



Department
of Energy &
Climate Change

Funding the Oil and Gas Authority: Consultation on Levy Design

DECC Consultation

URN 15D/132
23 March 2015



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General information

Purpose of this consultation:

Consultation on the levy design in respect of funding the Oil and Gas Authority.

Issued: 23 March 2015

Respond by: 20 April 2015

Enquiries to:

Eva Stepniewska

Department of Energy and Climate Change,

3rd Floor, Area 3B

3 Whitehall Place,

London, SW1A 2AW

Tel: 0300 068 8376

Email: Eva.Stepniewska@decc.gsi.gov.uk

Consultation reference: URN 15D/132

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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](http://www.gov.uk). 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

Executive Summary

In June 2013, the Secretary of State for Energy and Climate Change asked Sir Ian Wood to conduct an independent review of UK Continental Shelf (UKCS) oil and gas recovery, specifically looking at how economic recovery could be maximised. The Government accepted, and is committed to implementing fully, all of the Review's recommendations.

The Government is creating a strong, effective regulator – the Oil and Gas Authority (OGA) – which will be established as an Executive Agency on 1 April 2015, before transitioning to a Government Company in summer 2016 (subject to legislation being brought forward and approved by Parliament).

The Government agrees that the challenge of delivering the objective of maximising the economic recovery of offshore UK petroleum ("MER UK") requires the OGA to be significantly better resourced than the current equivalent team in DECC. In line with the established practice across regulation and service delivery, the Government considers it is appropriate for the body to recover its costs from companies who will benefit from the services of the Regulator.

Around 20% of the costs of the current Regulator are already recovered through fees charged for delivery of specific services to individual companies. The Gas and Petroleum (Consents) Charges Regulations 2013 (SI 2013/1138) allow for charging for the Secretary of State's energy functions, such as consent for a Field Development Plan and for an application for a Pipeline Works Authorisation.

The Government has concluded that an additional cost-recovery mechanism will be required to fully fund the OGA and a levy would provide the fairest and simplest method of achieving this aim. However, in the short term, from 2016-17 for a period of five years, the Government has agreed to contribute £3m per year towards the costs of running the OGA to ensure it is well-funded from the outset, and to demonstrate the Government's commitment to the tripartite approach to delivering MER UK.

A power to raise such a levy was included in the Infrastructure Bill, which received Royal Assent on 12 February 2015 (Infrastructure Act 2015). The provision provides for the Secretary of State to impose a levy on persons holding licences for the exploitation of petroleum, the unloading and storing of gas and the storage of carbon dioxide.

Call for Evidence feedback

Government undertook an extensive Call for Evidence which ran from 6 November 2014 to 31 December 2014. The purpose of this Call for Evidence was to seek views from all interested parties on how to implement the recommendations of The Wood Review.

In the Call for Evidence, we set out the scope of levy-funded activity, giving more detail on the functions of the OGA and the split of activities covered by the existing charges and the proposed levy.

We also proposed some possible methods to calculate the levy rate, and identified licence acreage and production output as the most two obvious metrics.

The following questions were asked in the call for evidence:

- Do you agree that using acreage is the most suitable metric on which to base the levy calculations?
- Do you have any comments or observations on our initial proposals for collecting the levy from industry?

The majority of respondents called for simplicity, fairness and cost-reflectivity to be taken into consideration when calculating the levy rates. In terms of the metric, the majority of respondents preferred acreage over production output, though a large number of respondents suggested calculating the levy as a surcharge on licence rentals.

Summary of our approach

This consultation sets out our proposed approach to allocating and collecting the levy from petroleum licence holders. We have considered several approaches to the levy design and identified one which we consider to be the most appropriate, fair and sustainable.

Any levy design must be in accordance with the principles of Managing Public Money¹, whereby we are required to establish a coherent mapping of the costs of different activities to be recovered under the levy to particular groups of payees to whom the activities relate. With these principles in mind, the Government proposes to levy only offshore petroleum licence holders as (in the short term) the OGA will incur costs related to these licence holders. Holders of unloading and storage of gas and storage of carbon dioxide licences and onshore licence holders will be exempt from paying the levy but will continue to pay direct charges for services to recover the costs which the OGA incurs in relation to these licensees.

Based on the OGA's projected activity and focus, the Government proposes to allocate the levy by first estimating how much of the OGA's costs are directed at work in respect of the pre-production and the in-production stages. It would then divide the costs in respect of each stage evenly between the licensees in each group. Our provisional analysis suggests that 11% of the OGA's costs should fall on pre-production and 89% on in-production stage licensees (recognising this apportionment of costs could change in the future as the OGA's plans and workload develops and matures). This is based on current best estimates and best available information on the costs of the OGA. DECC and the OGA will be monitoring the situation on an ongoing basis.

This consultation seeks views on the proposed approach. Following the consultation, we will publish a Government Response and draft regulations which will be laid before Parliament. We aim to have the levy in place by October 2015.

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212123/Managing_Public_Money_AA_v2_-_chapters_annex_web.pdf

How to respond to this consultation

The response period for this consultation is four weeks, closing on 20 April 2015. It is important to ensure that these proposals receive appropriate scrutiny through this consultation. Please respond either digitally to our official mailbox woodreviewimplementation@decc.gsi.gov.uk or by post to:

OGA Levy Consultation

Eva Stepniewska, Area 3B

3 Whitehall Place

London

SW1A 2AW

If you have any evidence or detailed feedback on the levy, as set out in this document, it would be helpful if you could also provide supporting analysis to explain your position.

Part 1: OGA levy allocation methodology

1.1 Costs to be recovered under the levy

DECC already charges companies for some services that it provides in relation to licences, including consents. There are a number of charging powers, including section 188 of the Energy Act 2004, and certain charges are set out in the Gas and Petroleum (Consents) Charges Regulations 2013.

Current charges cover a wide scope of services, including an application for consent to a Field Development Plan (FDP), an application for consent to a Carbon Dioxide Storage Proposal, an application for a Pipeline Works Authorisation and consents to drilling operations. These charges recover around 20% of the costs of the current Regulator at DECC.

The existing charging regime will remain in place but will be reviewed and updated in line with normal good practice to ensure that the charge for each service reflects the costs incurred by the OGA in service provision. In addition, following a review of the activities the OGA will undertake, and in accordance with the Principles of Managing Public Money (MPM), the Government considers it is appropriate to recover the costs of several additional services via direct charges (rather than through a levy). These activities will include metering inspections, licence extensions, and area retention plans.

To make these changes, the Government will first need to amend the provisions in section 188 of the Energy Act 2004, and intends to do so at the earliest available opportunity. Therefore, until this time, the costs will initially be recovered under the levy. The range of activities that the OGA will charge for directly, as opposed to funding via the levy, will be kept under review so that the OGA's charging regime remains as costs reflective to its customers as possible.

Other costs, not currently recovered by DECC, encompass activity required to underpin those services (such as licencing policy and work to prepare future licence rounds) and activities that benefit, to greater or lesser degree, all licence holders. DECC also does not currently recover the costs of activity to support the supply chain, research and development work (for example on innovative techniques for extraction of hydrocarbons) and costs related to collection and dissemination of data (for example, surveys in relation to geological work). The OGA will also incur costs in the course of developing the MER UK Strategy and developing and implementing the Sector Strategies to maximise recovery of hydrocarbons from the UKCS.

It is our intention, as discussed in the Call for Evidence, to recover all of these costs from petroleum licence holders via the levy. The table below lists the activities the OGA will perform and which mechanism (levy or direct charges) the costs will be recovered through.

Activities currently charged for	Activities to be recovered by levy	Additional Activities proposed to be charged for directly (but in the short term recovered via the levy)
Approval of an onshore or offshore Field Development Plan (FDP) - including approval to revisions and addenda.	Developing UKCS Strategy (PILOT / MER UK)	Inspecting metering systems on offshore platforms and onshore production sites.
Approval of an offshore Gas Storage Development Plan including approval to revisions and addenda.	Responding to non-licence related / public correspondence and FOI requests	Licence extensions
Approval of an offshore carbon dioxide Storage Permit including approval to revisions and addenda.	Data: Production returns & projections	Approval of Retention Area Plans
Pipeline Works Authorisations and variations thereto.	Operational Licensing Policy	
Pipeline deposit consents.	The Field Teams (Non FDP approval work)	
Consent to drilling operations To drill a new well To drill a sidetrack To complete (perforate) a well To suspend a well To re-enter a well To abandon a well	Exploration Team (e.g. Fallow Work)	
Consent to Licence Changes Change of licensee Change of the beneficiary of a petroleum field or subarea Change of the operator of a petroleum field or subarea	Upstream Emergency Planning	
Production/Flaring /Vent consents.	Upstream Petroleum Infrastructure Third party access and other dispute resolution procedures; costs associated with enforcement and sanctions processes.	
Methodology proposed for the measurement of petroleum (PON6 approval)	Metering inspections, licence extensions, approval of area retention plans (in the short term)	
Extended Well Tests	Other (including oil price and special commissions)	

1.2 To whom will the levy apply?

In line with the early focus of the OGA, the Government has determined that, initially, the levy will be targeted only at offshore petroleum licence holders. Holders of unloading and storage of gas and storage of carbon dioxide licences will, in the short term, be exempt from paying the levy, as we do not envisage that the OGA will incur costs for those categories of licence that cannot be recovered via direct charges. Similarly, it is envisaged that the OGA will recover all of its costs in relation to onshore licences via direct charges for services. Therefore, onshore licensees will also be exempt from paying the levy.

However, as the OGA's role develops, it may undertake work that should be funded under the levy by these other categories of licence holder. Any need to extend the scope of the levy would be signalled through the OGA's annual business-planning process and the OGA will communicate its intentions to affected groups, before publicly consulting.

All licence holders will continue to pay direct fees for costs associated with issuing permits and consents via the extant fees and charges regime, which will be extended to include the relevant activities mentioned in the table above.

1.3 Principles underpinning the levy design

Industry feedback to the Call for Evidence called for the levy design to be simple to administer, transparent and cost-reflective. The Government agrees with this, and also considers that the levy should be predictable and stable to aid planning for industry and the OGA.

In common with the practice of other Government departments and an extensive range of other public bodies delivering public services in the UK, the OGA needs to act in accordance with the guidance and principles set out in Managing Public Money (MPM). These principles set out demanding standards expected of public services and include: transparency, accountability, accuracy and fairness.

As with fees and charges, the norm is for levies to recover the full cost and for the design of a levy to be as cost reflective as possible. Given this and depending on the work to be carried out, it may be appropriate to charge different levy rates to different kinds of licences.

1.4 Mapping the OGA's costs to licence holders

Accordingly, DECC, on the basis of its most up to date best estimates, has identified a coherent mapping of the costs of different activities to be recovered under the levy to particular groups of payees to whom the activities relate. This is to eliminate any potential cross-subsidisation and avoid disproportionate allocation of costs to payees.

1.5 Options considered for allocating the levy

Schedule 7 to the Infrastructure Act 2015 illustrates how the levy power may be used. Acreage and production output were included as two illustrative (but non-exhaustive) examples of possible cost drivers to calculate the levy rates. These two options have been considered further, along with a proposal made by industry to divide the OGA's costs in proportion to licence holders' licence rental payments. However, DECC has concluded on the basis of the best information currently available that none of these approaches effectively meets our criteria

for allocating the levy among licence holders. The rationale for rejecting these options is set out below.

1) Production

Production levels attained by licence holders were initially considered as an appropriate metric for the levy. However, after discussion with industry it emerged that this method is not appropriate. It could not be applied to holders of production licences which are not producing, exploration licence holders or gas storage and carbon dioxide storage licences. And although we have decided to initially exempt holders of unloading gas and storage licences and carbon dioxide storage licences from paying the levy, the metric chosen to calculate the levy rate needs to be fit for purpose in the future to include these types of licence holders (including onshore licensees). It would therefore not be an equitable metric as all of the costs would fall only upon those licence holders producing petroleum. There are also various technical challenges to deal with, such as how to account for different compositions of output (e.g. proportion of oil versus gas), which means that this is also not a simple way of allocating the levy.

2) Acreage

Acreage was also considered as a possible allocation metric. However, upon further examination the practice of acreage being relinquished means that holders of production licences who are not producing petroleum could pay the vast majority of the costs. This would not therefore reflect the actual costs the OGA expects to incur in relation to those licences and therefore would not be cost-reflective and non-compliant with the MPM principles. This would also not be a stable and predictable method for both the OGA and the industry. Finally, this method would not be fit for purpose in the future as it would not be applicable to gas and carbon dioxide storage licence holders, should we decide to levy them in the future.

3) Licence rentals

A third option suggested by industry was to make levy payments proportionate to licence rental payments. The foremost attraction of this approach is its simplicity. However, several issues emerged with this option. The most significant of these is that the amount each licence holder is required to pay per acre was determined when the licence was awarded. Over time the amount per acre has increased and this would result in an inequitable allocation of costs between licence holders, with holders of older licences paying significantly less than holders of newly-granted licences. This option also raises administrative challenges as licence areas often change during the course of the year. This would result in a somewhat unstable and unpredictable levy for industry and the OGA.

1.6 Proposed approach

Based on the OGA's activity and focus, DECC believe the fairest and most cost-reflective method, compliant with the MPM principles, is to allocate the levy by first estimating how much of the OGA's costs will be directed at work in respect of pre-production, as opposed to in-production, and then divide the costs evenly between each group according to the number of licences. There were many methods to use in order to split offshore licence holders – i.e. geography, age of licence – but the split between in-production and pre-production seemed the simplest and fairest.

For the purposes of this analysis, we have considered all types of licence – Promote, Traditional, Frontier and Exploration. Exploration licences, granting rights to explore only, and production licences at initial and second term (where usually no production is taking place), are grouped within “pre-production”. All production licences in their third term are included in “in-production”. We acknowledge that in rare instances some licences could be producing petroleum in their initial or second term. Similarly, some licence holders may not be producing in their third term. DECC is aware of this and will continue to work on the levy design to ensure it correctly reflects the activities taking place in each term of the licence.

Our provisional analysis suggests 11% of the OGA’s costs should fall on holders within pre-production and 89% on holders in-production. However, DECC recognises that, as the OGA develops and matures, this apportionment of costs will be subject to change. Therefore, DECC will ensure that the position on costs and cost allocation will be monitored on an ongoing basis and in line with normal good practice and be subject to review at least on a financial year basis. The Government expects it will be necessary to review the allocation in advance of the first business planning round following the establishment of the OGA as a Government Company.

The approach is designed to deliver an outcome which minimises any unintentional cross subsidisation between licence holders, and it provides a method which is transparent, cost-reflective and administratively simple for the OGA and industry. It also helps with predictability of the OGA’s cash flow, as the levy rate is not linked to variables such as acreage and production. Unlike acreage, it is also an approach that DECC anticipates could easily be replicated to carbon dioxide storage and gas storage licences should the levy be imposed on holders of those types of licences in future.

It should be noted that all licensees would be jointly and severally liable for the levy charged in respect of their licence but that the expectation would be that, as with licence payments, the licence operator would make a single payment on their behalf.

1.7 Estimated levy rates

Using the approach set out above, and the estimated range for the OGA’s costs of £7.4m-£12m between 1 October 2015 and 31 March 2016 (explained in Chapter 2 of this consultation) projected levy rates for licence holders are set out in the table below.

The range presented here is based on a projected budget for the OGA and is subject to change as we continue to establish the OGA. We intend to publish a detailed business plan for the OGA later this year.

		Pre-production	In-Production
Total cost attributable to license holder	£ 7.4m - £12m	11%	89%
As % of overall cost across all license holders		£813,000 - £1.32m	£6.577m - £10.68m
Number of licences in category		361	377
Costs per licence		£2,250 - £3,660	£17,450 - £28,330

1.8 Suggested collection approach

The Government considers that the process used to collect the levy should be simple for both industry and the OGA. We are proposing to collect payments annually in one single payment. Invoices will be issued in April and will be required to be settled within 30 days.

However, as the intention is for the levy to be in place in October 2015, we propose to issue the first invoice to recover the costs of the OGA from October 2015 to the end of March 2016 in October 2015, and require settlement within 30 days.

1.9 Managing deficits and surpluses

Our intention is to avoid burdening industry, and the OGA is committed to keeping costs and administrative burden to a minimum whilst ensuring that it is adequately resourced to deliver its remit.

We expect the OGA to operate within the agreed budget. However, in the circumstances when the OGA underspends (i.e. the levy collected exceeds its running costs), it would calculate the amount owed to each licence holder and issue a credit note for that amount to each licence holder. This would be netted off against the amounts falling due the following year.

If the levy rate is set too low to recover the OGA's expected costs, the OGA would first attempt to work within budget by re-prioritising work. If it was not possible, the OGA would seek approvals from DECC and HMT before revising its budget and considering amending the levy rate.

1.10 Unpaid levy

The intention is that interest will be charged in respect of unpaid amounts of licensing levy and unpaid amounts will be recoverable as a civil debt.

The interest rate will be set out in regulations and will reflect the standard cost of borrowing.

1.11 Next steps

Once this consultation exercise has concluded, the responses will be considered. The relevant regulations will then be prepared and brought forward. We intend for the legislation to come into force in October 2015.

As with any other use of public resources, it is important to monitor performance and review the service routinely at least once a year to check and, if appropriate, revise the charging level.

The total amount due from each company would be requested at the start of the financial year (April). Prior to that, the OGA will seek approval for its proposed budget from DECC and HMT.

A notional timetable for this procedure is presented below. As we intend to have the levy in place in October, this timetable will be adjusted this year but will be in place for FY2016/2017.

Timeline	Activity
September	OGA to discuss business plan for year ahead with industry
October	OGA to produce business plan for year ahead and suggest required levy rate
October – December	DECC to consider business plan
December – January	DECC/HMG to approve levy rates
Mid-January – Mid-February	DECC to draft regulations
Mid-February	DECC to make and lay regulations
April	Regulations come into force. Invoices issued and levy paid

Part 2: Consultation questions

Consultation Question	
1.	Do you agree with the proposed metric?
2.	Do you agree with the suggested collection approach?
3.	Do you have any comments on the set out approach? Please provide evidence to support your views.

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3 Whitehall Place
London SW1A 2HD
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