to take account of present and future climate conditions.

More recent investigative activities in respect of onshore unconventional oil and gas has led to further assessment of applicable regulation and the interactive relationship with a number of regimes including environment, planning, waste and water.

33 What health, safety and environmental requirements apply to oil and oil product composition? What government body is responsible for this regulation; what enforcement authority does it wield? Is certification or other approval required? What kind of record-keeping is required? What are the penalties for non-compliance?

Health and safety legislation concerned with the regulation of oil and oil products in the downstream market has evolved into a broad framework of general legislation designed to regulate products and hazards across a range of industries. As well as the duties imposed under the relevant hazard-specific legislation (listed below), the manufacturer, supplier or importer of any product or substance will still be required to comply with their general duties under the HSWA (see question 32), which requires that they ensure, so far as is reasonably practicable, that substances produced, manufactured or imported are safe and without risks to health when properly used. Hazard-specific regulations of relevance for the processing, manufacture or distribution of oil and oil-related products include:

- Regulation No. 1907/2006 EC concerning the registration, evaluation and authorisation and restriction of chemicals (REACH);
- the Control of Substances Hazardous to Health Regulations 2002, which place duties on employers and employees in relation to hazardous substances by prohibiting their use in certain circumstances and placing controls on exposure;
- the Control of Major Accident Hazards Regulations 1999, which set out requirements for companies to prepare a plan for the control and containment of major incidents, through consultation with employees and other relevant persons (such as the emergency services) (note that these regulations will be replaced as of 1 June 2015 by the Control of Major Accident Hazards Regulations 2015); and
- the Chemicals (Hazard Information and Packaging for Supply) Regulations 2009, which apply to suppliers of dangerous chemicals. The purpose of the Regulations is to protect people and the environment from the effects of chemicals by requiring suppliers to provide information about the dangers and to package them safely. The regulations are to be replaced from 1 June 2015 by European Regulation (EC) No. 1272/2008 on classification, labelling and packaging of substances and mixtures.

As stated above, the enforcing agency for health and safety matters in the UK is the HSE. Breach of the HSWA or any of its subordinate regulations, such as those noted above, is a criminal offence that may be punished by prosecution (with unlimited fines and imprisonment for the most serious offences) or imposition of prohibition and improvement notices. Imprisonment of the company's officers (directors, managers and possibly even offshore installation managers) for up to two years is possible in certain circumstances, as is disqualification of directors.

The activities of the downstream oil sector, including refining, transportation and storage of oil and petroleum, are also subject to considerable environmental regulation. In undergoing these processes, the release of substances into the land, sea or air by a downstream operator or installation requires the issue of a permit or licence from the relevant authority. DECC, the EA, the NRW, the NIEA and SEPA regulate this regime in the UK. The environmental regime is contained within a suite of domestic legislation, including the Pollution Prevention and Control Act 1999, under which a number of regulations have been made. For example the Chemicals Regulations 2011 and the Oil Regulations 2011 created a new offence related to the release of an offshore chemical or oil. The definition of 'discharge' was amended to cover any intentional emission of an offshore chemical, and a new definition of 'release' was inserted that catches all other emissions. Further, amendments introduced by the Offshore Chemicals (Amendment) Regulations 2011 and the Offshore Petroleum Activities (Oil Pollution Prevention and Control) (Amendment)

Regulations 2011 had the effect that third parties may now be held directly liable for oil pollution incidents as DECC can take enforcement action against third party contractors (previously applicable statutory law did not trigger any liability or direct exposure of third party contractors).

Another significant development was the publication in June 2013 of the OSD as outlined in question 32. Further, while the present EU legal framework for environmental liability is restricted to territorial waters (about 22km offshore), under the OSD, the geographical zone for damage to waters will be extended to cover all EU marine waters including the exclusive economic zone (about 370km from the coast) and the continental shelf, where the coastal member state exercises jurisdiction.

It is also important to refer to the Environmental Permitting (England and Wales) Regulations 2010 (as amended) (the 2010 Regulations), which provide a consolidated system of environmental permitting in England and Wales. Breach of the 2010 Regulations is a criminal offence. For offences prior to 12 March 2015, offences are subject to a maximum fine of £50,000 or 12 months' imprisonment, or both, in the Magistrates' Court or an unlimited fine or imprisonment for a term not exceeding five years, or both, in the Crown Court. For offences after 12 March 2015, both the Magistrates' Court and the Crown Court have the power to impose unlimited fines. In respect of England and Wales, the Sentencing Council Environmental Offences Definitive Guideline (effective 1 July 2014) introduced significant changes to the way in which certain environmental offences are sentenced (including breaches of the 2010 Regulations), particularly in respect of setting the starting level of fines for companies as the fines are based on a tariff system according to an organisation's turnover, the level of harm and the level of culpability. In April 2015 the power of the Environment Agency to accept enforcement undertakings (offers of voluntary action including an element of financial contribution) in lieu of prosecution was extended to offences under the Environmental Permitting Regulations 2010.

The Pollution Prevention and Control (Scotland) Amendment Regulations 2009 apply similar requirements as the 2010 Regulations to Scotland. The 2010 Regulations were recently amended by the Environmental Permitting (England and Wales) (Amendment) Regulations 2013 (2013 Regulations), which transpose the requirements of the Industrial Emissions Directive (IED) into law in England and Wales. The IED consolidated and recast several directives concerning pollution control, including the Integrated Pollution Prevention and Control (IPPC) Directive and Large Combustion Plant Directive. The 2013 Regulations, which were implemented in order to strengthen the existing IPPC regime, make various changes to the existing regulatory regime, including providing for a more extensive range of regulated activities, imposing new requirements on installations and, in some cases, shifting regulatory responsibility to local authorities or removing certain installations from the regulatory regime entirely. All new installations became subject to the IED from 7 January 2013 and, from 7 January 2014, all installations that were already subject to the (now recast) directives also became subject to the IED. Separate regulations implement the IED in Scotland and Northern Ireland.

The EA has recently issued a Regulatory Position Statement extending the requirements for environmental permits from new onshore oil and gas exploration appraisal facilities to existing onshore oil and gas facilities, in addition to permits required for crude oil unloading, handling, storage or treatment. The EA intends to review all permits granted before 1 October 2013 and invite applications for new permits from existing facilities not previously required to comply with the 2010 Regulations. Although the EA states that it will not normally take enforcement action against operators of existing facilities for not having the requisite permit prior to permit determination, if certain requirements (including a duly made application for a variation or new permit) are not met then the EA will take enforcement action and sanctions in line with its broader policy.

In respect of damage to protected species or to natural habitats in the area of the seabed of the continental shelf, the Environmental Damage (Prevention and Remediation) Regulations 2009 as amended are also of key relevance, as they lay down steps to be taken by operators where there is imminent risk of environmental damage (similar regulations are applicable in other waters). Where damage has occurred, the enforcing authority must assess the damage and identify remedial measures, and serve a remediation notice on the responsible operator specifying what remediation is required. For damage to species and habitats and damage to water, the Regulations also require that, in addition to any measures taken to return the environment to the condition it was in before the damage occurred, compensatory measures should also be taken to make amends for where the damaged environment does not completely recover and for the loss of environmental resources and environmental services pending recovery. Sanctions under various environmental regimes and consequential costs of remediation can be significant.

Labour

34 What government standards apply to oil industry labour? How is foreign labour regulated and restricted? Must a minimum amount of local labour be employed? Are there anti-discrimination requirements? What are the penalties for non-compliance?

DECC does not apply specific standards to those employed in the oil industry. From a European perspective, as a member of the EU, EEA nationals are permitted to live and work in the UK without being discriminated against on the basis of nationality. All non-EEA nationals must obtain work permission in order to work in the UK. Those working purely offshore are exempted from this requirement. In order to sponsor an employee to work in the UK, an employer must be licensed to do so by the body known as UK Visas and Immigration. Penalties for non-compliance include civil penalties of £20,000 per illegal worker or unlimited fines or imprisonment for knowing non-compliance. There is no minimum amount of local labour that must be employed.

Once it has been ascertained that an individual has the right to work in the UK, they also have the benefit of the Equality Act 2010, which provides that employers are prohibited from discriminating against them on various grounds including race (where race includes colour, nationality and ethnic or national origins). The scope of this protection is wide, and includes the management of recruitment, terms of employment or engagement, access to job opportunities and benefits and termination. If an employer is found guilty of discrimination under this Act, it could be liable for unlimited compensation arising from the discrimination, including an award for injury to feelings. An employment tribunal may also make recommendations regarding the operations of the employer, and a failure to abide by such recommendations may result in the employer being made to pay further compensation. However, the tribunal's power to make recommendations for the wider workforce which would not benefit the claimant employee will be abolished from 1 October 2015.

There is no prescribed training fund for the local workforce.

Taxation

35 What is the tax regime applicable to oil exploration, production, transportation, and marketing and distribution activities? What government body wields tax authority?

There are three elements of taxation to which companies in the oil industry may be subject: petroleum revenue tax (PRT), ring fence corporation tax (RFCT) and a supplementary charge (SC). HM Revenue and Customs Large Business Service – Oil & Gas Sector (formerly the Oil Taxation Office) administers the taxation regime.

PRT

PRT is a field-based tax charged on the profits arising to each participant from the production of oil under a licence. It is charged before RFCT and SC and is deductible in computing profits for RFCT and SC purposes. Certain specified development and maintenance expenditure can be deducted for PRT purposes against profits from that particular field. The PRT tax rate is currently 50 per cent on profits after certain allowances, but this will be reduced to 35 per cent for periods ending after 31 December 2015. A 'supplement' allowance or 'uplift' provides relief at 35 per cent (on top of the basic 100 per cent relief) for certain expenditure incurred in bringing the field into production or substantially enhancing the rate of production. Two further key available allowances are the 'oil allowance' and the 'safeguard' – the former provides each field with a level of production that is not subject to PRT; the latter ensures that a participator receives a minimum return on its investment before PRT is payable. On 16 March 1993, PRT was abolished for fields given development consent on or after that date. With effect from 1 July 2007, fields that have previously been decommissioned and are later redeveloped have been removed from the charge to PRT. The effective rate of tax on oil-related profits has now gone from

Update and trends

Oil price

A combination of demand and supply-side factors brought the price of Brent crude from US$115 per barrel in June 2014 to below US$50 per barrel in early January this year. With prices currently around US$65 today, the commercial viability of the UK Continental Shelf remains a concern for the industry. As a mature and relatively expensive basin, the collapse in the oil price has had a significant impact on the margins of producers in the North Sea. The number of exploratory wells being drilled is declining, with many proposed developments placed on hold. This is especially prevalent in the frontier areas west of Shetland and high pressure, high temperature fields where extraction costs are high. Given these difficulties, some of the bigger players operating in the North Sea have, or have stated an intention to divest themselves of UK Continental Shelf assets. This will therefore likely be a destination for smaller exploration and production companies.

Onshore oil and gas update

The unconventional exploration industry continues as a slow burner with very few exploration wells having been drilled to date. Local community opposition and the lengthy planning permission process has meant that very little exploration of tight oil and gas has been conducted and the industry is therefore a long way off determining the commerciality of unconventional resources.

The Infrastructure Act 2015 has created a right for exploration companies to conduct operations below 300 metres without it amounting to a trespass to the above surface landowner. This therefore opens up the potential for horizontal drilling without the need to compensate above-surface land owners (aside from the landowner above the vertical well) for a technical trespass.

We wait to see whether government policy from the newly elected Conservative government will continue to support onshore exploration for unconventional hydrocarbons or not.

Oil and Gas Authority

The new Oil and Gas Authority(OGA) was established on 1 April 2015. It is an Executive Agency and is therefore still directly answerable to the Secretary of State and within the DECC 'family', but the intention is that it will transition to a government company by summer 2016. OGA's remit, on behalf of the Secretary of State, includes the following functions:

- conducting licensing rounds and handling all licence amendments for both onshore and offshore;
- determining licensing strategy and policy;
- exploration functions;
- decommissioning functions;
- determining field and area strategies;
- resolving upstream infrastructure commercial disputes;
- managing the UK oil and gas portal;
- govern all hydraulic fracturing activities;
- promoting supply chain growth; and
- managing the commercial relationship between the government and the industry as well as facilitating maximising economic recovery (MER) in the UK.

At the time of writing, the DECC personnel responsible for licensing have moved to OGA and are managing amendments to current licences. At present, it is not clear when the transfer of functions from DECC to OGA will be formally announced, but it may take some time for the recruitment process to fill all of the required roles within OGA and so it is worth keeping both organisations in mind until the situation is clarified.

DECC will continue to lead on the development of the MER policy in the UK and the associated new bill that will establish the powers of OGA. This bill is due to be prepared in time for the first session of the new Parliament in summer 2015.

OSR

It is unclear how the OSDR will implement the new Offshore Safety Regulations of 2015. See comments within for further information.

2015 Budget

As part of the 2015 Budget, the Chancellor took the opportunity to support the North Sea oil industry and build upon the new simplification principles that were set out in the autumn statement.

The Chancellor, George Osborne, announced a package of measures designed to ensure continued investment in the industry. The measures are expected to lead to over £4 billion of additional investment and at least 120 million barrels of additional production of oil by 2020. This is in recognition of the economic transformation of the market since George Osborne increased the supplementary charge from 20 per cent to 32 per cent in 2011.

Tax cuts are central to the package. George Osborne announced that petroleum revenue tax will be cut by 15 per cent to 35 per cent and the supplementary charge will also be reduced to 20 per cent.

A new basin-wide investment allowance will be introduced and the existing field allowances will be abolished. The new allowance will exempt a portion of a company's profits from the supplementary charge. According to the Budget documents, the amount of profit which the allowance will exempt will equal 62.5 per cent of the investment expenditure a company incurs. The government consulted on this relief at the beginning of the year and further details on the mechanics of the relief will be provided along with draft legislation.

It was also announced that following the Wood Review the government will provide £20 million for seismic and other geographic surveys to boost offshore exploration in unexplored areas of the UK continental shelf and will also charge the OGA with the task of scrutinising companies' decommissioning plans to ensure these are cost effective.

---

62 per cent to 50 per cent for non-PRT paying fields and from 81 per cent to 75 per cent for PRT paying fields (67.5 per cent from 1 January 2016).

RFCT

Oil companies are subject to corporation tax, but there are a number of variations to the usual rules, including the 'ring fence' mechanism. The ring fence rules prevent taxable profits from oil and gas extraction being reduced by losses from other activities by treating such ring-fenced extraction activities as a separate trade. However, it is possible to carry forward or back ring fence losses against other activities. Capital allowances on relevant qualifying expenditure are available to reduce profits for corporation tax purposes. The applicable rates of tax are 20 per cent from 1 April 2015) for non-ring fence profits and 30 per cent for ring fence profits.

Despite the continuing cut in the main rate of corporation tax (from 26 per cent in 2011 to 20 per cent in 2015), the rate will remain at 30 per cent for profits from oil extraction in the UK.

SC

Introduced in April 2002, the SC constitutes an additional charge on ring-fence profits (calculated in the same way as RFCT) without any deduction for financing costs. Costs that have been deducted for the purpose of paying corporation tax must be re-added before computing the SC liability. The SC is paid and administered at the same time as corporation tax. The SC is 20 per cent with effect from 1 January 2015 (previously 32 per cent). The effective tax rate on ring fenced activities is therefore 50 per cent, which may be further reduced by availability of the new investment allowance mentioned below.

Legislation was introduced in the Finance Act 2012 that effectively provides for a cap on the tax relief available for SC purposes for decommissioning costs. This restricts the use of SC losses arising as a result of expenditure incurred in connection with decommissioning to the old 20 per cent rate of SC for decommissioning carried out on or after 21 March 2012.

The Finance Act 2015 removed existing field allowances and introduced a new basin-wide 'investment allowance'. Rather than being available based on the nature of a particular field, the portion of profits reduced by the investment allowance is dependent on a company's investment expenditure. The allowance removes an amount equal to 62.5 per cent of investment expenditure incurred by a company in relation to a field from its adjusted ring fence profits subject to the supplementary charge.

Recent developments

As noted above, and partly in response to the current low oil price, the 2015 budget and resulting Finance Act 2015 brought significant tax cuts for the UK oil and gas industry, marking in the case of SC a reversal from rises introduced in 2011. It also introduced the legislative framework for a 'cluster area' allowance, which followed the 2014 consultation on a new allowance to encourage investment in ultra-high pressure high temperature field clusters. The Finance Act 2015 provides for the Secretary of State to determine offshore areas as 'cluster areas', with secondary legislation on this to follow. This and further recommendations from the Wood Review are likely to be implemented, particularly as the OGA begins to operate.

Commodity price controls

36 Is there a mandatory price-setting regime for crude oil or crude oil products? If so, what are the requirements and penalties for non-compliance?

Crude oil and crude oil products in the UK are not subject to a mandatory price-setting regime. The UK adopts a free market approach, and oil and oil products are therefore priced and valued accordingly.

Competition, trade and merger control

37 What government bodies have the authority to prevent or punish anti-competitive practices in connection with the extraction, transportation, refining or marketing of crude oil or crude oil products?

The Competition and Markets Authority (CMA) is the principal body responsible for the enforcement of competition law in the UK.

The CMA is an independent statutory body, created by the Enterprise and Regulatory Reform Act 2013 (ERRA 2013) to replace the Office of Fair Trading (OFT) and the Competition Commission (CC).

The creation of the CMA brings the competition work of the OFT and CC under one single authority. The CMA acquired full powers on 1 April 2014. Sector regulators have concurrent competition powers. There is no sector regulator for the upstream industry, but in the downstream markets the Office of Gas and Electricity Markets has concurrent powers to enforce the competition prohibitions. There is also a specialist competition court, the Competition Appeal Tribunal, which hears appeals against decisions of the CMA and sector regulators, as well as damages claims and certain other cases.

The CMA and the sector regulators enforce the UK's prohibitions on restrictive agreements and abuse of dominance (Chapter I and Chapter II prohibitions of the Competition Act 1998) and their EU equivalents (articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU)) in the UK. Under the Enterprise Act 2002, as amended by ERRA 2013, the CMA also enforces the UK's criminal cartel regime. The Serious Fraud Office assists in the prosecutions of the criminal cartel offence.

Penalties for breach of Chapter I and Chapter II prohibitions of the Competition Act 1998 include fines of up to 10 per cent of worldwide turnover, and directions that infringing conduct be brought to an end. They are therefore similar to the penalties applicable under articles 101 and 102 of the TFEU. Other consequences include possible contractual invalidity or liability to damages actions by aggrieved third parties. The penalties for criminal cartel offences include imprisonment for up to five years or fines, or both. A director involved in anti-competitive behaviour may be disqualified from acting as a director for up to 15 years or may give an undertaking not to act in that capacity. The first directors to be found guilty of the UK criminal cartel offence were involved in the marine hose cartel. They received prison sentences reduced on appeal that ranged between 20 and 30 months.

The Enterprise Act 2002 (as amended by ERRA 2013) makes provision for market investigations. It enables the CMA to carry out both phases of an investigation into a market, starting with an initial study of an entire market or part of it and the power to refer that market for a full investigation where there is a concern that features of that market may restrict or distort competition. Where the CMA carries out a market investigation it has wide powers to specify remedies (but not to impose fines). Government ministers may intervene in market investigations in very limited circumstances on public interest grounds. The Secretary of State for Business has the power to request the CMA to investigate public interest issues alongside competition issues in market investigation cases. ERRA 2013 introduced tight statutory timescales for the completion of studies, investigations and implementation of remedies stemming from investigations.

The merger control regime in the UK is subject to a voluntary notification system. The CMA runs the whole merger process, from Phase I (initial stage review of the proposed merger) to Phase II (second stage review of the proposed merger where it is believed that the merger has a realistic prospect of substantial lessening of competition). The CMA has a deadline of 40 working days to conduct a Phase I investigation and 24 weeks (subject to extension) from the date of reference to complete Phase II. The CMA has the power to require notifying parties and third parties to provide documentation and to request the attendance of witnesses to assist in an investigation at both phases of the process. The CMA also has powers to impose interim orders to suspend all integration steps and to prevent pre-emptive action in relation to anticipated or completed mergers.

38 What is the process for procuring a government determination that a proposed action does not violate any anti-competitive standards? How long does the process generally take?

Other than in relation to merger control, it is not possible to obtain a determination from any UK competition authority on the competition law compatibility of a proposed action or agreement. Companies are responsible for carrying out their own assessment of whether their activities comply with competition law (there is limited exception to this rule in that the Competition and Markets Authority (CMA) will provide a public short form opinion on proposals that raise novel or unresolved questions of law in relation to arrangements between competitors where the CMA considers that guidance would benefit business generally). Agreements that technically infringe the prohibition on restrictive agreements but that meet the criteria set out in Chapter 1 of the Competition Act 1998 (mirroring the provisions in article 101(3) of the Treaty on the Functioning of the European Union) or in relevant block exemptions will be legally enforceable. EU guidance is the common standard of reference. Companies may have to rely on or defend their conclusions on these matters in front of the competition authorities or the courts.

The UK domestic merger control regime in the Enterprise Act 2002 is a two-phase process. It does not impose mandatory notification, nor does it impose automatic suspension requirements. Notification is voluntary. The CMA does, however, have the power to start an own-initiative investigation and to refer a transaction for Phase II investigation up to four months after completion of a non-notified transaction. All mergers are subject to a statutory timetable, giving the CMA a deadline of 40 working days to conduct a Phase I investigation. Where a transaction is referred for a second-phase investigation, the CMA must report within 24 weeks, subject to an eight-week extension period. The CMA has broad powers to impose both structural and behavioural remedies.

International

39 To what extent is regulatory policy or activity affected by international treaties or other multinational agreements?

The UK is a signatory to a number of international treaties and multinational agreements that have an impact on UK regulation. Among the most important are the 1958 Geneva Convention on the Continental Shelf and the 1982 United Nations Convention on the Law of the Sea, which together set the limits for a state's territorial sea and continue to govern the UK's access to its continental shelf and beyond. Also significant to the oil industry is the Energy Charter Treaty, which regulates between member states a number of energy-specific areas such as competition, transit of energy goods, trade, investment and dispute resolution. Other notable multinational agreements include the 1998 OSPAR Convention, which has had a significant impact on the UK's decommissioning regulations. Following the OSPAR Commission meeting in June 2013, there has been no change to the policy on derogations for the decommissioning of installations under the OSPAR Convention. However, action has been taken to harmonise the OSPAR Harmonised Mandatory Control System, which regulates the discharge of offshore chemicals and the EU REACH Regulation. The next OSPAR Commission meeting is to be held in June 2015.

40 Are there special requirements or limitations on the acquisition of oil-related interests by foreign companies or individuals? Must foreign investors have a local presence (eg, local subsidiary or branch)?

While there is no specific limitation to foreign companies, DECC has the power to make a public interest assessment of the impact of a foreign company on the market. Further, DECC requires that, to be a licensee, a company must have a place of business within the UK. In assessing the suitability of a candidate to act as an operator, DECC has stated that the location of the company's operations may be a factor in assessing its ability to run operations effectively.

41 Do special rules apply to cross-border sales or deliveries of crude oil or crude oil products?

Under UK law, cross-border transactions of this nature are not governed by any specific legislation or rules.

C/M/S/ Law.Tax

Bob Palmer **bob.palmer@cms-cmck.com**

Cannon Place
78 Cannon Street
London EC4N 6AF
United Kingdom

Tel: +44 20 7367 3000
Fax: +44 20 7367 2000
www.cms-cmck.com