

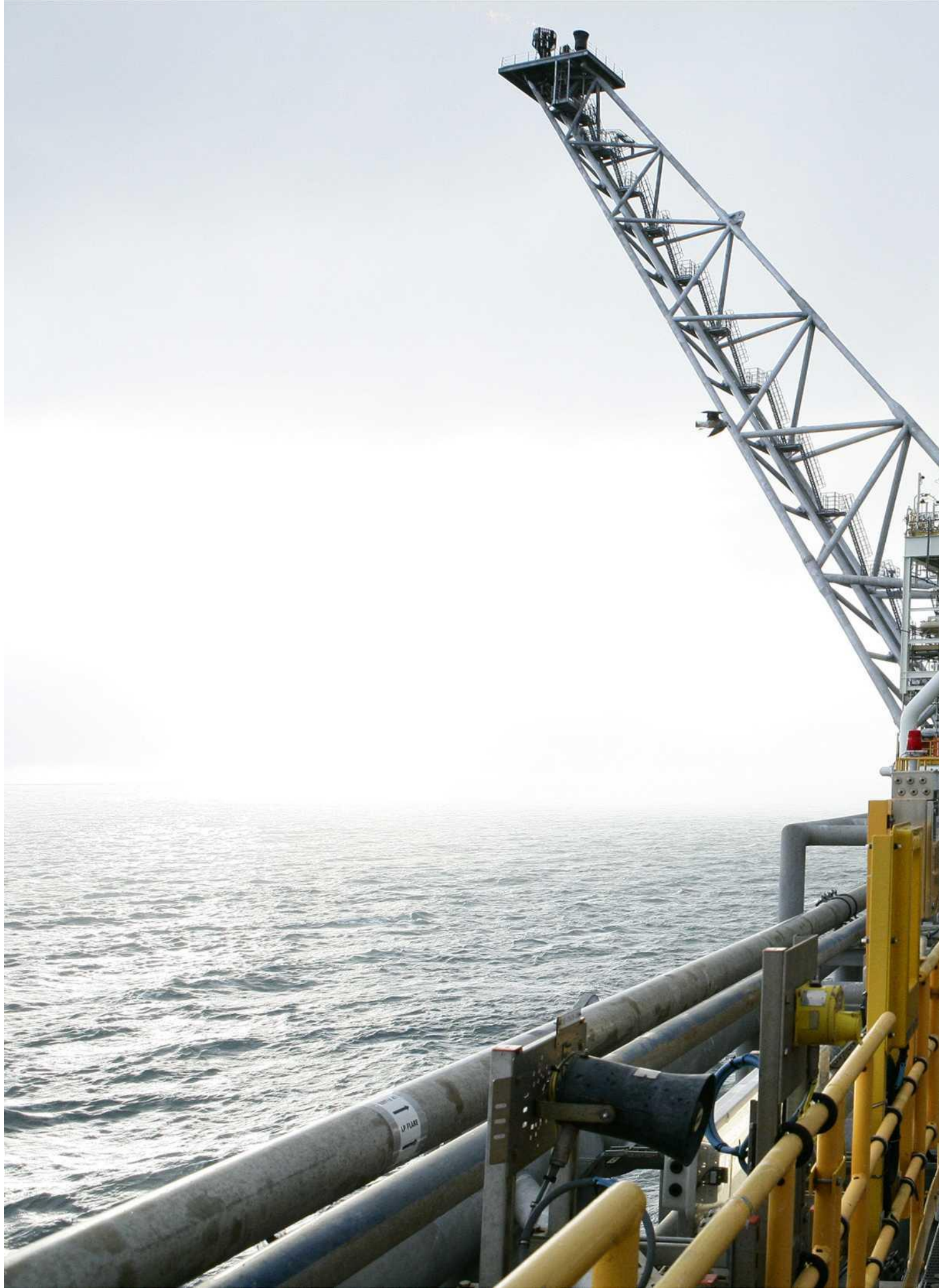


Department  
of Energy &  
Climate Change

# Maximising Economic Recovery of Offshore UK Petroleum: Draft Strategy For Consultation

DECC Consultation

15D/492 November 2015



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# General information

## **Purpose of this consultation:**

Section 9A of the Petroleum Act 1998 creates an obligation on the Secretary of State to produce a Strategy for achieving the Principal Objective of maximising the economic recovery of United Kingdom petroleum (the MER UK Strategy). Section 9G of that Act requires the Secretary of State to produce a draft of the Strategy and to consult such persons as she considers appropriate about the draft. This consultation seeks views on a draft Strategy. The Strategy, once in force, would be binding on the Secretary of State; the Oil and Gas Authority (the OGA); holders of offshore petroleum licences; operators appointed under those licences; operators of upstream petroleum infrastructure; and persons planning and carrying out the commissioning of upstream petroleum infrastructure. Measures proposed in the Energy Bill 2015/2016<sup>1</sup> (the Energy Bill) currently before Parliament would broaden the reach of the Strategy to relevant offshore installations and their owners. This consultation invites views on the suitability of this draft in particular from all those who will be subject to the Strategy.

**Issued:** 18 November 2015

**Respond by:** 8 January 2016

## **Enquiries to:**

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Consultation reference: URN 15D/492 (Maximising Economic Recovery of Offshore UK Petroleum: Draft Strategy For Consultation)

**Territorial extent: United Kingdom**

## **Additional copies:**

You may make copies of this document without seeking permission. An electronic version can be found at <https://www.gov.uk/government/groups/wood-review-implementation-team>.

Other versions of the document in Braille, large print or audio-cassette are available on request. This includes a Welsh version. Please contact us under the above details to request alternative versions.

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<sup>1</sup> <http://services.parliament.uk/bills/2015-16/energy/documents.html>

**Confidentiality and data protection:**

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information legislation (primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004).

If you want information that you provide to be treated as confidential please say so clearly in writing when you send your response to the consultation. It would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded by us as a confidentiality request.

We will summarise all responses and place this summary on the [GOV.UK website](#). This summary will include a list of names or organisations that responded but not people's personal names, addresses or other contact details.

**Quality assurance:**

This consultation has been carried out in accordance with the [Government's Consultation Principles](#).

If you have any complaints about the consultation process (as opposed to comments about the issues which are the subject of the consultation) please address them to:

DECC Consultation Co-ordinator  
3 Whitehall Place  
London SW1A 2AW  
Email: [consultation.coordinator@decc.gsi.gov.uk](mailto:consultation.coordinator@decc.gsi.gov.uk)

# Executive Summary

- I. The Wood Review<sup>2</sup> was commissioned to establish how to secure maximum value from the United Kingdom Continental Shelf (UKCS), recognising the changing nature of the basin as it matures. In response we have set up the OGA, as an independent, expert regulator and asset steward, empowered and equipped to bring industry together to drive common purpose and good outcomes for all. One of the key recommendations the Review made for safeguarding the future of the basin – increasing value recovered from it to the benefit of both industry and Government – was to develop and commit to a Strategy for maximising economic recovery from the UKCS.
- II. The Infrastructure Act 2015 inserted Part 1A into the Petroleum Act 1998, which set out the legal framework for the MER UK Strategy. It established who it applied to and in which circumstances, and created the Principal Objective of “maximising the economic recovery of UK Petroleum”. It created an obligation on the Secretary of State to produce a Strategy for enabling this objective to be met, and for the first Strategy to be produced before 12 April 2016.
- III. Meanwhile, the Energy Bill, as it stands following Report Stage of the House of Lords, contains a series of amendments to Part 1A of the Petroleum Act 1998. In light of the legislative timetable that currently exists to produce a Strategy by 12 April 2016, Government considers it necessary to consult on a draft MER UK Strategy that meets the requirements of Part 1A of the Petroleum Act 1998 as that Part currently stands. Government will consider the implications for the Strategy, on account of any changes to those requirements made by the Energy Bill, once the will of Parliament on these matters is settled.
- IV. The draft MER UK Strategy set out in Part 3 of this document has been developed through an iterative process of discussion with industry. This began in November 2014 with the publication of an illustrative “Straw Man”, to generate discussion of the concepts and obligations that should be included within a MER UK Strategy. These were developed further following discussions at workshops and industry meetings such as the Interim Advisory Panel<sup>3</sup>.

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[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/471452/UKCS\\_Maximising\\_Recovery\\_Review\\_FINAL\\_72pp\\_locked.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/471452/UKCS_Maximising_Recovery_Review_FINAL_72pp_locked.pdf)

<sup>3</sup> A panel of Government and industry representatives established to advise on implementation of the recommendations outlined in the Wood Review.



- V. The MER UK Strategy is a legal document containing obligations with which those bound by it are required to comply. Once in force, the Strategy will be binding on the Secretary of State, the OGA, petroleum licence holders, operators appointed under those licences, the owners of upstream petroleum infrastructure, and those planning and carrying out the commissioning of upstream petroleum infrastructure. There are also provisions in the Energy Bill which include extending this list to cover offshore installations and their owners.
- VI. The Energy Bill proposes to transfer various petroleum related functions and powers from the Secretary of State to the OGA. It also proposes to create a suite of new powers for the OGA, recommended in the Wood Review, to ensure compliance with regulatory obligations, including the MER UK Strategy. These powers include the ability to issue enforcement notices, revoke offshore petroleum licences, and to set financial penalties up to a maximum of £1 million per offence<sup>4</sup>.
- VII. This consultation seeks views on the suitability of the draft Strategy for achieving the Principal Objective. The consultation will run until 8 January 2016. We will be holding a workshop on November 24 in London to give interested parties the opportunity to discuss the draft Strategy in greater detail, provide their feedback, and help shape its development into a final draft. The final draft will then be laid before Parliament in early 2016 for scrutiny, before coming into force.
- VIII. The workshop will be targeted primarily at those who will be required to act in accordance with the Strategy. Further information about the workshop will be posted on the dedicated webpage <https://www.gov.uk/government/groups/wood-review-implementation-team> in due course. Interested parties may also register their interest to attend by emailing [woodreviewimplementation@decc.gsi.gov.uk](mailto:woodreviewimplementation@decc.gsi.gov.uk).

### **How to respond to this consultation**

The response period for this consultation will close on 8 January 2016. It is important to ensure that these proposals receive appropriate scrutiny through this consultation. Please respond either:

- by email to: [woodreviewimplementation@decc.gsi.gov.uk](mailto:woodreviewimplementation@decc.gsi.gov.uk)
- by post to:

MER UK Strategy Consultation  
William Cutler, Area 4C  
3 Whitehall Place  
London  
SW1A 2AW

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<sup>4</sup> Though it is possible to increase this ceiling to £5 million by Statutory Instrument.

# Part 1: Consultation

## Addressing the challenges facing the UKCS

1. The Wood Review described the challenges facing the UKCS. Those challenges were serious at the time the Review was published, but with the dramatic fall in the oil price since that time, the situation has got considerably tougher. We need to move quickly to ensure we can safeguard this important industry, which is why we've acted swiftly to set up the OGA. The OGA will play a vital role in this work to deliver MER UK; its actions, along with industry effort, will determine how successful we are at achieving this aim.
2. The MER UK Strategy will be an important document for the OGA. It is a legal document, which sets out the boundaries of people's obligations and provides a framework for the OGA as it carries out its role. It is purposefully high level, so that it can be applied to any material situation which may occur in the UKCS at any stage of the business cycle and, while being clear about people's obligations, it also provides reasonable space for the OGA to determine, in the light of the facts of any specific situation it encounters, how best to proceed. How the OGA uses and acts on the Strategy is therefore of great importance – it will set the tone for the basin and will be a key factor determining its attractiveness to industry and investors.
3. The OGA is very conscious of the delicate balance it needs to strike between driving good outcomes for the UK tax payer and ensuring that UKCS stays "open for business". The OGA's leadership, staff and Board have at the forefront of their minds the need to attract investment, help industry reduce costs and increase competitiveness, and retain and increase industry confidence in the UKCS. The MER UK Strategy should lead to significantly increased value overall; this was the vision of Sir Ian Wood and it is shared by the Department of Energy and Climate Change and the OGA. The principles and safeguards in the Strategy very much guide how the OGA will conduct its regulatory duties; the OGA will be proportionate in its approach, as demonstrated by the organisational structure it has decided to adopt, where there is separation between enforcement and asset stewardship activities, and where material enforcement decisions will be reviewed by the OGA Board. Much of the OGA's work will be in early facilitation, working closely with industry to increase value, as set out in the OGA's draft Corporate Plan<sup>5</sup>.
4. The OGA is working hard with industry to tackle the current challenges being felt in the UKCS, which is coming to terms with a dramatic fall in revenues as prices have reduced.

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<sup>5</sup> The draft Corporate Plan consultation can be found at the following <https://www.gov.uk/government/consultations/oga-corporate-plan-draft-for-consultation>.



The OGA recently published its “Call to Action: Six Months on” Report<sup>6</sup>, which shows the actions it has been taking, and sets out good examples of collaborative practices the OGA is already seeing from industry. The OGA is making its impact felt; the focus on driving collaboration and bringing companies together to create value is proving powerful, and will continue to be the regulator’s ethos.

5. The MER UK Strategy we are consulting on is the first of its kind. We want it to be in the best shape possible, so we want to hear all views during this consultation period. Knowledge of the Strategy and practice of working with it will develop over time, and the OGA plans to issue guidance in the future, informed by experience. This guidance will be developed in conjunction with industry, and it will further cement the proportionate approach the OGA will adopt to enforcing the MER UK Strategy.
6. The MER UK Strategy will be transparently integrated into the work of the OGA. There will be a clear link between the Strategy and the plans OGA is developing under it. MER UK will also be at the heart of a set of new sector strategies, recommended by Sir Ian Wood, which the OGA is developing with the support of Industry Boards it is working with and which will report to the MER UK Forum. The MER UK Forum, which replaces and integrates PILOT and the Oil and Gas Industrial Council, is the forum in which Sir Ian Wood’s recommended tripartite arrangement between government, industry and regulator is embodied. In this way the OGA and industry will work together to produce and review strategies covering topics including Exploration, Asset Stewardship, Regional Development and Infrastructure, Technology and Decommissioning. The Industry Boards will ensure there is clear focus for the work and good prioritisation. These sector strategies and, where appropriate, supporting guidance will set out in greater detail the practical steps which need to be taken under each topic.
7. All of this will deliver a regulator and asset steward with a clear focus, real expertise of the sector and the remit to work collaboratively with companies to deliver the best outcomes for both the industry and the UK tax payer.

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[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/458591/OGA\\_Call\\_to\\_Action\\_Six\\_Months\\_on.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/458591/OGA_Call_to_Action_Six_Months_on.pdf)

## Introduction to the MER UK Strategy

8. One of the central recommendations made by the Wood Review Final Report was for “Government<sup>7</sup> and Industry to develop and commit to a new Strategy for Maximising Economic Recovery from the UK Continental Shelf” The aim here is to secure increased value from the UKCS, for the benefit of both industry and the UK more broadly. For this to be effective, good collaboration will be needed from industry and the OGA. In accepting the recommendations outlined in the Review, Government set out measures in the Infrastructure Act 2015 to establish the MER UK Strategy in legislation.
9. Section 9A of the Petroleum Act 1998 (which was inserted by section 41 of the Infrastructure Act 2015) establishes an obligation on the Secretary of State to produce a Strategy for achieving the Principal Objective of maximising the economic recovery of UK petroleum. The Principal Objective specifically covers:
  - Development, construction, deployment and use of equipment used in the petroleum industry (including upstream petroleum infrastructure), and
  - Collaboration among the following:
    - i. holders of petroleum licences;
    - ii. operators under petroleum licences;
    - iii. owners of upstream petroleum infrastructure;
    - iv. persons planning and carrying out the commissioning of upstream petroleum infrastructure.
10. The Secretary of State and the four categories of industry stakeholders set out above are required to act in accordance with the Strategy when carrying out their relevant functions. These relevant functions are described in sections 9B and 9C of the 1998 Act.

## Proposals in the Energy Bill

11. Government amendments to the Energy Bill propose extending the scope of the MER UK Strategy to apply to persons who own offshore installations and also make clear how the obligations may apply in relation to the decommissioning of offshore installations.
12. The Energy Bill transfers the duty to produce a MER UK Strategy from the Secretary of State to the OGA. It also sets out a suite of new sanctions and enforcement powers which the OGA may use, including with respect to any breach of the MER UK Strategy. It is important to note that, whilst enforcement measures are a necessary backstop, the OGA is expected to act primarily as a convenor and facilitator, working together with industry to deliver increased value from the UKCS for both industry and the UK as a whole. Measures in the Energy Bill also set out matters that the OGA must have regard to

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<sup>7</sup> Including the OGA.

when exercising its functions. These include the need to work collaboratively with industry, and to maintain a stable and predictable system of regulation which encourages investment. As such, the OGA is conscious of the need to maintain and build constructive working relationships with both industry and Government in order to do its job effectively. In addition, the OGA will be under a raft of public law duties regulating the exercise of its functions, including duties to act rationally and reasonably.

13. The new sanctions and powers, formulated in line with the Wood Review recommendations, would give the OGA powers to:
  - Obtain data and samples;
  - Attend meetings;
  - Issue a non-binding resolution of disputes;
  - Impose sanctions for breach of the regulatory regime, including the MER UK Strategy. Possible sanctions being: enforcement notices; financial penalties; revocation of offshore licences; and removal of operatorship.
14. The proposals also set out an appeals mechanism which would allow parties to contest any sanctions imposed by the OGA. Appeals would be heard by the First Tier Tribunal.
15. More detail can be found in the Government Response to the Wood Review Implementation Call for Evidence<sup>8</sup>.

## **Development of the Draft MER UK Strategy**

16. This consultation seeks views on the draft MER UK Strategy set out in Part 3 of this document. This draft reflects engagement with industry since November 2014, when a “Straw Man” illustrative Strategy was published as part of a Call For Evidence on Government’s implementation of the Wood Review Recommendations<sup>9</sup>.
17. The Straw Man was developed to illustrate the range of concepts and requirements that would ultimately form part of the MER UK Strategy. Subsequent workshops and industry engagement have generated further feedback on that Strategy and the outcomes it should seek to achieve. The MER UK Strategy has now evolved into a legal document incorporating a set of obligations, guided by a set of core principles, which were discussed and shaped with input from industry. These principles have been retained, and are set out in the introduction to the MER UK Strategy. The purpose of these principles, and the structure of the MER UK obligations, are described in further detail in Part 2 of this document.

## **Relationship of MER UK Strategy to the “Sector Strategies”**

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[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/414444/Call\\_for\\_Evidence\\_Govt\\_Response-FINAL\\_120315.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/414444/Call_for_Evidence_Govt_Response-FINAL_120315.pdf)

<sup>9</sup> <https://www.gov.uk/government/groups/wood-review-implementation-team#call-for-evidence>

18. Aside from the MER UK Strategy, the Wood Review called for the development of a suite of six “Sector Strategies”. The recommendation was that these would cover the following areas:
- Exploration (including access to data)
  - Asset Stewardship (including Production Efficiency and Improved Oil Recovery)
  - Regional Development (starting with the Southern North Sea)
  - Infrastructure
  - Technology (including Enhanced Oil Recovery and Carbon Capture and Storage)
  - Decommissioning
19. The Sector Strategies will provide greater detail on the actions needed – whether by Government, the OGA or industry – to deliver MER UK in each of these sectors. Although the Sector Strategies are not binding (unlike the MER UK Strategy), it is expected that they will set out the OGA’s expectations for what is required to deliver MER UK. These expectations will give industry further clarity on what behaviours or levels of performance the OGA will expect in order to achieve MER UK.

### Consultation questions

20. In responding to this consultation we would be interested to hear your views, supported by evidence where possible, on the following questions:
- 1. Do the MER UK Strategy Obligations, as drafted, adequately encompass the full range of actions and behaviours required of all the parties which they bind to deliver MER UK? If not, what is missing?**
  - 2. Is there anything in the draft Strategy which should not be included? If so, why not?**
  - 3. Do the Obligations, as drafted, provide sufficient clarity on the required actions or behaviours? If not, which aspects need to be clarified?**
  - 4. Do you think the term “satisfactory expected commercial return” is adequately defined for the purpose of guiding all parties bound by the Strategy? If not, why not?**
  - 5. Do you think the term “economically recoverable” is adequately defined for the purpose of guiding all parties bound by the Strategy? If not, why not?**

## Next steps

21. This Consultation will close on 8 January 2016. We will be holding a workshop on November 24 in London to give interested parties<sup>10</sup> the opportunity to discuss the draft Strategy in greater detail, provide their feedback, and help shape its development into a final draft.
22. Further details and invitations will be published at <https://www.gov.uk/government/groups/wood-review-implementation-team> in due course. In the meantime, if you would like to register your interest, please email the [woodreviewimplementation@decc.gsi.gov.uk](mailto:woodreviewimplementation@decc.gsi.gov.uk) inbox, and we will keep you updated.
23. After the consultation closes, Government, in tandem with the OGA, will consider feedback received before producing a final draft Strategy.
24. This Strategy must then be laid before both Houses of Parliament for a period of 40 days before it can come into force (subject to a motion in either House resolving not to approve the draft). Our intention is to begin this process of Parliamentary scrutiny in early 2016, to ensure the Strategy can come into force by April 2016.

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<sup>10</sup> We would expect each party to attend only one workshop – whichever is the most convenient.

## Part 2: MER UK Strategy: Explanation of Structure and Purpose

25. Under the Petroleum Act 1998, the MER UK Strategy is a legally binding document. Following the coming into force of the Energy Bill, failure to comply with the Strategy will be capable of leading to a range of sanctions, up to and including revocation of a licence or operatorship. The Strategy has therefore been drafted in such a way as to make those obligations as clear as possible, so that both industry and the OGA understand their nature. We have also set out below some explanations of key concepts in the Strategy.
26. **Introduction:** The Straw Man contained a number of principles which explain MER UK, which were agreed with a range of industry representatives. These form the basis of the obligations in the Strategy and they are repeated in the introductory text. Although these principles do not form part of the binding obligations created in the Strategy, they are intended to be of interpretive effect, clarifying the nature of the obligations created by the Strategy.
27. **Structure:** Part 1A of the Petroleum Act 1998 sets out the Principal Objective of maximising economic recovery. Under that Part, the Secretary of State is required to produce a Strategy which gives effect to that obligation. This is set out in the “Central Obligation” in the Strategy, which imposes a binding obligation on all relevant persons when carrying out relevant functions to maximise economic recovery of petroleum in relevant UK waters. All of these key concepts are defined in the **Annex** to the Strategy.
28. This **Central Obligation** is, of necessity, generically worded. Therefore, in order to clarify the obligations that the Strategy places on relevant persons in different circumstances, the Strategy sets out how such persons must behave in such circumstances in order to comply with the Central Obligation. These are called **Supporting Obligations**. Although they are primarily intended to demonstrate how obligations under the Central Obligation apply in different circumstances, they bind relevant persons in the same way as the Central Obligation.
29. In addition to these two tiers of obligations, the Strategy sets out **required actions and behaviours**, which specify certain types of conduct which must be adhered to in demonstrating compliance with either the Central Obligation or any of the Supporting Obligations. Many of these derive directly from the recommendations outlined in the Wood Review, such as a requirement to collaborate and cooperate with others. This approach must underpin all actions taken to deliver obligations under the Strategy; for instance where relevant persons must plan, commission and construct infrastructure in the optimum way to deliver MER UK in a region, they must also collaborate with other relevant persons to do so.



30. To provide appropriate balance, the Strategy also sets out some fundamental **safeguards** for industry in the application of the obligations set out in the Strategy. The first is that this Strategy needs to be read in its proper context; i.e. as part of a wider regulatory regime that covers not just licensing but also environmental and health and safety legislation. The Strategy is not intended to cut across those obligations.
31. Neither this Strategy, nor any other legal instrument, confers powers on the OGA which would allow it to intervene directly in private contracts. It may occasionally be the case that the OGA will find that a relevant person's contractual provisions place that person, or could place that person, in breach of the Strategy. In these cases, the OGA will explore the matter further with the persons concerned in the manner described above. It may be that, occasionally, the OGA will need to assert its right as a regulator to use its sanctions where a relevant person fails to avoid a breach of its MER responsibilities through continued reliance on contractual provisions which conflict with the Strategy. However, it will always be for the relevant person to decide for itself how to deal with that in terms of its contracts.
32. Nor is the Strategy intended to lead to circumstances in which companies are required to make investments in which there will not be a satisfactory expected return on investment. The Strategy therefore allows for the making of a "**satisfactory expected commercial return**" and it follows that the OGA may not require investment in projects which do not meet this test. Again, it is possible that, occasionally, the OGA may come across circumstances in which a commercially viable project does not meet a particular company's required rate of return or where that company is unable or unwilling to prioritise that project – e.g. because of capital rationing. In these circumstances, the OGA would discuss the matter further with the company concerned (see paragraph 4 of the Strategy). In some cases such discussions may, for example, lead to an agreed re-scoping of a project to improve its commercial returns. However, where a company's inability or unwillingness to proceed with a commercially viable project is likely to undermine or damage the goal of MER UK, the Strategy provides that they must divest themselves of their assets, at fair market value, in order to allow in a different relevant person who is willing and able to maximising economic recovery. There have been some examples of such divestment in the UKCS in the past, so this concept is not new and it rests on existing powers within the licence.
33. The Strategy recognises the importance of ensuring continued investment in the UKCS in order to deliver upon the objective of maximising the economic recovery of UK petroleum. As such, a safeguard is included (paragraph 5 of the Strategy) which ensures obligations cannot be imposed where the immediate direct benefit would be outweighed by the resulting damage to **investor confidence**. This aligns with provisions in the Energy Bill, where the OGA, in exercising its functions (which include the development and enforcement of the MER UK Strategy), must have regard to the need to provide a stable and predictable system of regulation that encourages investment, as well as the need to work collaboratively with industry.
34. **Plans:** The Strategy enables the OGA to publish plans setting out its vision of how obligations on relevant persons under the Strategy may be met. The concept of a plan is

left undefined and deliberately broad to allow the OGA to develop practice over time, but the OGA would envisage defining clearer boundaries, taking into account responses to this consultation. A plan might target a particular or small range of circumstances, or might be broader and more strategic in nature, for example setting out how the OGA thinks a region should be developed or decommissioned.

35. Although the OGA's plans will provide a clear indication of how the OGA considers the Central Obligation might be met in particular sets of circumstances, and are therefore a good indication that failure to comply could result in sanctions being applied, the OGA's plans will not themselves be binding. It may be that the six sector strategies considered above are produced as plans under the MER UK Strategy, but this is subject to further consideration.
36. **Other significant concepts:** The Annex sets out definitions for the key concepts within the Strategy. In large part, these echo the definitions used in Part 1A of the Petroleum Act 1998.
37. There are two key concepts which merit further examination. The concept of "**economically recoverable**" in relation to petroleum is the threshold above which the Strategy applies. It does not create any obligations in relation to the recovery of petroleum which is not economically recoverable. However, what is economically recoverable is not limited to what is economically recoverable by the relevant person who is incumbent on a licence or the current owner of infrastructure. The standard is the maximum value that is economically recoverable by *any* person. The intention here is to encourage and reward efficiency across relevant UK waters.
38. What this means in practice is that if a relevant person is inefficient and is not recovering petroleum which could be recovered by another then they are not meeting the obligations under the Strategy to maximise the recovery of petroleum from relevant UK waters. However, it is important to read this in light of the safeguards which the Strategy puts in place for industry, in particular that no person can be required to invest in a project which will not yield a satisfactory expected commercial return to them. So in this example, the inefficient company could not be required to invest to recover all of the economically recoverable petroleum, but under the provisions on relinquishing assets it could be required to divest (at a fair market value) to another person who is able to recover the economically recoverable petroleum.
39. The second key concept here is "**satisfactory expected commercial return**". We have provided a definition such that this means "a reasonable return having regard to the risk and nature of the investment". This is a deliberately flexible definition. The OGA recognises that there are many factors that are considered and weighed before deciding whether to invest in a project. Matters like the risk associated with the project, the resources thought to be recoverable, the (future) oil price, the cost of capital for that company, and the complexity of the project and shareholder expectation will all play a part. It is therefore not realistic to set a single, clear figure on what a satisfactory expected commercial return would be. However, the definition we have included in this version of the Strategy is intended to recognise all of the factors set out above.

40. Although MER UK regards the recovery of “economic” petroleum, the concept used here is one of “commercial return”. This definition therefore expressly acknowledges that although there is a legal obligation to pursue economic petroleum, commercial operators cannot be expected to take on risks for a very marginal return. However, this concept of commercial is limited by what is “a reasonable return” in all of the circumstances. To that extent, projects which are low risk are likely to justify only a more modest return on investment whereas more complicated projects may reasonably justify a higher return.

# Part 3: Draft MER UK Strategy

## MAXIMISING ECONOMIC RECOVERY FOR THE UK THE MER UK STRATEGY

### **INTRODUCTION**

In drawing up the obligations imposed by this Strategy, regard has been had to the following high level principles:

- a. all stakeholders should be obliged to maximise the expected net value of petroleum produced from relevant UK waters, not the volume expected to be produced;
- b. compliance with the Strategy is intended to lead to investment and operational activities that, on an expected basis, add net value overall to the UK;
- c. compliance with the Strategy may oblige individual companies to reallocate value between them, matching risk to reward. However, while the net result should deliver greater value overall, it will not be the case that all companies will always be individually better off;
- d. compliance with the Strategy should not lead to any individual company investing in a project or operating existing assets where there is not a satisfactory expected commercial return on that investment. A satisfactory return *does not* necessarily mean a return commensurate with the overall corporate return on their portfolio of investment, e.g. a low risk investment could give low returns; and
- e. in determining whether something is consistent with the principal objective the OGA will need to balance the immediate benefit of economic recovery with the need to maintain the long term confidence of investors to invest in exploration and production of petroleum from relevant UK waters.

### **THE MER UK STRATEGY**

1. This Strategy is drafted, in accordance with section 9A(2) of the Petroleum Act 1998, to enable the principal objective established in that section to be met. To that end it sets out a Central Obligation, binding on relevant persons (including the OGA). In order to secure the effective delivery of the Central Obligation, this Strategy also sets out Supporting Obligations and Required Actions and Behaviours, which are as binding as the Central Obligation. The Supporting Obligations clarify how the Central Obligation applies in certain circumstances and the Required Actions and Behaviours are obligations which apply to relevant persons when carrying out the Central and Supporting Obligations.

## **SAFEGUARDS**

2. No obligation imposed by or under this Strategy permits or requires any conduct which would otherwise be prohibited by or under legislation, including legislation relating to health, safety or environmental protection.
3. No obligation imposed by or under this Strategy requires any person to make an investment or fund activity where they will not make a satisfactory expected commercial return on that investment or activity.
4. Where in the opinion of a relevant person, the commercial return required by that person is higher than what is offered by a specific project which is required for the fulfilment of this Strategy and that person is therefore minded not to undertake that project, the OGA will discuss that with the relevant person before taking any further action. (See relinquishment – paragraphs 27-29).
5. No obligation imposed by or under this Strategy requires any conduct (including investment or other expenditure) where the benefits to the UK deriving from that conduct are outweighed by the damage to the long term confidence of investors in oil and gas exploration and production projects in relevant UK waters.

## **CENTRAL OBLIGATION**

6. Relevant persons must, in the exercise of their relevant functions, take all steps necessary to secure that the maximum value of economically recoverable petroleum is recovered from the strata beneath relevant UK waters.

## **SUPPORTING OBLIGATIONS**

### ***Exploration***

7. The licensee of an offshore licence must plan and undertake exploration activities, including seismic and drilling activity, of a type and in a manner which is optimal for maximising the value of economically recoverable petroleum that can be recovered from the region in which the licence is located.
8. The licensee of an offshore licence who has made a firm commitment to carrying out a work programme in respect of that licence must not surrender the licence without first having completed the work programme as set out in the licence.
9. Where the obligation in paragraph 8 does not apply because paragraph 3 applies the licensee must carry out a work programme of the same or a similar nature to the one set out in the licence or such other work programme as the licensee may agree with the OGA enables the Central Obligation to be met. This might be in respect of another licence held by that licensee.

### ***Development***

10. Relevant persons must plan, commission and construct infrastructure in a way that meets the optimum configuration<sup>11</sup> for maximising the value of economically recoverable petroleum that can be recovered from the region in which the infrastructure is to be located.
11. In considering the configuration required by paragraph 10, relevant persons must give due consideration to:
  - a. whether or not any infrastructure proposed to be constructed under such a plan or commission could be of benefit to others, who are recovering petroleum from that region or who may begin to do so, by increasing the recovery of economically recoverable petroleum from that region; and
  - b. whether or not any infrastructure already in existence could be used in such a way as to reduce costs or otherwise increase the recovery of economically recoverable petroleum from the region.

This includes consideration as to whether any such infrastructure (whether proposed to be constructed or already in existence) could be so used if reasonable adjustments were to be made to it.

### ***Asset stewardship***

12. The owners and operators of infrastructure must ensure that it is maintained in such a condition and operated in such a manner that it will achieve optimum levels of performance, including production efficiency and cost efficiency, for the expected duration of production, taking into consideration the stage of field and asset development, technology and geological constraints.
13. Owners and operators of infrastructure must ensure that it is operated in a way that facilitates the recovery of the maximum value of economically recoverable petroleum from (as applicable):
  - a. the region in which it is situated; and
  - b. where the infrastructure is used by or for the benefit of others, the regions in which those others are situated.
14. The obligation in paragraph 13 includes:
  - a. allowing access to infrastructure on fair and reasonable terms; and
  - b. where the infrastructure is not able to cope with demand for its use, prioritising access which maximises the value of petroleum recovered.

### ***Technology***

15. Relevant persons must ensure that technologies, including new and emerging technologies, are deployed to their optimum effect in maximising the value of economically recoverable petroleum that can be recovered from relevant UK waters, including in relation to decommissioning.

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<sup>11</sup> In this context “configuration” includes not only the geographical placement of infrastructure, but also the sort of infrastructure to be used.



16. When considering whether to deploy new and emerging technologies in accordance with paragraph 15, relevant persons may have regard to:
- a. the risks and uncertainties associated with such technologies; and
  - b. the potential long-term benefits to the UK of the development and deployment of such technologies.

### ***Decommissioning***

17. Before commencing the decommissioning of any infrastructure in relevant UK waters, owners of such infrastructure must ensure that all options for their continued use have been suitably explored, including those which are not directly relevant to the recovery of petroleum such as the transport and storage of carbon dioxide.
18. Relevant persons must decommission infrastructure located in relevant UK waters in the most cost effective way that does not prejudice the maximising of the recovery of economically recoverable petroleum from a region. This includes ensuring due regard is given to the obligations in paragraph 15 insofar as they apply to decommissioning.
19. Where the OGA produces a plan under paragraph 20, which relates to the obligation in paragraph 18, it may identify particular pieces of infrastructure the decommissioning of which would prejudice the maximising of the recovery of economically recoverable petroleum in a region.

### ***OGA Plans***

20. Subject to paragraph 22, the OGA may produce a plan or plans which set out its view of how any of the obligations in this Strategy may be met. Such plans may address circumstances particular to a single or small group of relevant persons or may address circumstances at a regional level.
21. Where any person intends to carry out activities in a manner which is inconsistent with any current plan produced by the OGA under paragraph 20 that person must first consult the OGA.
22. Where the OGA intends to produce a plan under paragraph 20, it may first consult such relevant persons as it considers are likely to be affected by the proposed plan.

## **REQUIRED ACTIONS AND BEHAVIOURS**

23. Any obligation arising from or under either the Central Obligation or one or more of the Supporting Obligations includes the requirements set out below.

### ***Timing***

24. All obligations must be complied with in a timely fashion.

### ***Collaboration***

25. When considering how to comply with obligations arising from or under this Strategy relevant persons must, where relevant:

- a. consider whether collaboration or co-operation with others with interests in the region could reduce costs, increase recovery of economically recoverable petroleum or otherwise affect their compliance with the obligation in question;
- b. where it is considered possible that such collaboration or co-operation might improve recovery, reduce costs or otherwise affect their compliance with obligations arising from or under this Strategy, relevant persons must give due consideration to such possibilities; and
- c. co-operate with the OGA.

### ***Cost reduction***

26. The obligations set out in and deriving from this Strategy require that the full lifecycle costs of the recovery of petroleum and operations relevant to such recovery be reduced as far as possible.

### ***Relinquishing assets***

27. Where relevant persons decide not to ensure the recovery of the maximum value of economically recoverable petroleum from their licences or infrastructure (including because that does not achieve a satisfactory expected commercial return, in accordance with paragraph 3) they must relinquish or divest themselves of such licences or assets.

28. The obligation in paragraph 27 applies in all circumstances, including where the reason for the decision not to recover is because recovery generates returns which are unsatisfactory to the relevant persons, they cannot raise suitable finance and there are technical or other non-economic reasons.

29. Where a relevant person is seeking to divest themselves of infrastructure or licences in accordance with paragraph 27, that person must seek to do so without demanding compensation in excess of a fair market value or unreasonable terms and conditions, in order that other persons who are able to recover economically recoverable petroleum may do so.

## **Annex - Definitions**

For the purposes of this Strategy:

“Central Obligation” is described in paragraph 1 and set out in paragraph 6;

“economically recoverable” in relation to petroleum means those resources which could be recovered at an expected (pre-tax) market value greater than the expected (pre-tax) resource cost of their extraction, where costs include both capital and operating costs but exclude sunk costs and costs (like interest charges) which do not reflect current use of resources. In bringing costs and revenues to a common point for comparative purposes a 10% real discount rate will be used;

“infrastructure” includes production installations, pipes and equipment;

“offshore licence” means a licence granted under section 3 of the Petroleum Act 1998 in respect of an area, at least some of which is within relevant UK waters;

“the OGA” means the body entitled, at any time, to grant licences under section 3 of the Petroleum Act 1998 in respect of relevant UK waters;

“petroleum” has the same meaning as in the Petroleum Act 1998;

“region” means any area within relevant UK waters within which it is reasonable to expect that collaborative action could contribute to the fulfilment of the Central Obligation;

“relevant functions” means the functions which relevant persons are obliged by the Petroleum Act 1998 to exercise in accordance with the Strategy, but only insofar as those functions can affect the fulfilment of the principal objective;

“relevant persons” means the OGA and the persons listed in section 9C of the Petroleum Act 1998;

“relevant UK waters” has the same meaning as in Part 1A of the Petroleum Act 1998;

“satisfactory expected commercial return” means a reasonable post-tax return having regard to the risk and nature of the investment; and

“Supporting Obligation” is described in paragraph 1.

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