GETTING THE DEAL THROUGH

Oil Regulation

in 32 jurisdictions worldwide

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General

1 Describe, in general terms, the key commercial aspects of the oil sector in your country.

According to the Department for Energy and Climate Change (DECC), over 3 billion tonnes of oil have been produced from the UK continental shelf (UKCS) to date. Production from the UKCS peaked in 1999, reaching 137 million tonnes, though there has been a general decline since. In 2005, the UK became a net importer of crude oil for the first time since the early 1990s. Estimates of the remaining hydrocarbons range from 11 to 37 billion barrels of oil equivalent. In 2010, the industry produced 850 million barrels of oil and gas equivalent (2.3 million beopd), 5 per cent less than in 2009. Onshore oil contributes about 2 per cent of the total oil produced in the UK.

Investment in the UKCS resulted in 13 new oil and gas fields in 2010, together with four major redevelopment projects on existing fields. In 2010, 130 development wells were drilled (one fewer than in 2009) together with 62 exploration and appraisal wells. In addition, there were eight field start-ups in 2010 and 16 field approvals.

The UK has the fourth largest total refining capacity in the European Union and some of its nine refineries are among the largest in Europe. The refining business, however, has suffered from overcapacity and weak margins. As a result three refineries have been sold in 2011 to buyers from India, China and the US.

In 2010, the industry invested £6 billion of capital expenditure (almost 50 per cent more than in 2009) and spent a further £6.9 billion on operating costs. The oil and gas industry in the UK has paid more than £9.3 billion in production taxes for the fiscal year 2010–2011 and supports the employment of around 440,000 people across the UK.

2 What percentage of your country's energy needs is covered, directly or indirectly, by oil as opposed to gas, electricity, nuclear or non-conventional sources? What percentage of the petroleum product needs of your country is supplied with domestic production? What are your country's energy demand and supply trends, especially as they affect crude oil usage?

According to statistics published by DECC, oil represents 36 per cent of the UK's energy usage, natural gas 39 per cent, coal 14 per cent, electricity 8 per cent and renewables 3 per cent. In 2010 oil consumption fell by 3.5 per cent and gas consumption rose by 2.4 per cent. Total indigenous UK production of crude oil and natural gas liquids in 2010 was 7.7 per cent lower than in 2009 at 63 million tonnes and the UK remains a net importer of oil and oil products by 10.2 million tonnes. As a result of the heavy snowfall and volcanic ash, deliveries of aviation turbine fuel in 2010 were 3 per cent lower than in 2009. Indigenous production of natural gas in 2010 fell by 4.3 per cent. Imports and exports of natural gas in 2010 rose by 29.3 per cent and 28.7 per cent respectively, and demand for gas also rose by 8.3 per cent. Natural gas use for electricity generation increased by 4.3 per cent in 2010. In the domestic sector consumption increased by 15 per cent while consumption by the industrial sector rose by 8.9 per cent. Dependency on imported oil and gas is expected to rise to 30 per cent in 2011 (from 26 per cent in 2009) and to 64 per cent by 2025 (assuming production declines at an annual rate of 5 per cent).

3 Does your country have an overarching policy regarding oil-related activities or a general energy policy?

The Energy Act 2010, which became law in April 2010, implements some of the key measures required to deliver DECC's low carbon agenda. It includes provisions for delivering a new financial incentive for carbon capture and storage and for implementing mandatory social price support. It also introduces a number of measures aimed at ensuring that the energy markets are working fairly for consumers and are delivering secure and sustainable energy supplies. However, it was the Energy Act 2008 which enshrined the UK's current policy for the energy sector. The primary aim of the government in passing this Act was to tackle climate change, reduce carbon dioxide emissions and ensure secure, clean and affordable energy. The Energy Act 2008 also provided for a regulatory framework for offshore gas storage, introduced changes to the offshore oil and gas decommissioning regime and extended third-party access to upstream oil and gas infrastructure. The UK government has over a number of years encouraged smaller companies to apply for licences in the UKCS and has through initiatives such as the fallow acreage initiative and the Code of Practice on Access to Upstream Oil and Gas Infrastructure on the UKCS (ICOP) made a concerted effort to maximise recovery of oil from the UKCS. In addition, the Climate Change Act 2008 introduced the world's first long-term legally binding framework to tackle the dangers of climate change.

Regulation overview

4 Describe the key laws and regulations that make up the general legal framework regulating oil activities?

The Petroleum Act 1998 governs oil and gas exploration and production activities in the UK. This Act vests ownership of petroleum in the UKCS in the Crown and empowers the secretary of state for the Department for Energy and Climate Change (DECC) to grant licences for the exclusive right to search for, bore for and extract petroleum in the area covered by the licence. Licences are acquired through competitive licensing rounds held each year by DECC. A company will make (either by itself or as part of a joint venture) an application for a specific area. Licences may also be acquired through asset transfers between companies and the consent of DECC is required prior to any licence assignment. The conditions of a licence (known as 'model clauses') are set out in secondary legislation, which for current offshore production licences, is the Petroleum Licensing (Production) (Seaward Areas) Regulations 2008. The model clauses set

out in detail the conditions for the licence including: term, licence surrender, record-keeping, working obligations, appointment of operator, measurements and pollution. In awarding licences, DECC must also comply with the Hydrocarbons Licensing Directive Regulations 1995, which set out additional rules EU member states have to follow when issuing petroleum licences. In addition to the regulatory requirements, there are a number of voluntary industry-based codes of practice to which many UKCS licensees have signed up. ICOP is intended to facilitate access by a third party to oil infrastructure in the UKCS such that the parties involved can agree fair and reasonable terms. The fallow acreage initiative places pressure on licensees to deliver activity on old licences where companies have not been active for some time or relinquish licences in order for the acreage to be offered to other companies. With respect to transfers of licences, the Commercial Code of Practice establishes an agreed framework to minimise resources spent on negotiations and promote positive commercial behaviour.

5 Identify and describe the government regulatory and oversight bodies principally responsible for regulating oil activities.

The Department for Energy and Climate Change (DECC) is the government authority primarily responsible for the development and regulation of the oil and gas industry in the UK. DECC was established in October 2008 following a transfer of powers from the Department of Business Enterprise and Regulatory Reform. DECC administers oil and gas regulatory activities including: licensing, development consent, fiscal policy, environmental policy and decommissioning. Other regulatory bodies include the Health and Safety Executive (HSE), which is responsible for health and safety, and the Hazardous Installations Directorate (HID), which is responsible for regulating and promoting improvements in health and safety across the offshore oil and gas sector.

6 How does your country manage appeals of government regulatory decisions?

A decision made by a government body such as DECC may be challenged through the courts under judicial review proceedings. The basis for such appeal will be that the government body acted illegally (outside the powers of the government body in question) or that the decision was reached unfairly. If successful, the government body will be ordered by the court to reconsider or change its decision. Damages may also be available in certain circumstances.

7 What standards are employed for oil measurement and oil facility equipment? Are these voluntary or involuntary? Are they established by a government body?

The 'measurement' model clause in a licence regulates the standards for oil measurement by requiring licensees to measure oil by methods customarily used in good oilfield practice. A licensee may not alter the method of measuring without the consent of DECC. DECC has also issued guidance setting out the procedure to be followed in relation to new developments, or modifications to existing measurement systems.

8 What government body maintains oil production, export and import statistics?

Responsibility for oil production, export and import statistics is with DECC. The Office for National Statistics is the central data source and the statistics are produced to a high professional standard.

Natural resources

9 Who holds title over oil reservoirs? To what extent are mineral rights on private and public lands involved? Is there a legal distinction between surface rights and subsurface mineral rights?

The Crown (through the Petroleum Act 1998) holds all title and rights to oil reservoirs within the UK and its territorial waters. DECC (on behalf of the Crown) has the power and discretion to grant licences to persons deemed fit to search for and extract oil and to further distribute and sell such oil in the market.

10 What is the general character of oil exploration and production activity conducted in your country? Are areas off-limits to exploration and production?

UK oil exploration and production activity is predominantly conducted offshore. Such activities are regulated by a licensing regime. Each licence covers a particular area and there are separate licensing regimes for onshore and offshore exploration and production activities. Such activities (whether onshore or offshore) can be restricted for environmental, conservation or military reasons. DECC is required to carry out a strategic environmental assessment on areas proposed to be licensed to examine the impact on the environment of such activities.

11 What government body regulates oil exploration and production in your country? What is the character of that regulation?

DECC is the government body responsible for the regulation of oil exploration and production activities in the UK. Regulation is by a licensing regime rather than a production sharing arrangement. There are currently two types of offshore licence awarded by DECC: the 'exploration' licence and the 'production' licence. Under a seaward petroleum exploration licence, seismic surveys and shallow drilling can be performed in acreage not already licensed. Other parties may hold an exploration licence over the same area and it is therefore a non-exclusive licence. Under a seaward petroleum production licence the licensee is granted the right to search for, bore for and extract hydrocarbons from the UKCS in the area prescribed under the terms of the licence for the full life of the field from the exploration phase and development to decommissioning. Three sub-categories of production licence exist. The most common of these is the 'traditional licence'. Potential applicants must be able to demonstrate financial, technical and environmental capability in order to be successful. The 'promote' licence (introduced in 2002) is designed to award smaller companies with production rights and allow a two-year period in which to obtain the requisite financial and technical capabilities prior to development. The 'frontier' licence (introduced in 2003) recognises the difficulties in sourcing oil in remote areas of the UKCS (such as the deep waters west of Shetland) and permits screening over a large area to look for a wide range of prospects. Onshore production is governed by the onshore production and development licence, which follows a similar form to the offshore licences described above.

12 If royalties are paid, what are the royalty rates? Are they fixed? Do they differ between onshore and offshore production?

Royalties are no longer payable under a licence. Licences do carry a small annual charge, known as a 'rental', which is due on each anniversary of the date of the licence.

13 What is the customary duration of oil leases, concessions or licences?

Offshore licences

There are three types of offshore licence (traditional, frontier and promote) and each licence comprises of three terms. A licence will

expire automatically at the end of each term, unless certain conditions allowing the licensee to advance to the next term have been fulfilled.

Traditional licence

The duration of a traditional licence is split into successive terms of four, four and 18 years. In order to progress from the initial to the second term, the licensee must have completed a work programme as approved by DECC and relinquished a minimum of 50 per cent of the acreage under the licence. If, during the second term, DECC has approved the development plan and all of the acreage outside that development has been relinquished, the licence may continue into the third term. DECC may exercise its discretion to extend the third term beyond the prescribed 18-year period if production is ongoing.

Frontier licences

The duration of a frontier licence is split into successive terms of six (which is further subdivided into an initial two and then four year period), six and 18 years. By the end of the third year of the first term, the licensee must have relinquished 75 per cent of the licence area. At the end of the sixth year, the licensee must relinquish a further 50 per cent of the remaining acreage. This equates to a total relinquishment of seven-eighths of the original licence area by the end of the initial term. DECC may, in exceptional circumstances, where prospectivity can be demonstrated over more than 25 per cent of the licence area, allow, at its discretion, a licensee to relinquish only 50 per cent of the acreage by the end of the third year. However, the licensee would still need to relinquish all but one-eighth of the original licence area at the end of the initial term and must have completed the work programme in order to progress from the initial to the second term.

A new type of frontier licence for the areas west of Scotland was introduced in the latest (26th) licensing round announced in January 2010. The new frontier licence differs from the original frontier licence in that the first of its three terms is three years longer. This is in recognition of the particularly challenging nature of the geographical area where it applies and the relative scarcity of geophysical data.

Promote licences

The duration of a promote licence is split into the same successive periods as a traditional licence. However, the licence will expire at the end of the second year if DECC is not satisfied that the licensee has sufficient financial, technical and environmental capacity to undertake the work programme. At the end of the second year the licensee must also decide whether to 'drill or drop', in essence the licensee must make a firm commitment to DECC to drill a well in order for the licence to continue. Having committed to drilling, the licensee then has until the end of the initial period in which to drill.

Onshore licences

The duration of an onshore exploration and development licence is split into successive periods of six, five and 20 years. The licensee must complete the agreed exploratory work programme in the initial term before advancing to the second term. A development plan must then be approved during the second term before progressing to the third production term.

14 For offshore production, how far seaward does the regulatory regime extend?

The regulatory regime extends to the UK's territorial seas and the UKCS. The UK territorial sea extends from the low water mark (established by the Territorial Waters Order 1964) for 12 nautical miles. The designated area of the UKCS has been redefined over the years through a series of designations under the Continental Shelf Act 1964, following boundary agreements with neighbouring states. The Continental Shelf (Designation of Areas) (Consolidation) Order 2000 consolidated all previous designated UKCS boundaries. Recently, the Continental Shelf (Designation of Areas) Order 2001 designated the continental shelf in the Irish Sea as an area in which the UK may exercise its rights.

15 Who may perform exploration and production activities? What criteria and procedures apply in selecting such entities?

Companies may only perform exploration and production activities in the UK under licence. Applications for a licence are made (either individually or through a joint venture) to DECC as part of a formal annual licensing round. The licensing round is advertised online and in the *European Journal*. All applications are made in a prescribed form and companies applying for a licence must be registered in the UK, either as a company or as a branch of a foreign company. DECC considers each application on a case-by-case basis and will require a company to demonstrate its financial worthiness (that it is able to finance its share of the relevant work programme for the licence in question). With regard to technical capability, non-operators are not required to demonstrate a high level technical expertise. Companies wishing to be appointed as operator are considered against additional criteria including previous experience, technical expertise and environmental awareness.

16 What is the legal regime for joint ventures?

Companies generally engage in oil activities through unincorporated joint venture associations. The companies will normally enter into a joint operating agreement (JOA) to govern contractual relations between parties to the joint venture. An industry standard JOA has been produced by Oil & Gas UK (the oil industry representative body) which is often used as a template by parties and then tailored to a specific situation. The JOA will cover such matters as the appointment of the operator, the percentage interests of each of the parties and governs the day-to-day operational activities carried out by the operator.

17 How does reservoir unitisation apply to domestic and cross-border reservoirs?

Where a field is situated in two or more adjacent blocks which are licensed to different companies, DECC will require, prior to approving a field development programme, that the companies show that recovery of oil will be maximised and that competitive drilling is avoided. In most cases, this will require a unit operating agreement (UOA) to be entered into by the companies. The terms of the UOA will be heavily negotiated, especially provisions relating to the parties' participating interests, the selection of the operator and the ability to require a re-determination of the field. In the case of cross-border unitisation agreements, these issues may be compounded by country differences on matters such as taxation and export preferences. The UK government has in the past been willing to assist licensees with resolving cross-border issues on an intergovernmental level.

Transportation

18 How is transportation of crude oil and crude oil products regulated within the country and across national boundaries? Do different government bodies and authorities regulate pipeline, marine vessel and tanker truck transportation?

The Energy Charter Treaty (ECT) requires the UK to take measures to facilitate oil transit across its national boundaries in a non-discriminatory manner and according to the principles of freedom of transit, namely, without distinction as to the origin, destination or ownership of the oil and on the basis of non-discriminatory pricing. All of the UK's neighbours are parties to the ECT. Offshore pipelines require the approval of DECC before going ahead and in

granting approval DECC will have regard to the interests of other users of the sea for the transport of oil as well as the impact on the environment. Transportation of oil by road and rail is regulated by the Carriage of Dangerous Goods and Use of Transportable Pressure Equipment Regulations 2004, and is monitored by the HSE. Transportation of oil by sea is regulated by the Merchant Shipping (Prevention of Oil Pollution) Regulations 1996 (amended 2005) and the Merchant Shipping (Dangerous Goods and Marine Pollutant) Regulations 1990. The International Maritime Dangerous Goods Code contains internationally agreed guidelines on the transport of dangerous goods.

19 What are the requisites for obtaining a permit or licence for transporting crude oil and crude oil products?

The consent of DECC is required in order to transport oil by pipeline. Transportation of oil by marine vessel and tanker truck must comply with various domestic health, safety and environmental legislation.

Health, safety and environment

20 What health, safety and environment requirements apply to oil-related facility operations? What government body is responsible for this regulation; what enforcement authority does it wield? Are permits or other approvals required? What kind of record-keeping is required? What are the penalties for non-compliance?

Health and safety legislation on the UKCS is derived from a range of EU and national laws. A considerable body of offshore specific health and safety legislation and also more general provisions of UK health and safety laws exist, which also apply to the offshore industry. The Piper Alpha disaster triggered the creation of a new regulatory regime, underpinned by the concept of a 'duty holder' (either the owner of a non-production installation or the operator of a production installation) who has overall responsibility for managing risks and hazards on the installation. The cornerstone legislation created as a result is the Offshore Installation (Safety Case) Regulations 2005 (Safety Case Regulations). This is supported by a suite of offshore specific legislation such as the Offshore Installations and Pipeline Works (Management and Administration) Regulations 1995, the Offshore Installations (Prevention of Fire and Explosion and Emergency Response) Regulations 1995 and the Offshore Installations and Wells (Design and Constructions, etc) Regulations 1996.

In terms of formal records required under UK health and safety legislation by those operating on the UKCS, the principle requirement is for the preparation of a Safety Case which must be submitted to and accepted by the HSE for the relevant installation. For production installations, the obligation for submission of the Safety Case rests with the operator and for non-production installations, with the owner. In addition, any offshore employer (which may be an operator, owner or contractor company) or any person in control of work premises must record and report certain work-related accidents in terms of the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 1995.

Offshore operations have health and safety obligations imposed on them by the Health and Safety at Work Act 1974 (HSWA). In the UK and UKCS, the HSWA is the principal piece of legislation controlling and regulating health and safety in the workplace. It is supplemented by a large number of subordinate regulations relating to specific risks, hazards and industries, such as the offshore-specific regulations noted above. The HSWA imposes a general obligation on employers to ensure, so far as reasonably practicable the health, safety and welfare at work of employees and those affected by their undertaking. As well as a duty holder itself, most contractor companies working offshore will be 'employers' and will therefore have all of the duties of the HSWA and its subordinate regulations imposed on them.

The enforcing agency for health and safety matters in the UK is the Health and Safety Executive (HSE) which contains a specialist offshore division. Non-compliance with either the offshore specific legislation or the HSWA can result in criminal prosecution (punishable by unlimited fines and terms of imprisonment for the most serious offences) or by imposition of a prohibition or improvement notice. Each breach of the HSWA or of its subordinate regulations is a separate criminal offence. Breach of a regulation will often result in strict liability, that is, if it is proven that a breach has occurred, there will be no defence available. Corporate manslaughter prosecutions are now a possibility for any fatality occurring offshore. As well as prosecution, the HSE is able to enforce compliance through prohibition and improvement notices.

The environmental impact of offshore exploration and production activities is clearly considerable. The implications of drilling and production related emissions has seen an increase in regulation in recent years. In particular, since the Gulf of Mexico oil spill the Department of Energy and Climate Change (DECC) has taken action to double the number of annual environmental inspections to drilling rigs. Obligations arising from various international conventions such as the Convention for the Protection of the Marine Environment of North East Atlantic (OSPAR) has culminated domestically in a number of environmental regulations. The Offshore Chemicals (Amendment) Regulations 2011 and Offshore Petroleum Activities (Oil Pollution Prevention and Control) (Amendment) Regulations 2011 amend, respectively, the Offshore Chemicals Regulations 2002 and the Offshore Petroleum Activities (Oil Pollution Prevention and Control) Regulations 2005 for the purpose of making changes to the regulatory framework for offshore chemicals and oil pollution, prevention and control. The key change is contained in the Offshore Chemicals (Amendment) Regulation 2011, to ensure that enforcement action can be taken in respect of non-operational emissions of chemicals, such as accidental leaks or spills. An Oil Pollution Emergency Plan (OPEP) must be prepared accordingly and submitted to DECC for approval. Regulatory approvals and consents are withheld until the OPEP is approved. An Oil Record Book must be maintained at all times. In addition, the Oil Regulations 2011 extend the scope of the Oil Regulations 2005 so that they cover emissions from pipelines. The recent Energy Act 2008 (Consequential Modifications) (Offshore Environmental Protection) Order 2010 extended both regimes to installations used for the offshore storage of natural gas, offshore unloading of Liquefied Natural Gas (LNG) and the offshore storage of carbon dioxide for the purpose of its permanent disposal.

In the event of a significant oil spill event the operator, in accordance with its OPEP, would activate its emergency response centre to take appropriate actions to prevent further pollution and implement a response strategy. In the event of an oil leak in UK waters the liability for all costs lies with the owners of the well. This is an unlimited liability. As a back-up should the operator default, the Offshore Pollution Liability Association Limited (OPOL) was established to help pay for any cleanup and liability costs.

There is also a framework of regulations governing offshore atmospheric emissions which relate to the flaring of gas, diesel engines, gas turbines and other 'combustion plant'. The Offshore Combustion Installations (Prevention and Control of Pollution) Regulations 2001 requires permits to be put in place and complied with for offshore combustion installations with a thermal input of 50MW. As regards waste, waste disposal licences and a waste management plan must also be put in place.

The enforcing authorities for environmental matters in the UK are DECC, the Environment Agency (EA) and the Scottish Environmental Protection Agency (SEPA). The Maritime and Coastguard Agency (MCA) is the competent UK authority in terms of counter pollution measures and response at sea, and the Joint Nature Conservation Committee (JNCC) provides advice on environmental sensitivities which may be impacted as a result of any oil spill. Both MCA

and JNCC are consulted as part of the OPEP review and regulatory approval process.

Developing areas

The Climate Change Act 2008 (CCA) sets targets for the reduction in greenhouse gases (GHGs) for the UK. The provisions of the CCA relating to emissions of GHGs apply to emissions from sources or other matters occurring in, above or below the UK sector of the continental shelf, as they apply to emissions from sources or matter occurring in the UK. Developments may be expected in this area.

The Marine Strategy Framework Directive implemented in the UK by the Marine Strategy Regulations 2010 requires each member state to develop a marine strategy. This includes steps to protect and preserve the marine environment, prevent its deterioration and prevent and reduce impacts in the marine environment. The UK is required to produce a marine strategy to phase out pollution. This may over time have more relevance to oil and gas activities.

The Marine and Coastal Access Act 2009 provides for greater protection of the marine area and process to designate marine conservation zones. It also establishes a Marine Management Organisation for the waters around England and the UK offshore area. The Marine (Scotland) Act 2010 establishes a similar organisation Marine Scotland in Scottish waters.

21 What health, safety and environmental requirements apply to oil and oil product composition? What government body is responsible for this regulation; what enforcement authority does it wield? Is certification or other approval required? What kind of record-keeping is required? What are the penalties for non-compliance?

Health and safety legislation concerned with the regulation of oil and oil products in the downstream market has evolved into a broad framework of general legislation designed to regulate products and hazards across a range of industries. As well as the duties imposed under the relevant hazard specific legislation (listed below), the manufacturer, supplier or importer of any product or substance will still be required to comply with their general duties under the HSWA (discussed at question 20), which requires that they ensure, so far as is reasonably practicable, that substances produced, manufactured or imported are safe and without risks to health when properly used. Hazards-specific regulations of relevance for the processing, manufacture or distribution of oil and oil-related products include:

- Regulation No. 1907/2006EC concerning the registration, evaluation and authorisation and restriction of chemicals (REACH);
- the Control of Substances Hazardous to Health Regulations 2002 which place duties on employers and employees in relation to hazardous substances by prohibiting their use in certain circumstances and control of exposure to such substances;
- the Control of Major Accident Hazards Regulations 1999, which set out requirements for companies to prepare a plan for the control and containment of major incidents, through consultation with employees and other relevant persons (such as the emergency services); and
- the Chemicals (Hazard Information and Packaging for Supply) Regulations 2002 (CHIP), which apply to suppliers of dangerous chemicals. The purpose of the Regulations is to protect people and the environment from the effects of chemicals by requiring suppliers to provide information about the dangers and to package them safely.

The enforcing agency for health and safety matters in the UK is the Health and Safety Executive (HSE). Breach of the HSWA or any of its subordinate regulations, such as the regulations noted above, is a criminal offence that may be punished by prosecution (with unlimited fines and imprisonment for the most serious offences) or by imposition of prohibition or improvement notice. Individual imprisonment of the company's officers (directors, managers and possibly even offshore installation managers) for up to two years is possible in certain circumstances.

The activities of the downstream oil sector, including refining, transportation and storage of oil and petroleum are also subject to considerable environmental regulation. In undergoing these processes, the release of substances into the land, sea or air by a downstream operator or installation requires the issue of a permit or licence from the relevant authority. DECC, the Environment Agency (EA) and the Scottish Environmental Protection Agency (SEPA) regulate this regime in the UK. The environmental regime is contained within a suite of domestic legislation, including the Pollution Prevention and Control Act 1999, under which a number of regulations have been made. The recently amended Chemicals Regulations 2011 and the Oil Regulations 2011 create a new offence related to the release of an offshore chemical or oil. The definition of 'discharge' is amended to cover any intentional emission of an offshore chemical, and a new definition of 'release' is inserted which catches all other emissions. Also of relevance presently is the Environmental Permitting (England and Wales) Regulations 2010 (the 2010 Regulations), which provide a consolidated system of environmental permitting in England and Wales. Breach of the 2010 Regulations is a criminal offence which is subject to a maximum fine of £50,000 and/or six months imprisonment in the Magistrates Court, or, an unlimited fine and/or imprisonment for a term not exceeding five years in the Crown Court. The Pollution Prevention and Control (Scotland) Amendment Regulations 2009 apply similar requirements to Scotland. In respect of damage to protected species or to natural habitats in the area of the seabed of the continental shelf the Environmental Damage (Prevention and Remediation) Regulations 2009 as amended are also of key relevance, as they lay down steps to be taken by operators where there is imminent risk of environmental damage. Where damage has occurred, the enforcing authority must assess the damage and identify remedial measures, and serve a remediation notice on the responsible operator specifying what remediation is required. For the damage to species and habitats and damage to water, the Regulations also require that, in addition to any measures taken to return the environment to the condition it was in before the damage occurred, compensatory measures should also be taken to make amends for where the damaged environment does not completely recover, and for the loss of environmental resources and environmental services pending recovery. Sanctions under various environmental regimes and consequential costs of remediation can be significant.

Labour

22 What government standards apply to oil industry labour? How is foreign labour regulated? Are there anti-discrimination requirements? What are the penalties for non-compliance?

DECC does not apply specific standards to those employed in the oil industry. From a European perspective, as a member of the EU, EEA nationals are permitted to live and work in the UK without being discriminated against on the basis of nationality. The only exception to this is for Bulgarian and Romanian employees whose access to the UK labour market has been restricted by the UK. All non-EEA nationals, and Romanian or Bulgarian employees, must obtain work permission in order to work in the UK. Those working purely offshore are exempted from this requirement. In order to sponsor an employee to work in the UK, an employer must be licensed to do so by the UK Border Agency. Penalties for non-compliance include civil penalties of £10,000 per illegal worker or unlimited fines or imprisonment for knowing non-compliance.

Taxation

23 What is the tax regime applicable to oil exploration, production, transportation, and marketing and distribution activities? What government body wields tax authority?

There are three elements of taxation to which companies in the oil industry may be subject: petroleum revenue tax, ring fence corporation tax and a supplementary charge. HM Revenue and Customs Large Business Service – Oil & Gas Sector (LBSOG) (formerly the Oil Taxation Office) administers the taxation regime.

Petroleum revenue tax (PRT)

PRT is a field-based tax, charged on the profits arising to each participant from the production of oil under a licence. Certain specified development and maintenance expenditure can be deducted for PRT purposes against profits from that particular field. The current PRT tax rate is 50 per cent on profits after certain allowances. The two key allowances are an 'oil allowance' and the 'safeguard' – the former provides each field with a level of production that is not subject to PRT; the latter ensures that a participator receives a minimum return on his investment before PRT is payable. On 16 March 1993 PRT was abolished for fields given development consent on or after that date. With effect from 1 July 2007, fields that have previously been decommissioned and are later redeveloped have been removed from the charge to PRT. The effective rate of tax on oil related profits is now 62 per cent for non-PRT paying fields and 81 per cent for PRT paying fields.

Ring fence corporation tax (RFCT)

Oil companies are subject to corporation tax, but there are a number of variations to the usual rules, including the 'ring fence' mechanism. The ring fence rules are designed to prevent losses from other activities being set off against profits from oil and gas extraction by treating ring-fenced activities as a separate trade. However, it is possible to carry forward or back ring fence losses against other activities. The applicable rates of tax are currently 28 per cent for non-ring fence profits and 30 per cent for ring fence profits.

Despite the cut in the main rate of corporation tax (from 28 per cent to 23 per cent over four years from 2011 to 2014) announced in the June 2010 and March 2011 Budgets, the rate will remain at 30 per cent for profits from oil extraction in the UK.

Supplementary charge (SC)

Introduced in April 2002, the SC constitutes an additional charge on ring fence profits (calculated in the same way as RFCT) without any deduction for financing costs. Costs that have been deducted for the purpose of paying corporation tax must be re-added before computing the SC liability. The SC is paid and administered at the same time as corporation tax. The SC is 32 per cent with effect from 24 March 2011 (previously 20 per cent). The effective tax rate on ring-fenced activities is therefore 62 per cent.

If in future years the oil price falls below a set trigger price on a sustained basis, the government has committed to reducing the SC back towards 20 per cent on a staged and affordable basis for as long as prices remain low. The government has indicated that a trigger price of US$75 per barrel would be appropriate. Following consultations with oil companies and motoring groups during the course of 2011 the government will confirm the trigger price and mechanism for any such reduction.

Recent changes to the North Sea tax regime

The principal aim of recent changes is to encourage new development and extend field life, and to create incentives to reuse existing infrastructure (eg, for carbon capture and storage). There have been a number of legislative changes in recent years and these include the following.

The Finance Act 2010 (No. 3) amended the reinvestment relief rules to allow relief to be claimed by another company within the same group as the company making the disposal for disposals made after 23 March 2010.

Provisions in the Finance Bill 2011 (published on 31 March 2011) provide for the extension of reinvestment relief so that it can apply when proceeds are reinvested in exploration and development expenditure, including drilling costs; the extension of the relief in respect of gains on a swap of post-development interests in licences; and the extension of field allowances for SC purposes, to include investments in fields that have previously been decommissioned (this will have retrospective application to fields whose development is authorised on or after 22 April 2009). These measures were first announced in the 2009 Pre-Budget Report.

In addition, a restriction was included in the Finance Bill 2011 to ensure that a revenue deduction is not available under the corporation tax intangible fixed assets rules (effective from 23 March 2011) for goodwill or any intangible asset which relates to, derives from or is connected with an oil licence or an interest in an oil licence.

Despite the increase in the SC from 20 per cent to 32 per cent, the 2011 Budget announced that tax relief for decommissioning costs will (with effect from the Budget 2012) be restricted to the 20 per cent rate of the SC. This restriction will be included in the Finance Bill 2012.

On more welcome news, the 2011 Budget also stated that there will be no further restrictions to tax relief for decommissioning in the life of the current Parliament and the government will work with the industry with a view to announcing further longer term certainty of tax treatment of decommissioning in the 2012 Budget.

Commodity price controls

24 Is there a mandatory price-setting regime for crude oil or crude oil products? If so, what are the requirements and penalties for non-compliance?

Crude oil and crude oil products in the UK are not subject to a mandatory price-setting regime. The UK adopts a free market approach and oil and oil products are therefore priced and valued accordingly.

Competition, trade and merger control

25 What government bodies have the authority to prevent or punish anti-competitive practices in connection with the extraction, transportation, refining or marketing of crude oil or crude oil products?

The Office of Fair Trading (OFT) is the principal body responsible for the enforcement of competition law in the UK. Sector regulators have concurrent competition powers. There is no sector regulation for the upstream industry but in the downstream markets the Office of the Gas and Electricity Markets (OFGEM) has concurrent powers to enforce the competition prohibitions. The Competition Commission (CC) is the second phase body for market investigations and merger control, and has certain functions in the regulated industries. The OFT and the CC are independent statutory bodies. There is also a specialist competition court, the Competition Appeal Tribunal, which hears appeals against OFT, sector regulator and CC decisions, as well as damages claims and certain other cases.

The OFT and the sector regulators enforce the UK's prohibitions on restrictive agreements and abuse of dominance (chapter I and chapter II prohibitions of the Competition Act 1998) and their EU equivalents (articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU)) in the UK. Under the Enterprise Act 2002, the OFT also enforces the UK's criminal cartel regime. The Serious Fraud Office assists in the prosecutions of the criminal cartel offence.

Penalties for breach of the chapter I and chapter II prohibitions of the Competition Act 1998 include fines of up to 10 per cent of worldwide turnover, and directions that infringing conduct be

Update and trends

The UK oil and gas industry spent much of 2010 responding to the blowout of the Macondo well in the Gulf of Mexico. Following the Gulf of Mexico disaster, the UK's Health & Safety Executive (HSE) and the Department of Energy and Climate Change (DECC) conducted a review of the UK's existing safety and environmental regulatory regime and concluded that overall it was robust and fit for purpose reflecting the fact that the UK has not suffered a blowout since 1990. The HSE has nevertheless reinforced its existing rules and procedures by increasing levels of peer review in areas such as well design. DECC had strengthened the environmental regime by increasing the number of environmental inspections by DECC inspectors and revising and enhancing requirements for Oil Pollution Emergency Plans to ensure proper systems and procedures are in place in the event of an oil spill.

Within a month of the disaster, the Oil Spill Prevention and Response Advisory Group (OSPRAG) was set up comprising oil companies, contractors, the HSE, the DECC, the Maritime and Coastguard Agency and trade unions. OSPRAG's mandate was to look at the UK's regulation and practices concerning pollution prevention and response; the adequacy of financial provisions for such a response; the findings from investigations into the Gulf of Mexico disaster and assist the implementation of any recommendations relevant to the UK; and sharing information across European and other regulatory bodies across the globe. Some of the main actions to come out of OSPRAG to date include: the construction of an oil spill containment device which will be available to all operators in the UK in the event of an uncontained well; the identification of industry best practices in well management; and a National Contingency Plan exercise to be held in May of 2011.

In light of the Gulf of Mexico disaster, members of Offshore Pollution Liability Association Ltd (OPOL) subsequently agreed to increase the OPOL limit from US$120 million to US$250 million. The House of Commons energy committee has expressed the view that the new limit of US$250 million is still insufficient to cover the costs of dealing with a blowout in the UKCS. It has therefore recommended that it should be a requirement of the licensing process that licensees prove their ability to pay for the consequences of any incident that could occur and also that the government consider whether third-party insurance should be required for small E&P companies.

The latest (26th) round of licence applications saw a record level of interest from oil and gas companies operating in the UKCS. Greenpeace challenged DECC's award of new licences in deepwater areas in October 2010, arguing that it should have awaited full results of the Macondo investigation, and reconsidered environmental assessments in light of the incident. At the time of writing (April 2011), a judicial review is to be held in the next few months.

The Chancellor's Budget announcement in March 2011 paved the way for a higher tax rate on oil companies and within a week of the announcement a number of oil and gas companies had said that their developments were to be put on hold on the basis that the tax changes had made them uneconomic.

brought to an end. They are thus similar to the penalties applicable to articles 101 and 102 TFEU. Criminal cartel offence penalties are imprisonment for up to five years and/or fines. Directors involved in anti-competitive behaviour may be disqualified from acting as a director for up to 15 years or may give an undertaking not to act in that capacity. The first directors to be found guilty of the UK criminal cartel offence were involved in the marine hose cartel. They received prison sentences ranging between 20 and 30 months.

The Enterprise Act 2002 makes provision for market investigations. It enables the OFT and the sector regulators to carry out an initial study of an entire market or part of it, and to refer that market to the CC for a full investigation, where there is a concern that features of that market may restrict or distort competition. Where the CC carries out a market investigation it has wide powers to specify remedies (but not to impose fines). Government ministers may intervene in market investigations in very limited circumstances on public interest grounds.

The OFT's role in the UK domestic merger control regime is to undertake the first stage review of qualifying transactions, and to decide whether the transaction should be referred to the CC, which carries out the second phase review.

At the time of writing (April 2011) the UK government is carrying out a major consultation on the potential merger of the OFT and the CC, on changes to the criminal cartel offence, on the possibility of introducing a mandatory merger filing regime, and on various procedural points.

26 What is the process for procuring a government determination that a proposed action does not violate any anti-competitive standards? How long does the process generally take?

Other than in relation to merger control, it is not possible to obtain a determination from any UK competition authority on the competition law compatibility of a proposed action or agreement. Companies are responsible for carrying out their own assessment of whether their activities comply with competition law. Agreements which technically infringe the prohibition on restrictive agreements but which meet the criteria set out in chapter 1 Competition Act 1998 (mirroring the provisions in article 101(3) TFEU) or in relevant block exemptions will be legally enforceable. EU guidance is the common standard of reference. Companies may have to rely on or defend their conclusions on these matters in front of the competition authorities or the courts.

The UK domestic merger control regime in the Enterprise Act 2002 is a two-phase process. It does not impose mandatory notification or suspension requirements. Notification is voluntary. The OFT does, however, have the power to start an own-initiative investigation and to refer a transaction for phase 2 investigation by the CC up to 4 months after completion of a non-notified transaction. There are alternative forms of notification: a statutory fast-track which gives the OFT 20 working days (with a possible extension of 10 workings days) to make its decision; and the more frequently-used informal process in which the OFT aims to reach a decision within an administrative timetable of 40 working days. Where a transaction is referred to the CC for second phase investigation, the CC must report within 24 weeks, subject to an 8 week extension period. The CC has broad powers to impose both structural and behavioural remedies.

International

27 To what extent is regulatory policy or activity affected by international treaties or other multinational agreements?

The UK is a signatory to a number of international treaties and multinational agreements which impact on UK regulation. Among the most important are the 1958 Geneva Convention on the Continental Shelf and the 1982 United Nations Convention on the Law of the Sea (UNCLOS), which together set the limits for a state's territorial sea and continue to govern the UK's access to its continental shelf and beyond. Also significant to the oil industry is the Energy Charter Treaty which regulates between member states a number of energy-specific areas such as competition, transit of energy goods, trade, investment and dispute resolution. Other notable multinational agreements include the 1998 OSPAR Convention which has had a significant impact on the UK's decommissioning regulations.

28 Are there special requirements or limitations on the acquisition of oil-related interests by foreign companies or individuals?

While there is no specific limitation to foreign companies, DECC has the power to make a public interest assessment of the impact of a foreign company on the market. Furthermore, DECC requires that to be a licensee a company must have a place of business within the UK. In assessing the suitability of a candidate to act as an operator, DECC has stated that location of the company's operations may be a factor in assessing its ability to run operations effectively.

29 Do special rules apply to cross-border sales or deliveries of crude oil or crude oil products?

Under UK law, cross-border transactions of this nature are not governed by any specific legislation or rules.

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