Department of Energy & Climate Change

Funding the Oil and Gas Authority: Government Response

Government Response to 23 March 2015 Consultation on Levy design to fund the Oil and Gas Authority.

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Introduction

Purpose of this document

1. This document sets out the Government's response to feedback received to the consultation on the proposed levy methodology to fund the Oil and Gas Authority (OGA). It sets out the key issues raised by organisations responding to this consultation and Government's response to these points. It also provides the levy rate for licence holders and the next steps in having the levy in place by October 2015.

Consultation overview

2. The Government is committed to supporting the oil and gas industry which plays a vital role towards our energy supplies. The OGA, which was established as an executive agency on 1 April 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, both for Britain's energy security as well as our long-term economic outlook.

3. The OGA will transition to a Government Company in summer 2016, subject to Parliamentary approval for the Energy Bill. The new Energy Bill, which was introduced into the House of Lords on 9 July, will 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.

4. The challenge of delivering the objective of maximising the economic recovery of offshore petroleum (MER UK) requires the OGA to be significantly better resourced than the equivalent DECC team. In line with the established practice across regulation and service delivery, it is appropriate for the OGA to recover its costs from companies who will benefit from the services of the regulator, in line with the principle of 'user pays'.

5. Some of the current costs of the Regulator are recovered through fees for delivery of specific services to individual companies. But an additional cost recovery mechanism will be required to fund the reminder of the costs of the OGA, and a levy will provide the fairest and simplest method of achieving this aim.

6. The Government carried out a consultation between 23 March and 20 April 2015. A consultation document[1] and Impact Assessment[2] outlined options in respect of a mechanism by which the levy will be initially apportioned across petroleum licence holders. The document also sought out views on the proposed collection mechanism and other details of the methodology.

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[1] DECC, (2015), Funding the Oil and Gas Authority: Consultation on Levy Design. [web], available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/415693/Levy_con-doc.pdf

[2] DECC, (2015), Funding the Oil and Gas Authority (OGA): Levy design. [web], available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/417638/OGA_Levy_Impact_Assessment_-_Final.pdf

Feedback to the consultation

7. We received 18 responses to the Consultation, which was open for a period of four weeks.

8. The submissions 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. A list of all contributors can be found in the Annex A. This document does not list or comment on every response received but all the submissions have been analysed by Government.

Structure of the Government Response

9. Section One of this document sets out the detailed feedback received on each of the consultation questions and sets out the Government's response to the points raised. The consultation included three questions on the proposed levy methodology.

10. Section Two summarises the key points and sets out the rate payable by licence holders to fund the OGA between 1 October 2015 and 31 March 2016.

Next steps

11. The intention is that Regulations will be brought forward which will come into force on 1 October 2015. This will allow the funding of the OGA between 1 October 2015 and 31 March 2016. The intention is that a new set of regulations will be brought forward next year which will set out the rate of the levy for the period 1 April 2016 to 31 March 2017.

Detailed feedback

Consultation questions and feedback

Consultation Question	
1.	Do you agree with the proposed metric?

Summary of responses

12. Based on the OGA's projected activity and focus, we proposed to allocate the levy by first estimating how much of the OGA's costs are directed at work in respect of pre and in-production licence holders and then divide the costs in respect of each group evenly between the number of licence holders.

13. Out of 18 respondents, more than 14 agreed with the proposed allocation methodology to apportion the levy based on the work the OGA will conduct on behalf of particular types of licence holders.

14. There was broad agreement that this method appears to be simple and more cost-reflective than previously considered methods of allocating the levy based on acreage held or production won. Some support was also voiced for levy payments to be proportionate to licence rental payments.

Government response

15. HM Treasury's Managing Public Money (MPM) allows different fees to be charged for objectively different categories of service which cost different amounts to provide. As this is the case for the OGA, we have designed a levy around this principle which requires us to estimate the costs that are directly attributable to each type of activity, a methodology for allocating indirect costs, and the number of each type of licence that are expected to be issued (which is proposed to be the basis for collecting the levy).This allocation exercise relating to the first levy period between 1 October 2015 and 31 March 2016 demonstrated that, at least initially, the OGA will for the most part undertake activities and incur costs in relation to offshore petroleum licence holders. Thus, as already announced in the levy consultation earlier this year, we intend at this stage to levy <u>offshore petroleum licence holders only</u>. Onshore licence holders as well as holders of licences for unloading and

storage of gas and storage of carbon dioxide licences are exempt from paying the levy in the short term.

16. The allocation exercise also demonstrated that the OGA will incur costs on behalf of two types of offshore licence holders: those producing petroleum and those not producing petroleum. After further analysis, we identified that the majority of the OGA's costs are incurred in relation to licences producing petroleum – around 89% - while the remaining 11% of the OGA's costs are incurred with regard to non-producing licences.

17. In the levy consultation we proposed that exploration licence holders and production licence holders in their initial and second term would be grouped as non-producing licences as exploration licensees by definition do not have the right to produce hydrocarbons while no production is usually taking place in the initial and second terms (exploration and development/appraisal phase) of the production licence. Production licence holders in their third term would be classified as in-production as production usually takes place in the third term.

18. However, after closer examination of all licences and the terms the licences were in, we discovered that there were a number of production licences in their first and second term already producing and a number of production licences in their third term not producing (for example, a discovery was not made).

19. To simplify the methodology and to prevent an incorrect apportioning of the levy across licence holders, we propose to use a simple determinant in allocating the levy rate: **production**, regardless of the term the production licence holder is in.

20. Therefore, we intend to introduce a two-tier system which would allow us, in accordance with MPM, to instate two different rates to offshore licence holders, depending on whether they are producing hydrocarbons.

21. The trigger for determining that the higher rate of the levy is payable will be either a consent for the licensee to get petroleum or to carry out relevant works (an approval to a Field Development Plan) for more recent licences, or the approval of a works programme for older licences. This is because once the relevant approvals are in place there is nothing stopping the licensee from producing petroleum.

22. The OGA collates information in relation to all licensees and all fields and endeavours to update the relevant information (with regard to producing fields) in a timely manner. We encourage licence holders to maintain regular contact with the OGA to ensure field and licence status is kept up to date and to ensure licensees pay the correct levy rate.

Consultation Question	
2.	Do you agree with the suggested collection approach?

Summary of responses

23. On collection mechanism, most submissions agreed with our proposal that the levy payment should be collected annually and invoices should be settled within 30 days. Several submissions noted that aligning the levy payment with the payments for licence rentals would make the process simpler and the settlements easier to administrate.

Government response

24. In response to industry calls for simplicity in collecting the levy, we propose to issue invoices annually and require settlement within 30 days. The obligating event, which determines the status of a licence, will be set in early April for each charging period to aid with financial planning. The intention is that invoices will be issued shortly afterwards.

25. On the suggestion that the levy payments should be aligned with payments for licence rentals – this approach, despite its simplicity, cannot be adapted as rentals for each licence are due each year on the licence's anniversary (except pre-20th Round Seaward Production Licences, which were only due in their initial year) which do not fall on the same date.

26. Prior to invoices being issued, the OGA will determine which production licence holders have the relevant consents in place – an approval to a Field Development Plan for more recent licences or the approval of a works programme for older licences – and these licensees will be required to pay a higher levy rate. Licensees with no approved FDP, including exploration licences holders who by definition have no right to produce petroleum, will be required to pay a lower rate.

Consultation Question	
3.	Do you have any comments on the set out approach? Please provide evidence to support your views.

27. There was some support for introducing more direct fees for services which bring direct benefits to a specific licence holder.

28. We welcome this view and are currently planning to introduce more direct fees for the OGA's services. We intend to make provision for this in the new Energy Bill. These activities are: metering inspections, (including a separate fee for inspector attendance at flow calibrations), licence extensions and amendments, area retention plans, cessation of production requests, determination and re-determination of fields, data storage and applications for the right to use a pipeline, pipeline modification and other authorisations.

29. In the short term, until provisions are brought in to apply to these activities, the costs in questions will be recovered via the levy. Our intention is to bring these activities under the fees regime following establishment of the OGA as a Government Company.

30. Several submissions called for the OGA to deliver value for money and for its business planning process to be prudent and rigorous to prevent additional burden on licence holders. The Government agrees 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.

31. Some submissions also called for a cap on the OGA's costs and consequently a cap on the levy rate. Whilst we recognise that licence holders want assurance that the costs of running the body will not spiral out of control, a cap on costs would be impractical at this stage. The OGA will be bound to establish value for money budgets and DECC will be incentivised to make sure costs do not exceed this given it may have fund any overspend.

32. As noted in the consultation, several safeguards will be in place to ensure that the OGA delivers value for money and its costs do not exceed its income. In an event that the running costs do exceed the levy rate, due to heavier than anticipated workload, the OGA would first attempt to work within budget by re-prioritising work. If this was not possible, the OGA would seek approvals from DECC and HMT before revising its budget and considering amending the levy rate. 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.

33. A number of responses called for a Service Level Agreement between the OGA and Industry. The OGA will be held into account based on delivery against its objectives and delivering MER UK (according to its progress against its published strategy).Therefore, we do not propose that a service level agreement should be considered.

34. Finally, we can confirm that the levy will be deductible for tax purposes for Ring Fence Corporation Tax (RFCT), Supplementary Charge (SC) and Petroleum Revenue Tax (PRT).

Levy rates and additional information

Levy rates

As set out in Section 1, the mapping exercise demonstrated that 89% of the OGA's costs are incurred in relation to in-production licences holders, i.e. licence holders with relevant consents to get petroleum or to carry out relevant works (an approval of a Field Development Plan or the approval of a works programme). The remaining 11% are incurred with regards to pre-production licensees, i.e. exploration licences and production licence holders without the relevant consents mentioned above.

Based on these calculations, the number of active licences and the running costs of the OGA of around £10.1m between 1 October 2015 and 31 March 2016, the levy rates are as follows:

		Pre-production	In-Production
Total cost attributable to license holder	**£ 10.084**	11%	89%
As % of overall cost across all license holders		**£1,109,240.00**	**£8,974,760.00**
Number of licences in category		402	295
Costs per licence		£2,759.30	£30,422.92

Pre-production licences: £2,759.30

In-Production licences: £30,422.92

These levy rates will recover the operational costs of the OGA and will ensure the body has sufficient funds to deliver its remit and to be an effective regulator and steward of the UKCS.

The levy rates have been agreed on by DECC and HM Treasury and are based on the assumption that 100% of the OGA's costs are funded by Industry, excluding the fee income for direct service provisions.

The OGA will issue invoices in October this year with a requirement of settling the invoices within 30 days to ensure the body is well funded from the outset and can carry out its role in full.

The OGA will monitor its spending and income and will prudently approach the following year's expenditure and costs to ensure the levy rate is reflective of its costs.

Ahead of the Financial Year 2016/2017, a new set of regulations will be brought forward. The OGA will share its business plans with industry to ensure transparency and will consult DECC and HM Treasury to ensure its budget has been sufficiently scrutinised to deliver maximum value for money.

Additional information

All offshore licence holders will be required to pay the levy to fund the OGA. The obligation to pay the levy will stop only once the licensee has handed back their licence to the OGA as that is when the OGA will stop incurring most costs with regard to that licensee.

All licensees who have ceased production or have started decommissioning processes while still holding a licence will continue to pay in-production rate until they hand back their licences to the OGA.

Whether a licensee should be paying a lower or higher levy rate will be determined at the relevant date. In the event that the licensee moves from pre-production to in-production after the relevant date, i.e. its Field and Development has been approved, the levy rate the licensee pays will not increase until the following charging period.

Similarly, should a licensee hand back their licence at any point during the charging period, the relevant date in respect of the subsequent charging period will determine whether the licence holder is exempt from paying the levy and no rebate will be given for the part of the year when the licensee no longer held the licence.

We acknowledge that licences span across multiple fields and some of the fields the licence covers will have the relevant consents (i.e. an approved FDP) while others may not have advanced as quickly and are still in the process of agreeing to the consents. In these circumstances, if at least one field under the licence has the relevant consents in place, the licensee will be subject to a higher levy rate.

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

It would be the OGA's intention to issue a single yearly invoice to each company liable to pay the levy, listing each of the licences upon which the levy payment has been calculated.

Regulations, setting out the details of the levy and the exact levy rate will be laid in Parliament no later than on 10 September to ensure the OGA can be funded from 1 October 2015.

Annex A: List of respondents

Oil and Gas UK

Shell U.K. Limited

GDF Suez

BP North Sea

Maersk Oil

National Grid Carbon Ltd.

Total E&P UK Limited

OMV (U.K.) Limited

Nexen Petroleum

Chrysaor

JX Nippon

CCSA

And 6 other respondents

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