



Department
of Energy &
Climate Change

Maximising Economic Recovery of Offshore UK Petroleum: Government Response to Consultation

DECC Consultation

16D/023 February 2016

© Crown copyright 2016

URN 16D/023

You may re-use this information (not including logos) free of charge in any format or medium, under the terms of the Open Government Licence.

To view this licence, visit www.nationalarchives.gov.uk/doc/open-government-licence/ or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: psi@nationalarchives.gsi.gov.uk.

Any enquiries regarding this publication should be sent to us at woodreviewimplementation@decc.gsi.gov.uk

Contents

Introduction	4
Purpose of this document.....	4
Consultation overview	4
Feedback to the consultation.....	5
Structure of the Government Response	5
Next steps	6
PART ONE.....	7
Consultation questions and feedback.....	7
PART TWO.....	17
Revised Strategy with tracked changes.....	17

Introduction

Purpose of this document

1. This document sets out the Government's response to feedback received to the consultation on the draft Strategy for Maximising Economic Recovery from offshore UK Petroleum (MER UK Strategy), which was conducted between November 18 2015 and January 8 2016. It sets out the key issues raised by individuals and organisations responding to this consultation and Government's response to these points.

Consultation overview

2. The Government is committed to supporting the oil and gas industry, which plays a vital role in meeting our energy supplies as well as supporting employment and our economy more generally. The OGA, which was established as an executive agency on April 1 2015, is already engaging with industry to drive down costs and improve efficiencies and to maximise economic recovery of our offshore oil and gas reserves.
3. The Petroleum Act 1998, as amended by the Infrastructure Act 2015, places a duty on the Secretary of State to produce one or more strategies for enabling the Principal Objective of "maximising the economic recovery of UK petroleum to be met". The first MER UK Strategy is required to be produced within 12 months of the relevant clauses coming into force, therefore by April 2016.
4. The OGA will transition to a Government Company in summer 2016, subject to Parliamentary approval for the Energy Bill 2015/16 (the Energy Bill). The Energy Bill, which was introduced into the House of Lords on 9 July 2015, seeks to establish the OGA as a Government Company and equip the body with additional powers to maximise economic recovery of oil and gas from beneath UK waters. These powers will give the OGA the ability to issue enforcement notices and financial penalties, and to revoke licences for clear or persistent breaches of the MER UK Strategy.
5. Therefore, the MER UK Strategy should be read as a legal document containing obligations with which those bound by it will be required to comply. Once in force, the Strategy will be binding on 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.
6. The consultation set out a draft MER UK Strategy which had been developed following 12 months of engagement with a range of industry stakeholders, including a number of well-attended workshop discussions. These included a pre-consultation workshop in Aberdeen on 13 November, and a further workshop in London on 26 November following the launch of the consultation.
7. The consultation sought views 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?

Feedback to the consultation

8. We received 37 responses to the Consultation in addition to the feedback received at the stakeholder events.
9. Responses came from a range of stakeholders, including large and small companies as well as industry bodies, including Oil and Gas UK which represents over 500 members and Oil and Gas Independents’ Association representing 35 members, and other organisations and bodies with an interest in this area.
10. There were also responses from a small number of respondents who disagreed with the legal obligation established in Primary Legislation under the Infrastructure Act for Government to maximise the economic recovery of UK Petroleum on the grounds that such an objective is inconsistent with the need to reduce UK Greenhouse Gas emissions.
11. This document does not list or comment on every response received but all the submissions have been considered by Government and the OGA.

Structure of the Government Response

12. **Section One** of this response document summarises the detailed feedback received on each of the consultation questions and sets out the Government’s response to the points raised.
13. **Section Two** sets out the revised MER UK Strategy, and details the key changes that have been made on account of the feedback. In revising the Strategy, full account has been made of all of the feedback, including where relevant comments were made outside of the 5 specific questions the Consultation asked respondents to consider.

Next steps

14. The revised MER UK Strategy was laid in Parliament on 28 January 2016 for scrutiny. If, after the applicable timeframe¹, neither house “prays” against the Strategy, the Secretary of State may bring it into force. Government’s intention is to do so at the earliest possible date.
15. Meanwhile, the passage of the Energy Bill gives rise to the possibility of changes being made to the Principal Objective which this draft Strategy has been drafted to meet. Government will consider what changes, potentially in the form of an addendum to this draft Strategy, might be needed should the will of Parliament be to amend the Principal Objective from that as it currently stands in law.
16. To support effective implementation, the OGA will work with industry to develop accessible guidance that promotes good practice and clearly outlines obligations. Priority will be given to guidance that facilitates action and will include publications on the OGA functions outlined in the Energy Bill and technical guidance to support the delivery of MER UK. The OGA will keep in mind all of the feedback received during this consultation as it develops this guidance.

¹ Section 9G of the Petroleum Act 1998 as amended by the Infrastructure Act 2015 set out a 40 day period of scrutiny, for which no account may be made of days in which Parliament is dissolved or prorogued or during which both Houses are adjourned for more than 4 days.

PART ONE

Consultation questions and feedback

Consultation Question	
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?

Summary of responses

17. Many respondents used this question to suggest drafting changes to the Strategy to clarify how the Central and Supporting Obligations should be read and interpreted together with the Safeguards. These respondents felt it was essential to make clear that the Safeguards apply in all cases, and under each of the obligations.
18. There was also a range of suggestions made to rephrase some of the existing Safeguards included in the Strategy. These included suggestions to add the phrase “*including existing activities*” after “*fund activity*” to paragraph 3 to make clear that the protection against the obligation to fund activity except where there is a “*satisfactory expected commercial return*” applied to ongoing activities as well as new ones. There was also a suggestion made to remove the phrase “*long-term*” in paragraph 5 so that the potential detrimental impacts on investor confidence, whether arising in the short-term, or the long-term must be weighed against the potential benefits before any conduct arising from the Strategy is required.
19. A theme that was repeated by many responses in relation to a number of areas in the draft Strategy was that there was a lack of recognition of how an individual company or Joint Venture might be compensated by any investment or activity required of it to accommodate the need of a third party to deliver greater value over all. The remedy proposed, in one way or another, was that the Strategy should include a safeguard to make it clear that where investment generates common benefit, costs should be shared in a manner reflecting this benefit and taking account of the parties’ risk exposure.
20. Many respondents, whether answering this question directly, or through their general comments on the draft Strategy, made other suggestions for additional Safeguards that should be included. Suggestions were made for additional Safeguards to;
- explicitly reference Competition law and Intellectual Property Law in paragraph 2 to ensure obligations under the Strategy would not require companies to breach requirements under those laws;
 - put the OGA under a duty “to act in a proportionate, equitable and transparent manner”;

21. Some responses to this question suggested that the introductory paragraphs be brought into the main part of the Strategy. This would give those paragraphs a binding effect, rather than an interpretive one as originally drafted.
22. There was a widely made suggestion that the obligation under paragraph 22 (plans) should be altered such that the OGA “*must consult*”, rather than “*may consult*” before producing a plan.

Government response

23. Government agrees with the majority of comments made in relation to this question. As a consequence the Strategy has been redrafted in many places to take account of the feedback. Unless otherwise stated, the comments described above have been addressed. However, Government does not agree that all of the changes requested were necessary or appropriate. The rationale for not making some of the changes requested is described below.

Incorporating the “principles” from introductory paragraphs into the Strategy itself.

24. The principles included in the introduction were derived from the earlier rounds of engagement DECC and the OGA had with industry, on which there was widespread agreement. As such, Government and the OGA have used them to help develop the obligations under the Strategy. Where possible, the principles have been directly translated into obligations (or safeguards). However, for others, the wording required some minor alterations. On this basis, the Government does not agree that it is necessary to include the introductory paragraphs in the Strategy itself.

25. The table below sets out how the principles have been reflected within the revised Strategy.

Principle	Position within Strategy
a.	Implicit in new para 7 (central obligation)
b.	Implicit in new para 7 (central obligation)
c.	Consistent with new para 5 (safeguards) Also consistent with the concept of “satisfactory expected commercial return and its application in new para 3 (safeguards).
d.	New para 3 (safeguards)
e.	New para 6 (safeguards).

Safeguard against conflicts with existing legislation

26. The safeguard in new paragraph 2 is drafted to ensure that no obligation imposed by the Strategy overrides any obligation prescribed under any existing legislation. While the Government and OGA have engaged with the Competition and Markets Authority on the competition aspects of the OGA’s functions, in light of the CMA’s letter of 3rd December 2015, to which DECC will respond this month, the Government has decided that it is important, for the avoidance of doubt, to explicitly reference here certain legislation and has

decided to add Competition Law to that list. However, it is not the intention for the list to be exhaustive; therefore, further additions, such as the suggestion to include Intellectual Property Law, have not been made beyond this.

Obligation on OGA to act in a proportionate, equitable and transparent manner

27. As a public body the OGA will be under a raft of obligations deriving from the common law. As such, Government does not think it is necessary to create a raft of new obligations on the OGA of uncertain extent and has instead inserted a new section to new paragraph 2 to clarify that the OGA will be bound by such duties as exist under common law which include an obligation to act reasonably at all times. The Government believes that this clarification, in addition to the requirement that the OGA “*have regard to the need to maintain a stable system of regulation which encourages investment in relevant activities*”, which is contained within the Energy Bill 2015/16, should provide sufficient reassurance to those bound by the Strategy that the OGA will use its statutory powers appropriately.

Consultation Question

2.	Is there anything in the draft Strategy which should not be included? If so, why not?
----	---

Summary of responses

28. Respondents to this question expressed a wide range of views. A small number of responses suggested that the Principal Objective of maximising economic recovery of UK Petroleum, and thus the Strategy as a whole, were incompatible with the Government’s obligations under the Climate Change Act to reduce UK’s greenhouse gas emissions by 80% by 2050.
29. In regards to the obligations set out in the draft Strategy some responses suggested that the Central Obligation was drafted too broadly. The expression “*take all steps necessary*” was considered by many to be too far-reaching, and unclear as to what this might require of relevant persons. These respondents wished to see “*take all steps necessary*” be replaced by “*endeavour*”, or “*take reasonable steps*”. However, others felt “*take all steps necessary*” should remain so as strengthen the regulator’s powers to achieve MER UK.
30. Similar comments were raised in the technology and decommissioning sections of the Strategy. Under technology, some felt that the obligations should only be on relevant persons to “*consider*” new and emerging technologies, rather than “*deploy*”. In relation to 16b there were differences of opinion about whether the benefits to the UK of deploying a new technology were a relevant consideration, or indeed whether this should be something the OGA alone should be required to consider.
31. In a similar vein, under the decommissioning section, while some respondents felt that the obligations as drafted created additional risks of increasing the costs of decommissioning by requiring assessment of alternative future uses of the infrastructure, others believed the obligations should include additional references to the consideration of future use.
32. A significant number of responses raised concerns with the obligations set out under the Exploration section (paragraphs 7-9 of the draft Strategy). There were concerns raised that

the obligations amounted to a retrospective change to licence terms requiring, under paragraph 7, action to explore on a regional basis, and under paragraph 9, to transfer licence obligations to different licences to those for which the work commitments were originally intended. While some objected to the principle of apparent retrospective changes, and therefore suggested the section as a whole should be removed from the Strategy or else only be made applicable to new licences, others highlighted the practical difficulties the obligations created.

33. Finally, under the Development section a key issue raised was the apparent inconsistency between the obligation under 14b - “*where infrastructure is not able to cope with demand for its use, prioritising access which maximises the value of petroleum recovered*” - and the existing Guidance on Third Party Access Disputes² which presupposes priority for the owner.

Government response

34. The revised Strategy included in Part 2 of this document includes many of the changes respondents suggested in their responses to this question. Below is an explanation of the key changes that have been made, and those where Government has decided not to revise the Strategy.

Compatibility of the Principal Objective with Climate Change Targets

35. Government does not agree with the suggestions made that meeting the Principal Objective - of maximising economic recovery of UK petroleum - is inconsistent with the goal of reducing the UK’s Greenhouse Gas emissions by 80% by 2050, as required by the Climate Change Act.
36. The UK will still need significant oil and gas supplies over the next decades while we decarbonise and transition to a low carbon economy. Projections show that in 2030 oil and gas will continue to be a vital part of the energy mix, providing around 70 per cent of the UK’s primary energy requirements. Meeting as much of this demand from domestic sources will reduce our reliance on international sources, and the additional costs on the economy these may entail.
37. In 2013 UK oil and gas production saved UK importing energy worth £28 billion and the balance of trade in goods and services was further boosted by the export of oilfield goods and services. In 2014 UKCS oil production was equivalent to around 56% of UK oil product demand, while gas production equated to just over half of domestic demand. The UK has substantial potential for continuing production and, given right business conditions which promote investment, UK industry can continue to supply a significant proportion of our needs to 2020 and beyond.
38. Therefore, the objective of maximising economic recovery of UK petroleum, through both improving efficiency and increasing levels of production, will help support growth and jobs as well as maintaining security of supply.

2

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212482/Guidance_on_Disputes_over_Third_Party_Access_to_Upstream.pdf

Central Obligation

39. As explained in the Consultation document, the wording of the Central Obligation is, by necessity, drafted broadly. However, in light of the consultation responses, Government has decided to amend the wording slightly. The new wording, set out in Part 2 of this document reads;

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

40. Government did not feel that it would be appropriate to reduce the obligation here to take “*all reasonable steps*” (or similar) as some suggested. Government believes that to do so would materially weaken the OGA’s ability to help achieve the maximising of economic recovery of petroleum from relevant UK waters. In particular it is difficult to see how such an amended obligation would operate with the safeguards set out elsewhere within the Strategy. It would also add an unnecessary degree of uncertainty into assessments of what was required by the Strategy, that Government did not feel was desirable. Government notes that the safeguards already provide strong levels of protection, for example such that no obligation applies where actions or investment would not lead to relevant persons making a “satisfactory expected commercial return”. In addition changes have been made to extend these protections further:

- within the “investor confidence” protection in new paragraph 6, the reference to “*long-term*” has been removed to ensure that any immediate damage to investor confidence is also considered.
- there is an additional safeguard at new paragraph 5 to clarify how a relevant person could expect contributions from third-party beneficiaries of any costs associated with an activity they might undertake or cost they might incur for that third party’s benefit.
- additional wording has been inserted, for example at new paragraphs 1, 8 and 9, to put beyond doubt that the Safeguards are intended to apply to all of the obligations, and in all circumstances.

Interaction with Guidance on Third Party Access to Infrastructure Legislation

41. As noted in many responses, the obligation at paragraph 14b of the draft Strategy interacts with the existing Guidance on Third Party Access to Infrastructure powers under Energy Act 2011 (Chapter 3). Paragraph 14b requires that owners of upstream petroleum infrastructure must:

“where the infrastructure is not able to cope with demand for its use, prioritising access which maximises the value of petroleum recovered.”

42. Government believes this is an important principle necessary for achieving MER UK. However, it is sympathetic to respondents who noted that there was an inconsistency between this obligation and the existing guidance referred to above. As such, the OGA will consider amending its published Guidance on Chapter 3 of Part 2 of the Energy Act 2011 so that it is consistent with this principle.

Exploration

43. Government has agreed that some changes to the Exploration obligations are necessary, though does not agree with the suggestion made by some that they should be removed entirely, or else made only applicable to new licences. The changes made for the revised Strategy are principally as follows:

- The regional aspect of the obligation under old paragraph 7 has been made into a separate obligation in new paragraph 11. The obligation has been clarified to make clear that it applies only where the OGA has set out a “plan” on this matter. Government believes this change is necessary to reflect the fact that licence holders cannot unilaterally commit to activity beyond the area for which they are a licence holder. Government notes that the OGA would be required to seek the views of those who may be affected by a plan before issuing one. In so doing, the OGA can ensure that any plans it chooses to issue reflect the particular circumstances, constraints and opportunities as may apply to the area, and/or persons in question.
- For similar reasons, and to avoid unnecessary confusion, the last sentence of old paragraph 9 (paragraph 12 in the revised draft) – “*this might be in respect of another licence held by that licensee*” – has been removed.

Consultation Question

3.	Do the Obligations, as drafted, provide sufficient clarity on the required actions or behaviours? If not, which aspects need to be clarified?
----	---

Summary of responses

44. This question prompted respondents to identify areas where further clarity on the nature and extent of the obligations (as well as some of the terms used) would be helpful for relevant persons to interpret the intended effect of the draft Strategy.

45. Taken together, such comments addressed many aspects of the draft Strategy. Some of the most commonly expressed areas where respondents felt that further explanation would be helpful were :

- Clarity over whether the Strategy requires prioritisation of value over volume of economically recoverable petroleum;
- The interrelationship between different “OGA plans” and “regional plans”;
- Procedures to govern a forced divestment or relinquishment of licences, and what would happen in the event a suitable buyer could not be found;
- Interpretation of the term “optimum” and potential tension between “to maintain infrastructure to maintain optimum levels of performance, production efficiency and cost efficiency in view of that asset’s stage of field life”, and the obligation to operate in order to facilitate “maximum recovery from the region”;

- How relevant persons (including the OGA) would determine the UK benefits of the deployment and development of new and emerging technologies;
- The scope of “others with interests in the region” whom relevant persons should consider collaborating with under paragraph 28a of the draft Strategy.

Government response

46. Many of the comments raised in response to this question can most effectively be dealt with in the guidance that the OGA will issue on implementation of the Strategy. Government and the OGA will consider all of the responses with a view to providing industry with the necessary guidance it needs. The OGA will set out further detail of their plans for producing guidance, and developing the Sector Strategies recommended by the Wood Review, in their response to the consultation on the draft Corporate Plan, which will be published shortly.
47. Where appropriate and necessary, however, Government has amended the draft Strategy to ensure it is as targeted as possible, without reducing the flexibility of relevant persons (including the OGA) to comply with the obligations it creates.
48. In particular, the new section at new paragraphs 30 to 34 is drafted to give greater clarity over the steps that should be taken where a relevant person is unable or unwilling to maximise the value of economically recoverable petroleum from their licences or infrastructure. In addition, the obligation to “*consider whether collaboration or co-operation with others with interests in the region*” at paragraph 28a of the draft Strategy has been narrowed to; “*where relevant, consider whether collaboration or co-operation with other relevant persons and those providing services relating to relevant functions in the region.*”

Consultation Question

- | | |
|----|--|
| 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? |
|----|--|

Summary of responses

49. Many responses to this question supported the view that the concept of “Satisfactory Expected Commercial Return” should be crafted broadly to provide flexibility to accommodate the wide range of investment activities in the industry. There was also strong support for it to be defined as a post-tax measure and to identify the “*risk and the nature of the investment*” as central to a determination of whether it is “*satisfactory*”.
50. However, others requested further elaboration of the definition. These respondents wished to see the inclusion of “*due consideration being given to all relevant risks including technical, geological, commercial, market and other risks*” within the definition.
51. Many of the responses highlighted an apparent tension between the definition in the annex, which was intended to be an objective measure subject to a test of reasonableness, and the reference to it in the “Safeguards” section (paragraph 4 of the draft Strategy) where it is acknowledged to be a matter of opinion for the relevant person. While some requested

clarity over whether the test is an objective one, or one that is subjective from the perspective of the investor or person carrying out the activity, others suggested that at all times the test should be one for the relevant person investing, or carrying out the activity, to determine.

52. The latter group suggested the definition should therefore be redefined to include a clear acknowledgment of the subjective nature of “satisfactory expected commercial return” (for example “*in the opinion of the potential investor*”) and the wide range of measures which industry uses to make investment and divestment decisions.

Government response

53. Government has made a number of changes both to the definition of Satisfactory Expected Commercial Return itself, and also at various places within the Strategy, to give greater clarity over how the test should apply where a relevant person does not believe a particular investment or activity would deliver a return they themselves find satisfactory.

54. At new paragraph 4 (Safeguards) the wording has been modified to ensure that wherever a relevant person decided not to proceed with a particular investment or activity because they do not believe it would deliver a satisfactory expected commercial return (in their view) then they and the OGA must discuss the situation before the OGA will take any enforcement action in relation to that decision.

55. New paragraphs 30 to 34, in a new section; “*Actions where relevant parties decide not to ensure the maximum economic recovery*”, replace paragraphs 27-29 from the section previously titled “*Relinquishing Assets*”. This section sets out with greater clarity the steps that would be taken where relevant persons decide not to proceed with a particular investment or activity.

56. The changes retain the obligation that the person choosing not to proceed with a particular investment or activity must allow others to seek to maximise the value of economically recoverable petroleum from their licences or infrastructure, including by divesting themselves of such licences or assets to other financially and technically competent persons.

57. However, Government believes that to enforce this obligation, the OGA needs to be able to rely upon an objective test of whether a particular investment or activity is capable of achieving a satisfactory expected commercial return, and does not agree that the test should be determined solely by each individual relevant person. However, the definition of what is a satisfactory expected commercial return has been amended to give greater clarity over the factors that might be applicable to a particular investment or activity. The revised definition is:

“satisfactory expected commercial return” means an expected post-tax return that is reasonable having regard to all the circumstances including the risk and nature of the investment (or other funding as the case may be) and the particular circumstances affecting the relevant person”.

Consultation Question

- | | |
|----|---|
| 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? |
|----|---|

Summary of responses

58. The majority of responses that addressed this question believed that the definition of “Economically Recoverable” should be post tax to mirror the way investors would evaluate the attractiveness of a particular investment or activity. However, there was also recognition that, from a national viewpoint, consideration of pre-tax returns is legitimate. Other comments suggested that the Strategy itself, or otherwise future guidance, should give greater clarity on how the OGA would apply the definition in different circumstances. There were also a number of responses that requested decommissioning costs be explicitly referenced in the definition, as well as to make reference to how commodity costs, as well as capital and operating costs, have a cyclical nature.

Government response

59. Government believes that the duty to “*maximise the economic recovery of UK Petroleum*” as established by clause 41 of the Infrastructure Act 2015 necessitates consideration of the economically recoverable resources as seen from a national viewpoint. On this basis Government intends to retain a definition which focuses on a pre-tax assessment.

60. In confirming this decision it should be noted that this continues the practice used by the OGA, and by its predecessor in DECC³. Furthermore, Government notes that the “*satisfactory expected commercial return*” definition is a post-tax measure, and the safeguard included in paragraph 3 of the Strategy ensures that no obligation contained within the Strategy applies where a relevant person does not achieve a satisfactory expected commercial return as defined. Paragraph 3, as amended reads:

“No obligation imposed by or under this Strategy requires any person to make an investment or fund activity (including existing activities) where they will not make a satisfactory expected commercial return on that investment or activity.”

61. Aside from a minor drafting change, Government felt it was appropriate to add some explanatory text (outside of the definition, in new paragraph 29) to make clear that the definition applies to the full life-cycle of an asset, and that use of the word “expected” is intended to ensure that a full assessment of the appropriate risks of any particular investment or activity are factored into the analysis. This would, for example, include consideration of the cyclical nature of commodity prices, and capital and operational costs.

62. The definition used in the Final Strategy is thus:

³ The definition of economically recoverable OGA currently uses is set out in its Guidance on Field Development Plans. Appendix 3 explains the approach used
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/265842/FDP_guidance_notes_November_2013_web.pdf

“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 (such as 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”.

PART TWO

Revised Strategy with tracked changes

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 economically recoverable 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~~allocate 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~~will 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 or activity. Such a 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 of petroleum with the need to maintain the ~~long term~~-confidence of new and current investors to invest in exploration and production of petroleum from relevant UK waters, taking into account market conditions at the time of making its determination.

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. The Strategy also contains a number of Safeguards and the Central Obligation, Supporting Obligations and Required Actions and Behaviours must be read subject to those safeguards.

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.~~
 - a. any legislation, including legislation relating to competition law, health, safety or environmental protection; or
 - b. the common law, including the OGA's duty to act reasonably.

3. No obligation imposed by or under this Strategy requires any person to make an investment or fund activity (including existing activities) where they will not make a satisfactory expected commercial return on that investment or activity.

4. ~~Where This paragraph applies where this Strategy (read in the opinion of accordance with paragraphs 2, 0, 5 and 6) requires a relevant person, the commercial return required by to make an investment or fund activity and that person is higher than what is offered by a specific project which is required for the fulfilment of this Strategy and intends either:~~
 - a. to delay that person is therefore minded investment or funding; or
 - b. to not to undertake that project investment or funding,

because it will not produce a return which they consider to be sufficiently high. Where this paragraph applies, the OGA will must discuss the situation with that with the relevant person before taking any further action. (See relinquishment—paragraphs 27-29)-enforcement action in relation to that decision.

5. Where this Strategy requires a relevant person (A) to invest in infrastructure or fund activity wholly or partly for the benefit of another relevant person or persons (B):
 - a. A may require from B⁴ a contribution to the costs associated with installing and operating the infrastructure or carrying out the activity; but
 - b. that contribution shall not exceed one that is fair and reasonable in all of the circumstances, taking into account the importance of realising B's assets to meeting the Central Obligation.

- 4.6. _____ No obligation imposed by or under this Strategy requires any conduct (including investment or ~~other expenditure~~ funding activity) where the benefits to the UK deriving

⁴ Where B is comprised of more than one person the contribution required may be different for the different persons.

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

~~5-7.~~ Relevant persons must, in the exercise of their relevant functions, take ~~all the~~ steps necessary to secure that the maximum value of economically recoverable petroleum is recovered from the strata beneath relevant UK waters.

8. The Central Obligation must be read subject to paragraphs 2-6 (Safeguards).

SUPPORTING OBLIGATIONS

9. The Supporting Obligations must be read subject to paragraphs 2-6 (Safeguards).

Exploration

~~6-10.~~ The licensee of an offshore licence must plan, fund 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.;~~

- a. in relation to matters within their licence area, optimal for maximising the value of economically recoverable petroleum that can be recovered under the licence; and
- b. in relation to matters outside their licence area, set out in a plan produced under paragraph 23.

~~7-11.~~ 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/relinquish~~ the licence without first having completed the work programme as set out in the licence.

~~8-12.~~ Where the obligation in paragraph 11 does not apply because paragraph 0 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

~~9-13.~~ Relevant persons must plan, commission and construct infrastructure in a way that meets the optimum configuration⁵ for maximising the value of economically recoverable petroleum that can be recovered from the region in which the infrastructure is to be located.

~~10-14.~~ In considering the configuration required by paragraph 13, 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

⁵ In this context “configuration” includes not only the geographical placement of infrastructure, but also the sort of infrastructure to be used.

- 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

~~11.15.~~ 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 efficiency⁶ and cost efficiency, for the expected duration of production, taking into consideration the stage of field and asset development, technology and geological constraints.

~~12.16.~~ 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.

~~13.17.~~ The obligation in paragraph 16_ 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 economically recoverable petroleum ~~recovered.~~

Technology

~~14.18.~~ Relevant persons must ensure that technologies, including new and emerging technologies, are deployed to their optimum effect, as set out in a plan produced under paragraph 23, in maximising the value of economically recoverable petroleum that can be recovered from relevant UK waters, including in relation to decommissioning.

~~15.19.~~ When considering whether to deploy new and emerging technologies in accordance with paragraph 18, 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

~~16.20.~~ Before commencing the planning of decommissioning of any infrastructure in relevant UK waters, owners of such infrastructure must ensure that all viable options for

⁶ Optimum production efficiency here is not necessarily the same as the highest achievable levels of production efficiency.

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.

~~17.21.~~ 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 18 insofar as they apply to decommissioning.

~~18.22.~~ Where the OGA produces a plan under paragraph 23, which relates to the obligation in paragraph ~~18~~20, 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

~~19.23.~~ Subject to paragraph ~~22~~25, 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.

~~20.24.~~ Where any **relevant** person intends to carry out activities in a manner which is inconsistent with any current plan produced by the OGA under paragraph 23 that person must first consult the OGA.

~~21.25.~~ Where the OGA intends to produce a plan under paragraph 23, it ~~may~~**must** first ~~consult~~**seek the views of** such relevant persons as it considers are likely to be affected by the proposed plan.

REQUIRED ACTIONS AND BEHAVIOURS

~~22.26.~~ 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

~~23.27.~~ All obligations must be complied with in a timely fashion.

Collaboration

~~24.28.~~ When considering how to comply with obligations arising from or under this Strategy relevant persons must, ~~where relevant~~:

- a. **where relevant**, consider whether collaboration or co-operation with ~~others with interests~~**other relevant persons and those providing services relating to relevant functions** 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

~~25-29.~~ The obligations set out in and deriving from this Strategy require that the full lifecycle costs of the recovery of petroleum, including decommissioning, and operations relevant to such recovery matters be reduced as far as possible.

Relinquishing assets Actions where relevant parties decide not to ensure maximum economic recovery

30. Where this paragraph applies, by virtue of paragraphs 0 or 32, relevant persons must allow others to seek to maximise the value of economically recoverable petroleum from their licences or infrastructure including by divesting themselves of such licences or assets to other financially and technically competent persons who are able to recover economically recoverable petroleum.

Where relevant persons are not able

~~26-31.~~ ~~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.~~ for financial reasons they must seek to secure investment from other persons. If they are not able to secure sufficient investment in a reasonable time, the obligation in paragraph 30 applies.

~~27-32.~~ The obligation in paragraph ~~27~~30 applies in all other circumstances where relevant persons decide not to ensure the recovery of the maximum value of economically recoverable petroleum from their licences or infrastructure, 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/or~~ there are technical or other non-economic reasons.

33. Where a relevant person is seeking to ~~divest themselves of infrastructure or licences in accordance~~ comply with the obligation in paragraph 2730, 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 financially and technically competent persons who are able to recover economically recoverable petroleum may do so.

34. Where after a reasonable period the relevant person is unable to secure alternative funding or to divest themselves of the asset then, if the recovery of maximum value of economically recoverable petroleum would achieve a satisfactory expected commercial return they shall relinquish the related licenses.

Annex - Definitions

For the purposes of this Strategy:

“Central Obligation” is described in paragraph 1 and set out in paragraph ~~6~~7;

“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 such as~~ 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~~means terminals and, upstream of a terminal, equipment, pipelines, platforms, production installations, pipes and equipment subsea and subsurface facilities;

“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. These do not include any functions in relation to any infrastructure or activities which are downstream of an oil or gas terminal;

“relevant persons” means the OGA and the persons listed in section 9C of the Petroleum Act 1998 at the date this Strategy is laid in Parliament;

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

“satisfactory expected commercial return” means a reasonable expected post-tax return that is reasonable having regard to all the circumstances including the risk and nature of the investment (or other funding as the case may be) and the particular circumstances affecting the relevant person; and

“Supporting Obligation” is described in paragraph 1

© Crown copyright 2016

Department of Energy & Climate Change

3 Whitehall Place

London SW1A 2AW

www.gov.uk/decc

URN 16D/023