

UK PUBLISHES CONSULTATION ON MER STRATEGY FOR THE OIL AND GAS INDUSTRY – TRANSITIONING OR MAXIMISING – THE ROAD TO NET ZERO

To Our Clients and Friends:

This briefing examines the United Kingdom’s latest oil and gas industry sector consultation relating to the regulator’s (the Oil and Gas Authority (the **OGA**)) strategy to maximise economic recovery from the basin, and integrating this strategy with the United Kingdom’s carbon emissions reduction ambitions. This briefing will be relevant to all existing and prospective market actors in the United Kingdom’s offshore hydrocarbons industry, as well as those companies involved in the United Kingdom’s energy transition to a low carbon economy.

Background to the MER Strategy

The United Kingdom’s Continental Shelf (the **UKCS**) is a mature basin with many ageing assets. In 2013, the UK Government announced a review of UKCS recovery and regulation by Sir Ian Wood (the **Wood Review**). The Wood Review report was published in 2014 with key recommendations to maximise economic recovery from the UKCS, including the establishment of a new regulator and the development of a new strategy to maximise economic recovery, which recommendations were accepted by the Government.

The UK’s upstream oil and gas sector has since been regulated by the OGA. The OGA is required to set strategies for achieving the “principal objective” under Part 1A of the Petroleum Act 1998 (the **Act**), which is to maximise the economic recovery of the UK’s oil and gas resources. In 2016, the OGA set its first strategy to achieve this objective – the Maximising Economic Recovery, or MER Strategy, which came into force on 18 March 2016.

Under the Act, the OGA has the power to produce a new strategy or revise a current strategy at any time, and is also required to review each current strategy every four years (s.9F of the Act).

Proposal to revise the MER Strategy

On 6 May 2020, the OGA launched a formal consultation to review the MER Strategy. The OGA has invited comments, and the UK oil and gas industry is actively engaged in dialogue, on the terms of the revised proposal for the MER Strategy (the **Proposal**). The terms of the Proposal remain open to the consultation process, with the OGA due to review responses to the consultation before a draft of the revised strategy is laid before Parliament.

At the heart of the Proposal is the integration of the maximisation of economic recovery from the UKCS with the UK's recent commitments to reducing carbon emissions and achieving a transition to net zero by 2050. This significantly widens the original scope of the MER Strategy from one that focussed on the economic and commercial considerations of recovery of oil and gas from the basin to the environmental impacts of recovery and associated infrastructure.

Background to the UK's net zero ambitions

In the backdrop to this consultation is the UK's statutory commitment to the net zero carbon emission 2050 target. Under the Climate Change Act 2008, the UK initially committed to achieving an 80% reduction (to 1990 levels) in greenhouse gas (GHG) emission levels by 2050. In June 2019, this target was revised upward to 100% (net zero reduction in GHG levels) by 2050 by way of the Climate Change Act 2008 (2050 Target Amendment) Order 2019 (SI 2019/1056).

Referring to the Committee on Climate Change's "Net Zero" report, the OGA has reemphasised in the consultation (p.6) that, although the UK will be transitioning to net zero, for the foreseeable future, oil and gas will remain a crucial part of the UK's energy mix and that the oil and gas industry's capital, skills and technology will be vital in achieving the net zero target. The OGA also expects the oil and gas industry to play "*a critical role in delivering net zero for the UK as a whole*" (p.7).

Given that oil and gas accounts for around 75% of the UK's total energy needs,[1] working towards carbon neutrality and playing a critical role in delivering the transition is the right step for the industry.

Extent of existing statutory mandate

In integrating the net zero commitments in the Proposal however, the OGA has expanded the "Central Obligation" to include the requirement to assist the Secretary of State in meeting the net zero target – both by reducing GHG emissions and by supporting, in particular, carbon capture and storage (CCS) projects. By way of the "Supporting Obligations", these obligations apply at each stage of operations – so relevant persons must consider reduction of GHG emissions and support for CCS from exploration to decommissioning. The attempt to tie-in net zero to the original scope of the MER Strategy is clear – the inclusion of the words "*and, in doing so*" at the end of the original MER central obligation (s.2a) is an attempt to preserve the sanctity of the legislative mandate (i.e. the primary objective under the Act). However, carbon neutrality does not fall within the existing "principal objective" as the statutory basis for the MER Strategy under the Act. Whilst supporting obligations can rightly be used to deliver the central obligation, the central obligation remains a reflection of the principal objective under the Act and we question whether this can be expanded without a new legislative mandate notwithstanding the terms of the Energy Act (which empower the OGA in connection with certain CCS matters) and the Climate Change Act (as amended).

Given the UK oil and gas industry is in no way ignoring the need to transition by 2050, inclusion of the net zero target as a central obligation rather than a supporting obligation in this way seems unnecessary.

The industry is working with industry bodies, the Government and regulators (see below) to commit not only to a “Net-Zero Basin” but also towards developing a “Sector Deal” which will ultimately have legislative force.

Industry commitments to emission reduction and the Sector Deal

In September 2019, UK’s oil and gas industry group, the Oil & Gas UK (**OGUK**), released “Roadmap 2035: A Blueprint for Net Zero” highlighting the role that the industry can play in the transition to a decarbonised economy. On 16 June 2020, working with industry and regulators, the OGUK also set targets in the “Pathway to a Net-Zero Basin: Production Emissions Targets” to reduce emissions associated with the UKCS oil and gas production – through changes to operations, reductions in flaring and venting, capital investment programmes for the electrification of offshore facilities. The industry has committed to halving the GHG emissions from UKCS exploration and production activities by 2030, delivering 90% reduction by 2040.

Alongside the recent emissions targets, the industry is also in formal discussions with the Government on a range of options for a sector deal (the **Sector Deal**) to support a green recovery. The Sector Deal is expected to act as a catalyst in delivering both energy security and a transition to net zero, whilst stimulating jobs growth and technological advancements and the supply chain.[2]

The inclusion of the net zero target in this way also seems premature. The Government has not yet delivered its wider strategy roadmap to achieving energy transition (the Energy White Paper – see further below). This move by the regulator, in the absence of the Government’s direction and the Energy White Paper creates a potential for inconsistency and overlap. With an Environment Bill also in Parliament, there remains a lack of clarity on the authority/ies that wield(s) enforcement powers on environmental and emissions matters.

At a time when the oil and gas industry is facing a “triple whammy” and about to embark on a fundamental re-set, it would be better guided by a more co-ordinated and holistic Government approach – with the Energy White Paper leading the way, followed by a Parliament-approved Sector Deal and any required strategy or guidance rounding up the rough edges (if any).

Energy White Paper and enforcement of climate change commitments

The Energy White Paper – the Government’s roadmap to achieving net zero 2050 – was initially scheduled for an early summer 2019 release. Following the Department for Business, Energy & Industrial Strategy’s (**BEIS**) release of a number of consultations in summer 2019 targeting these areas, there was speculation that the Energy White Paper would eventually include clear direction on new nuclear, CCS and similar projects to transition the UK to net zero. Through the course of 2020, the Government has indicated different timelines for the release of the Energy White Paper, which is yet to be published. Though the global COVID-19 pandemic has in many ways reinforced the need to push ahead with de-carbonisation of the economy, the effects of global

shut-down measures has also arguably slowed the pace of change in some respects, with the COP26 United Nations climate change conference being postponed from November 2020 until 2021 and the Government having substantial competing legislative priorities.

The Government also introduced the Environment Bill in October 2019. This Bill envisages the establishment of a new independent regulator – the Office for Environmental Protection – with enforcement powers, covering all climate change legislation and the UK’s commitment to reaching its net zero target.

Under the Energy Act 2016 (s.8), the OGA must have regard, when exercising its functions, to the storage of carbon dioxide, including “[t]he development and use of facilities for the storage of carbon dioxide, and of anything else (including, in particular, pipelines) needed in connection with the development and use of such facilities, and how that may assist the Secretary of State to meet the target in section 1 of the Climate Change Act 2008”. The OGA is also the licensing authority for carbon dioxide storage. However, these powers do not extend to the entire CCS value chain – perhaps the OGA needs to clarify that it is not seeking to (and it has no legislative mandate to) regulate the entire CCS chain, which is the domain of BEIS.

The Proposal refers specifically to CCS and hydrogen. Although the OGA may not have intended to discourage investment in other green technologies and clean energy strategies, clearer drafting could be used to clarify that the references to CCS and hydrogen are not to the exclusion of other welcome green investment.

ESG and Governance

The non-binding introductory “high-level principles” introduce ESG and governance for the first time (para (c)), requiring relevant persons to “develop and maintain good environmental, social and governance practices in their plans and daily operations”. At one level, it would have been remiss of the OGA not to refer to both ESG and governance – these are fundamental pillars, which are intrinsically linked, to ensure a careful and appropriate approach to meeting the UK’s net zero targets. There are no binding obligations included in the Proposal supporting ESG, which area is already covered by other governance standards, including the 2020 UK Stewardship Code.

However, a significant change to the scope of the MER Strategy and the OGA’s own powers is the introduction of “Governance” as a new Supporting Obligation (s.3). This obligation requires offshore licensees and the joint ventures in which they engage to “apply good and proper governance at all times, including complying with any principles and practices as the OGA may from time to time direct”. Prior to making a direction, the OGA “would consult on what is proposed and consider any responses made”. However, it is worth noting that there are no such corporate governance requirements in the Act, the Energy Act or the model clauses that apply to UKCS petroleum licences.

In the consultation, the OGA rightly acknowledges (para 39) that a number of governance codes/principles already exist for both public and private companies (referring specifically to the 2018 UK Corporate Governance Code, 2020 UK Stewardship Code and the Wates Corporate Governance

Principles for Large Private Companies), which would indicate that the OGA intends to direct companies to follow the “Comply or Explain” approach under existing codes and principles. However, the OGA also believes (para 40) it “*requires the flexibility to be able to update and adapt what is considered good and proper governance based on current events and learning*”. Whilst good governance systems are necessary, this indicates a wider approach to governance than currently exists – this power could extend further than a direction to comply or explain non-compliance to the OGA.

Neither the consultation nor the Proposal clarify the scope of the OGA’s powers in this regard – it is unclear whether the OGA has identified gaps in applicable principles, the companies covered by the scope of existing principles or if it expects to hold licensees to a higher standard than other private and public companies, which would be both unusual and dangerous. If the intention is to hold private companies to public company standards, query whether this should be expressly acknowledged and, in any event, whether instead consultation through existing codes should be undertaken. This new inclusion is likely to make the area of governance murkier rather than clearer – inevitably leading to overlapping (and potentially conflicting) governance standards, enforcement powers and increasing the administrative burden on companies in reporting to multiple regulators on governance matters.

Collaborate and co-operate

Originally, the MER Strategy required relevant persons (as a “Behaviour”) to “*where relevant, consider whether collaboration or co-operation with other relevant persons and those providing services*” would achieve cost reduction or improve recovery (s.28). The Proposal (s.21) states that relevant persons “*must*” collaborate and co-operate with other relevant persons, the supply chain and “*persons seeking to acquire an interest or invest in offshore licences or infrastructure in a region*”.

This subtle change in language from “consider” to “must” signifies a fairly significant shift in position – this is the first time the OGA has required collaboration and co-operation in the UKCS. The industry recognises the importance of collaboration, which is indeed crucial during a transition period. However, the OGA has not explained why the wording in the existing MER Strategy did not meet the OGA’s expectations. The OGA has also changed the focus of this provision – collaboration previously tied into the obligations under the MER Strategy – the Proposal de-links the collaboration requirement from the central obligation(s) under the Proposal, significantly expanding the scope of the requirement.

Although the Act (s.9A(1)(b)) includes “collaboration” in meeting the principal objective of MER, it does not require collaboration with the categories of persons included in the Proposal – the addition of new entrants/potential licensees and the wider industry supply chain are not covered by the Act. Whilst the Act always referred to collaboration^[3], the solution reached by the OGA when drafting the original MER Strategy was sensible, i.e. to “consider” collaboration as opposed to requiring it. It is unclear how the OGA will implement, monitor compliance or enforce the collaboration or co-operation requirement also noting that agreements to agree are not enforceable under English law.

Existing players and new entrants will likely watch this area closely, as it also requires collaboration and co-operation with new entrants, potentially easing the way for further private equity access to the basin.

Collaboration and Competition Law

In connection with the Energy Act 2016 and the creation of the OGA, the UK Competition and Markets Authority (the **CMA**) and the Government had discussed the approach to collaboration objectives. The CMA had confirmed that the collaboration objectives of the OGA were not necessarily inconsistent with UK competition law. However, it also identified risks (inherent in the proposals) in terms of encouraging or facilitating anti-competitive information exchange or anti-competition collusion or agreements, with care required to avoid breaching competition laws.^[4]

The Proposal (s.1) clarifies that the Supporting Obligations and any Required Actions and Behaviours “*must be read subject to the Safeguards*”. According to the Safeguards provision (s.32), “[n]o obligation imposed by or under this Strategy permits or requires any conduct which would otherwise be prohibited by or under any legislation, including legislation relating to competition law, health, safety or environmental protection”. The Proposal (including the obligation to collaborate) is therefore expressly subject to competition law. Relevant persons are expected to consider whether any proposed arrangement or collaboration complies with competition law on a case-by-case basis.

Third Party Access to Infrastructure

The Proposal includes new supporting obligations requiring infrastructure owners to negotiate access to infrastructure (terminals and, upstream of a terminal, equipment, pipelines, platforms, production installations and subsurface facilities) in a timely fashion and in good faith (s.12a). The Proposal requires access to the infrastructure to be provided on “*fair, reasonable and non-discriminatory terms*” (s.12b). Notably, the Proposal now expressly requires infrastructure owners and operators to achieve optimum potential for the re-use and re-purpose of infrastructure taking account of the UK’s net zero target (s.10c) and to negotiate access to infrastructure for CCS projects (s.22).

The newly introduced supporting obligations are consistent with the existing access to infrastructure principles set out in the non-statutory Infrastructure Code of Practice (the **Code**). The OGA encourages all parties to follow the Code and, when considering third party access disputes under the Energy Act 2011, the OGA will assess the extent to which parties have followed the Code (see also **Third Party Access Disputes Guidance**). The supporting obligations in the Proposal therefore represent a continued shift in emphasis from a voluntary industry-led access to infrastructure regime (with the OGA resolving issues) to a requirement under the Proposal enforceable directly by the OGA.

When negotiating access to infrastructure, owners and operators should also remain conscious of the CMA powers to investigate abuses of a dominant position under UK competition law; and the European Commission’s (the **EC**) ability to investigate similar breaches under EU competition laws, where conduct may have an effect on trade between Member States. The OGA stated in the Third Party Access Disputes Guidance that the CMA “*is unlikely to consider that infrastructure owners infringe the Chapter II prohibition on abuse of a dominant position where they offer third parties use of their infrastructure*

on fair, reasonable and non-discriminatory terms". This is now the test that the OGA has included in the Proposal. The changes proposed may potentially overlap with the CMA's and EC's jurisdiction.

The consultation also states that the OGA will, in due course, work with industry to provide further guidance on the asset stewardship supporting obligations. Such guidance should specifically address how parties are expected to negotiate access to infrastructure whilst balancing the potential competing or conflicting demands of (i) the maximising economic recovery objective, (ii) the net zero target, (iii) the commercial objectives and existing contractual commitments of the infrastructure owners and operators, and (iv) competition law.

Conclusion

The OGA's bold steps towards the integration of the path to net zero within the oil and gas industry's roadmap are likely to be welcomed by society and industry. Engagement by industry in committing to emission reduction targets and developing a Sector Deal with the Government show buy-in from industry into delivering energy transition. The industry and industry bodies are actively engaging in the consultation process.

In the absence of any clear policy steer by the Government by way of the Energy White Paper or agreement on a Sector Deal, the OGA's move has jumped ahead of the more logical sequence of the Government's fully framed strategy and action plan leading the way. The twin-track being created by the Proposal may not only dilute the purpose of the MER Strategy but also confuse the net zero message. The OGA may therefore want to reconsider whether the MER Strategy is the right instrument by which to introduce the energy transition obligations. Perhaps if covered by a separate instrument for energy transition, there may be an ability to consider collaboration with offshore renewables – an area currently missing in the Proposal as it is not within the OGA's purview.

Where the OGA intends to integrate two fundamental concepts, the Proposal leaves potential for conflicts between maximising economic recovery of natural resources and the UK's net zero objective. In any redraft, the OGA should ensure that the primacy of the MER principal objective is clear over energy transition – perhaps delivering the transition net zero as a supporting obligation, rather than a central obligation.

The OGA will need to work closely with industry and other existing regulatory bodies to ensure that projects are able to maintain a reasonable balance between maximising and transitioning and that there is no overlapping areas of authority and jurisdiction between regulators. These areas would benefit from clarity – preferably by way of the original drafting rather than future guidance.

Over the past four years, the OGA has been flexible and supportive in the interpretation and implementation of the MER Strategy. The extensive proposed amendments require industry to place a lot of reliance on that behaviour. In order to future-proof the MER Strategy, it would be prudent and good practice to clarify the OGA's intentions in relation to a number of the changes and also to include more clear drafting to avoid ambiguity.

Next steps

The consultation closes on 29 July 2020, followed by a period of (potential) redrafting by the OGA based on representations received.

The process for revising an existing strategy is set out in the Act (s.9G) and summarised below:

- OGA produces a draft of the revised strategy;
- OGA consults with persons it thinks appropriate;
- OGA considers representations / responses to consultation;
- OGA sends the draft (original or modified) to the Secretary of State for BEIS (the **SoS**), who may return it if he/she considers that the draft does not enable the principal objective to be met or if the consultation process was not followed;
- SoS lays the draft before each House of Parliament;
- If neither House of Parliament passes a negative resolution after 40 days (excluding periods of Parliament adjournment of more than four days, dissolution or prorogation), the OGA may issue the revised strategy; and
- OGA can determine when the revised strategy comes into force (the earliest date being the date of issue).

[1] Pathway to a Net-Zero Basin: Production Emissions Targets, OIL & GAS UK (June 16, 2020), <https://oilandgasuk.cld.bz/OGUK-Pathway-to-a-Net-Zero-Basin-Production-Emissions-Targets-Report-2020> (p.4).

[2] UK offshore oil and gas industry outlines plan to cut emissions as talks on transformational sector deal formally begin, OIL & GAS UK, <https://oilandgasuk.co.uk/category/press-release/>.

[3] In addition, under the Energy Act 2016 (s.8), the OGA is required to have regard, when exercising its functions, to “collaboration”, i.e. the need to work collaboratively with the Government and with persons who carry on, or wish to carry on, relevant activities.

[4] Letter from the CMA to the Department of Energy and Climate Change (December 3, 2015), *see* paras 5 to 13, [here](#).



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Gibson Dunn's lawyers are available to assist with any questions you may have regarding these developments. For additional information, please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Oil and Gas practice group, or the following authors:

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