

INSIGHTS

The Future of the UK North Sea: A New Game with More Rules

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By: [Darren Spalding](#)

On 24 February 2014, Sir Ian Wood delivered his Final Report (the "**Report**") on the future of the UK Continental Shelf ("**UKCS**"). The Report sets out a number of conclusions and recommended actions relating largely to more stringent regulation, a focus on regional development and better industry co-operation. If the recommendations are implemented, they will fundamentally change the North Sea oil and gas industry. The Report's overriding message is that for production from the UKCS to be prolonged, a change to both the regulatory and commercial landscapes will be required. The Report proposes a new regulator (the "**Regulator**") which would sit within the government department currently responsible for the oil and gas industry in the UK, the Department of Energy and Climate Change (or "**DECC**"). The Regulator will be tasked with developing strong relationships with both UKCS operators and the Treasury, and will enjoy a significant degree of independence and operational freedom. The Report envisages that the Regulator would be staffed with experienced personnel from industry as well as attracting top new graduates. To achieve this, the Regulator would "the Report suggests" be funded by UKCS operators and should offer agreed levels of service in return for such funding. On the commercial side, the Report supports much greater co-operation between operating companies, led by the introduction of regional development, increased third party access to infrastructure, wider sharing of data and streamlining of legal and commercial negotiations between parties. Any failure to co-operate in furthering these principles could subject the relevant party to sanctions from the Regulator, including the loss of a licence. The Report's executive summary sets out these key principles as 4 main recommendations: (1) maximising economic recovery from the UKCS; (2) creation of the Regulator; (3) additional powers for the new Regulator; and (4) development and implementation of important sector strategies. **Recommendation 1: Strategies to Maximise Economic Recovery** To maximise the economic recovery from the UKCS, the Report proposes six major strategies relating to:

- exploration, including increased data sharing and promotion of UKCS exploration opportunities internationally;
- asset stewardship, meaning the efficient development, maintenance and operation of assets and infrastructure, assessed against measures set by the Regulator in relation to production and recovery;

- regional development, including increased third party access to infrastructure on fair and economic commercial terms;
- infrastructure, meaning extending the life of existing infrastructure and driving investment in new key infrastructure;
- technology, ensuring that existing technologies are deployed to their full effect and that new technologies are developed to maximise recovery; and
- decommissioning, achieving maximum economic extension of field life and preventing premature abandonment.

Implementation of these strategies would include a regional outlook for the UKCS, rather than applying a UKCS-wide strategy as has been seen in the past. Specifically, the Report supports differentiating between the more mature areas of the basin and the areas which are still frontier, which are to be granted longer development terms. Additionally, the Report suggests that specific fiscal regimes should be used for areas producing predominantly gas, and that special tax allowances should be applied for discoveries high in impurities. **Recommendations 2 and 3: A New Regulator With Additional Powers** The Report suggests that the new Regulator's stronger presence would be sufficient to convince operators to comply with new requirements imposed to implement the Report's strategies. Nevertheless, the Report proposes that the Regulator should have enhanced powers to give it more "teeth" including:

- the right to attend meetings of licence holders (as an observer only);
- the power to undertake a non-binding mediation process for disputes over licences or collaboration;
- the right to sanction licence holders that do not act in accordance with new requirements imposed to implement the Report's strategies. The potential sanctions are significant and range from a notice requiring remedial action to public formal warnings, then facilitation of a change of operatorship, suspension of the licence and, finally, termination of the licence (including the ability either to sanction the non-compliant member or the consortium as a whole); and
- a role to ensure that enhanced data sharing between operators would not trigger competition law issues.

The Report also suggests that the Regulator should facilitate industry and operators carrying out additional seismic work, with Government sponsorship funding for speculative seismic shoots in new plays and prospective areas which lack coverage (this idea being borrowed from Norway and the Netherlands), using the most advanced technology available. **Recommendation 4: Sector Strategies** Several areas which have already seen existing work should be encouraged under the new Regulator, according to the Report, including data access, production efficiency and recovery, infrastructure, regional development and new technology. Specifically, the Report suggests further detail around regional exploration plans, working with the Treasury for the evaluation of new plays, more speculative seismic analysis (possibly with the Government funding noted above), an on-line and updatable source of digital geological maps, review of the

terms of new and existing licences, and greater release and better management of data. The Report notes that infrastructure access is not an issue in the Netherlands partly due to the Dutch Government being an active owner of infrastructure, and therefore being positioned to facilitate transparency, fairness and information flow. Whilst the Report marks this as a valuable learning opportunity, it stops short of suggesting that the UK Government should take ownership stakes in infrastructure. **Industry collaboration** The Report concludes that the most efficient way to develop assets will be through greater collaboration between operators on the UKCS. This is to be achieved by operators committing to the new strategies, developing cluster plans to make the most economic use of infrastructure (including efficient sharing, thereby promoting third party access) and a reduction in the burden of working in what the Report says is perceived to be one of the most adversarial legal and commercial basins in the world. **What does the Report mean for the UK North Sea?** The Report is timely for the UKCS, given that "" as a mature and declining basin "" these issues are ripe for consideration. As noted in industry body Oil & Gas UK's 2014 Activity Survey, the UKCS has seen continued declining production in recent years, with new exploration at an all-time low and operational costs rising, and the nature of the basin has also changed from one with fewer large fields to now have a significantly higher number of small fields. Some stimulus for change is therefore required. However, the nature of the Report's recommendations are likely to raise eyebrows amongst at least some industry participants "" improved data sharing, cluster development, better third party access and a less adversarial commercial and legal interface are valuable ideals, but it is questionable how they will be achieved in a highly competitive environment, even with a newly constituted and empowered Regulator. Additionally, the proposal for the Regulator to attend operating committee meetings is not only likely to be unpopular, but may even lead to conflicts of interest if disputes between co-venturers are subsequently submitted to the Regulator for mediation. Further, the requirement for industry to fund the Regulator will likely be seen as yet another tax on operations in the North Sea. Nevertheless, the UK Government appears committed to fast-tracking the Report's recommendations in an effort to stimulate UK North Sea activity; further details on the Government's intended implementation will become clearer when its full response to the Report is released within the next few months. Finally, one cannot forget the looming wildcard of the September vote on Scottish independence and the potentially significant effect that it could have on the UKCS. Although to date general industry reaction to the Report has been relatively muted, Oil & Gas UK has welcomed it, calling it a seminal moment in the history of the UKCS and a "game changer"². There is no doubt that this is a critical time for the UK North Sea and it seems not only that there will be a new game, but that it could be one with substantially different rules.