Regulatory Policy Committee	**Validation of the One-in, Two-out Status and the Net Direct Impact on Business**
Validation Impact Assessment (IA)	New Shale-Friendly Model Clauses for Landward Areas
Lead Department/Agency	Department for Energy and Climate Change
IA Number	DECC0162
Origin	Domestic
Expected date of implementation	SNR 7
Date of Regulatory Triage Confirmation	04 December 2013
Date submitted to RPC	01 May 2014
Date of RPC Validation	17 June 2014
RPC reference	RPC13-FT-DECC-1966(2)
Departmental Assessment	
One-in, Two-out status	OUT
Estimate of the Equivalent Annual Net Cost to Business (EANCB)	-£45.8 million
RPC assessment	**VALIDATED**

Summary RPC comments

The Validation IA is fit for purpose. The proposal reduces regulatory barriers to the development of shale gas, resulting in increased production and therefore net benefits to business. Based upon the information provided, the Committee is able to validate the estimated EANCB of –£45.8 million. The Department should take account of the comments below before the IA's publication.

Background (extracts from IA)

What is the problem under consideration? Why is government intervention necessary?

"Exploration for and development of onshore oil and gas resources in Great Britain is possible only in areas where licences have been awarded. Much of the prospective area is currently unlicensed. Since licensing began in 1923, DECC and its predecessors have honed the terms of licences until they are very well-suited to facilitate the exploitation of conventional oil and gas, by allowing licensees to retain exclusive rights only as long as they meet certain minimum targets for progress. By now, though, conventional resources are thoroughly

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explored and current interest lies in shale gas. Industry tells us that the licence terms are not well-suited to shale gas and need to be adjusted if they are not to inhibit it."

What are the policy objectives and the intended effects?

"Secondary legislation is required to set out new Model Clauses. The aim of the new clauses is to facilitate exploration for and development of unconventional hydrocarbons (especially shale gas) as well as conventional. The commercial viability of shale gas is as yet unproven in Great Britain but there is a significant resource in areas that are currently unlicensed. New licensing is expected to double the developable shale gas resource. The value of this measure is expected to be greater than assessed here because timely and comprehensive exploration for and development of shale gas will also benefit from policy being explored to streamline access rights to underground land."

RPC comments

DECC currently uses 'model clauses' in licences granted to developers for the exploration and development of hydrocarbons. Through requiring licensees to surrender unused land, these clauses help to ensure that licensees use the land for this purpose rather than simply 'banking' it as a valuable asset. The current clauses are not suitable for shale gas and therefore act as a barrier to its development. This is because shale gas is likely to be dispersed across a whole licensed area and developers are therefore unlikely to be able to identify land to be surrendered.

The Department proposes to introduce new model clauses to facilitate exploration for, and development of, hydrocarbons (especially shale gas). The new model clauses provide increased flexibility compared to the existing licensing system by allowing retention of greater areas of land by an explorer/developer, subject to agreement by DECC, where this is justified by plans to develop shale gas (or other) resources. This is expected to result in additional exploration and development of hydrocarbons, notably shale gas.

The IA estimates the benefits to business as the surplus of revenue over costs from the additional activity that would take place. The key assumptions that affect the calculations are: activity levels (the number of shale gas pads); production levels (number of wells and average recovery per well); development and production costs; gas prices; and time profile. The assumptions here use official DECC forecasts (e.g. for gas prices) and information provided by industry (e.g. for development and production costs). The Department estimates that the impact of the proposal will be to increase steadily the number of new shale gas pads, rising to an additional two per year by 2027 (page 6 of the IA). This assessment is informed by the Department's estimates of shale gas reserves and advice from industry, which

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is in turn informed by their experience in North America. Several other forecast sources are referenced. The central assumptions used in the IA for shale gas recovery are within this range of forecasts (and below those in the recent reports by the Institute of Directors and the UK Onshore Operators Group - page 7 of the IA).

The RPC notes that the IA states that "any environmental effects are indirect" for OITO purposes (see below).

The IA explains that the estimates do not presume that the separate proposal on streamlining underground access rights is implemented. The estimated benefits here are independent of that proposal. This is supported by the accompanying cost model, which has separate costs and benefits lines relating to access rights. The IA for underground access rights, when submitted, will need to demonstrate that the estimated benefits from that regulatory change are additional to those in the present IA.

Based upon the IA and supporting cost model, the Committee is able to validate the estimated EANCB of –£45.8 million.

Additional points

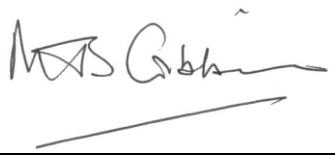
The IA document would benefit from including some additional information - for example, a summary table of costs and benefits over time, from the cost model. This would help readers to understand further how the overall costs and benefits have been estimated.

Although they do not affect validation of the EANCB, the Committee has some further comments on the IA:

- The IA should recognise that any administrative costs "*which could be handled within existing DECC resources*" (page 8) would still represent an opportunity cost to the public sector;

- The type of sensitivity analysis undertaken (page 9), which provides for no (low case) or double (high case) shale gas activity, is of limited value;

- The IA should provide further discussion of the environmental effects, as this is a matter of wide public interest.

Signed		**Michael Gibbons,** Chairman

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