

## Validation Impact Assessment

<b>Title of regulatory proposal</b>	Proposed Changes to the Model Clauses for Seaward Production Licences
<b>Lead Department/Agency</b>	Department for Business, Energy and Industrial Strategy (BEIS) / Oil and Gas Authority (OGA)
<b>Expected date of implementation</b>	30 May 2017
<b>Origin</b>	Domestic
<b>Date</b>	11 April 2017
<b>Lead Departmental Contact</b>	Lauren Babuik (EDU)
<b>RTA Rationale</b>	Low-cost regulation (fast track)

### Background

The Oil and Gas Authority (the OGA), a Government Company whose sole shareholder is the Secretary of State for Business, Energy and Industrial Strategy (BEIS), administers the oil and gas licensing system in England (and, until certain functions are devolved, in Scotland and Wales), in the UK territorial waters and on the UK Continental Shelf. Oil and gas licensing administration has been carried out by the OGA (first as an Executive Agency of BEIS and then as a Government Company) since 1 April 2015. The OGA became a Government Company and had certain functions regarding oil and gas licensing or administration transferred to it via legislation on 1 October 2016.

'The Maximising Economic Recovery Strategy for the UK' (MER UK Strategy) was published in early 2016. The Strategy sets out a 'central obligation', 'supporting obligations' and 'required actions and behaviours' – all of which are legally binding on the OGA and industry. The Central Obligation states that "relevant persons must, in the exercise of their relevant functions, take the steps necessary to secure that that maximum value of economically recoverable petroleum is recovered from the strata beneath UK waters". The supporting obligations cover the areas of; exploration, development, asset stewardship, technology, and decommissioning. The required actions and behaviours cover timing, collaboration, cost reduction, and actions where relevant parties decide not to ensure maximum economic recovery.

The Central Obligation, Supporting Obligations and Required Actions and Behaviours must be read subject to a number of Safeguards also contained within the Strategy, which set out protections for industry and the OGA and include clarification that:

- No obligation under the Strategy will require a relevant person to breach any legislation, including competition law;

- The OGA is bound by its duties under common law, including that it must at all times act reasonably
- The Strategy sets no obligations where a proposed investment or funded activity fails to deliver a *'satisfactory expected commercial return'*
- No obligation under the Strategy requires any conduct where the benefits to the UK deriving from it are outweighed by the damage to the confidence of investors in UK oil and gas.

Section 3 of the Petroleum Act 1998 ('the Act') empowers the OGA to grant licences to search and bore for and get petroleum. The OGA generally offers areas for licensing via competitive 'licensing rounds', where companies can apply for licences. Section 4 requires the Secretary of State to make regulations prescribing (among other things) Model Clauses to be incorporated in any such licence.

Production Licences have a duration broken into several terms. Before the 29<sup>th</sup> Licensing Round (2016) the durations of the Initial Term and Second Terms were defined as part of the invitation to apply for a licence (both four years in the case of a Traditional Licence, for example). The Initial Term is a period during which the licensee carries out an agreed exploration Work Programme, which always culminates in the drilling of a well. The Licensee will be entitled to continue into a Second Term if (among other things) that programme has been carried out; if not, the Licence will expire at the end of the Initial Term.

### **Rationale for intervention and intended effects**

As part of the principal objective of Maximising Economic Recovery of UK (MER UK) petroleum (set out in Part 1A of the Petroleum Act 1998), the OGA considered how Seaward Production Licences could be improved and updated. After discussions with industry, the OGA devised the 'Innovate' concept.

A central part of this concept is that the OGA will take a more flexible approach to the timetable for the Initial Term and its Work Programme, so as to be able to comply with the circumstances and stated plans of all potential applicants, reducing the limitations that are created by the current one-size-fits-all approach. As a matter of policy, the OGA is currently contemplating Initial Terms up to nine years long. However, an Initial Term as long as that could compromise the OGA's objective of maximising economic recovery if a licensee could retain the Licence and its valuable exclusive rights without doing any work; a longer Initial Term requires a more granular Work Programme with intermediate deadlines.

The Innovate concept therefore introduces a more granular approach to the design of Work Programmes. Under this new approach, the OGA will break the single-length Initial Term into as many as three Phases, with the Work Programme being divided up accordingly: Phase A for activities other than seismic surveys and drilling, such as the acquisition of existing data, Phase B to acquire new seismic surveys and Phase C to drill. It will be for each applicant to propose the duration of these Phases to suit their actual requirements.

When inviting applications in the 29<sup>th</sup> Round, the OGA offered this new flexibility by not specifying the duration of the Initial Term and Second Term of the licences to be applied for. While it also offered some aspects of the new granularity by offering to draft Work Programmes broken into Phases, the Innovate framework is not fully effective without regulatory change. This is because the current Model Clauses for Seaward Production Licences only provide for termination of the licence at one intermediate deadline in the Initial Term. Therefore, if a licence has a Phase A, Phase B and Phase C, the licence would not terminate at the end of Phase A if the licensee does not complete Phase A. There would only

be the possibility for termination at the end of Phase B.

As set out in the Consultation Document of November 2016<sup>1</sup> the Secretary of State will therefore amend the Regulations which set out the Model Clauses<sup>2</sup> so that a single type of Seaward Production Licence to be called the Innovate Licence can be introduced in full. This will set out the provisions governing the new concept of Phases within the Initial Term. The existing provisions for termination during the Initial Term will be amended. This will provide for termination of the licence at the end of Phase A and Phase B if the associated part of the Work Programme for that Phase is not completed, unless the OGA decides otherwise. Therefore, OGA will be able to let the licence continue, if it judges that to be reasonable and best calculated to promote its objective of maximising economic recovery.

In fairly exceptional circumstances, the OGA may also include additional deadlines in the Work Programme that do not coincide with the end of a Phase. This would be where a Licensee seeks an unusually long Phase; for example, a five-year Phase C (drilling) might include a deadline to prove a new technology within the first two years of the Phase. An amendment of the Model Clauses is therefore proposed so the licence will terminate if the Licensee fails to meet the agreed intermediate deadline, unless the OGA decides otherwise.

The proposed changes to the Model Clauses would also allow for phases and deadlines to be extended by notice in response to a request from the Licensee where the Licensee has valid reasons for not being able to meet the original deadlines.

Other amendments to Seaward Production Licence Model Clauses are proposed which are intended to clarify the Model Clauses and simplify their administration, in order to contribute to the principal objective of MER UK. One change is to allow amendments to the Work Programme to be made by notice in response to a request from the Licensee. This again arises from the OGA's recognition that commercial and technological factors and the state of knowledge may change after a licence is awarded, and that it may therefore be reasonable to amend a Work Programme so as to give the Licensee more time to complete it or to change the activities required to be completed. The Model Clauses already allow the Initial and Second Terms to be extended via notice, and the amendment will extend this mechanism to changes to the Work Programme. This mechanism will replace the previous requirement to amend a Work Programme by Deed of Variation, thus reducing the administrative burden on both the OGA and the Licensee.

Where a licence is terminated or expires, the OGA is able to reoffer the acreage to other companies. This is intended to lead to an overall benefit to business and society as the new licensees are more likely to maximise economic recovery than one that has failed to carry out its agreed Work Programme.

It is intended that all amendments will apply to the 30<sup>th</sup> Seaward Licensing Round licences (expected later in 2017) onwards. The changes have no effect on existing licences. Model Clauses for licences already held will not change, so that the proposed changes being consulted on are relevant only for licences not yet issued. Also, licences awarded for the 29<sup>th</sup> Round will be subject to the current Model Clauses.

### **Additional amendments**

---

<sup>1</sup> Oil and Gas Authority, Consultation on proposed changes to model clauses for seaward production licenses, November 2016.  
[https://www.ogauthority.co.uk/media/2975/oga\\_consultation-on-seaward-production-licenses11-2.pdf](https://www.ogauthority.co.uk/media/2975/oga_consultation-on-seaward-production-licenses11-2.pdf)

<sup>2</sup> The Model Clauses for Seaward Production Licences are set out in the Petroleum Licensing (Production) (Seaward Areas) Regulations 2008.

The Secretary of State is also making minor amendments to the Petroleum Licensing (Applications) Regulations 2015, the Petroleum Licensing (Exploration and Production) (Landward Areas) Regulations 2014 (which sets out the Landward Licence model clauses) and Offshore Gas Storage and Unloading (Licensing) Regulations 2009 (which sets out the Offshore Gas Storage Licence model clauses). These changes just update and clarify the legislation, and do not change the policy or the regulatory burden on business.

### **Viable policy options (including alternatives to regulation)**

Two main policy options were considered:

- Option 1: The 'do nothing' option: not introducing new termination provisions to Model Clauses would prevent the OGA from awarding Licences with longer Initial Terms, because there would be insufficient safeguards against valuable exclusive rights lying unexploited for correspondingly longer periods. This approach was ruled out as it would not achieve the policy objective.
- Option 2: Amend the Model Clauses for Seaward Production Licences in order to introduce a single type of Seaward Production Licence that provides the necessary termination provisions in the Initial Term that will allow the OGA to be more flexible regarding the length of that Term. This is the preferred option as it will support the principal objective of MER UK.

### **Assessment of business impact**

The policy changes made and the proposed Regulations are not expected to lead to any material increase in costs to business. With the aim of contributing towards the principal objective of MER UK, the policy intent is to support flexibility regarding the length of the Initial Term for all potential applicants for Seaward Production Licences. This requires additional, termination provisions during the Initial Term in order to ensure there are proportionate safeguards against sufficient progress not being made towards the production of hydrocarbons within a timely fashion. Other amendments clarify the Model Clauses and simplify their administration. The proposed amendments will have no effect on existing licences. The flexibility provided by the Innovate model allows an applicant to choose from a range of permutations of timings and Work Programmes, and three of these permutations correspond to the three patterns of licence previously offered (Traditional, Promote and Frontier). The change can therefore be considered as permissive, in the sense that a company that wanted a licence on one of the old patterns will be able to apply for an Innovate Licence of that pattern, and will not be obliged to apply for something different. It is therefore expected that businesses will adopt an alternative timetable or Work Programme under the Innovate model only if they are expected to result in benefits to that business. As it is not possible to monetise the potential benefits, for the purposes of this analysis it is assumed that benefits are at least equal to costs and therefore overall the proposed regulatory changes are considered a zero cost measure i.e. the Equivalent Annual Net Direct Cost to Business (EANDCB) is estimated as £Nil.

To accommodate more diverse companies with more diverse plans, the Innovate concept is to offer greater flexibility to licensees in the timings associated with their Work Programmes. However, to offer longer Initial terms (up to nine years as a matter of policy) requires greater granularity in the Work Programme; it would not be consistent with the obligations in the MER UK Strategy to allow exclusivity to be retained for as long as nine years by a company that is unable or unwilling to do anything with the licensed area. Therefore the OGA proposes a change to the Model Clauses that splits the Initial Term into up to three Phases, with provisions allowing the OGA to terminate the licence at the end of each one if the Licensee has failed to complete the Work Programme associated with it. The OGA will then be able to offer the acreage to other companies.

In order to secure the continuation of a Licence from one Phase to another, the Licensee must submit a written request. The cost of preparing and submitting the written request is not significant. In order to enter Phase C, the Licensee must also provide supporting information to demonstrate its financial and technical capacity. This is not a new requirement. Previously every applicant had to provide this information either when applying for a licence or two years later if the licence was a Promote Licence. Under the Innovate concept a licensee will have to provide this information either when applying for a licence or later to enter Phase C. While the words may have changed there is no net change in the requirements on the Licensee.

The division of the Initial Term into Phases with termination provisions at the end of each phase is not considered a new burden on Business. This is because termination of a licence will only occur where a licensee fails to comply with the agreed minimum amount of work and incur the corresponding costs in support of the OGA's Principal Objective of Maximising Economic Recovery. The intention is that the acreage can then be offered to other companies in a timely manner, who will make productive use of the valuable exclusive rights to produce oil and gas which would result in a net benefit to Business and society as a whole. It has always been the case that a licensee who failed to carry out an agreed Work Programme may lose their licence. To the extent that termination could occur earlier than otherwise due to increased granularity, this would only transpire where the decision by the OGA were proportionate, reasonable and consistent with the obligations and safeguards in the Strategy.

There is no change to the fact that a Licensee cannot retain a licence into a Second Term without completing the Initial Term Work Programme. There is also nothing new in that the Work Programme may contain an intermediate deadline – Promote Licences and those with a 'Drill-or-Drop decision deadline' did that. The proposal is that where the Licensee has proposed, and the OGA agreed, to three Phases, there may now be two intermediate deadlines at which the licence may be terminated (one at the end of Phase A and one at the end of Phase B). Also, where the length of a Phase is particularly long, other intermediate deadlines may be agreed and the licence would terminate if the other agreed deadlines are not met. Against this, it must be noted that the Licensee may have proposed, and the OGA may have agreed a significantly longer Initial Term. It must also be noted that the OGA may use its discretion to provide that the licence will not terminate where appropriate, in accordance with its objective of maximising economic recovery. The proposed changes to the Model Clauses would also allow for phases and deadlines to be extended by notice in response to a request from the Licensee where the Licensee has valid reasons for not being able to meet the original deadlines. Where a Licensee fails to carry out part of the Work Programme by its agreed deadline and the licence terminates, there will be no administrative burden on business; the OGA will write to the Licensee to inform it. Other companies will then have the opportunity to seek a new Licence over the acreage thus freed up. As such, it is expected that there would be a benefit to business and society overall from acreage being transferred to companies that are more likely to maximise economic recovery of oil and gas resources.

The other proposed changes are intended to clarify the Model Clauses and simplify their administration so they do not materially impact on business.

It is expected that there will be very small administrative burdens for business associated with representatives familiarising themselves with the Innovate concept and the increased flexibility afforded to them when preparing an application. Based on one representative each from an estimated 75 companies taking a maximum of 2 hours to read the accompanying guidance - of which only a subset will refer to the proposed changes - at an average wage cost of £31.88 per hour, the EANDCB is estimated at £4,326 (2014 prices, 2015 present value base year, 3.5% discount rate). As the net impact to business is estimated to be less than £50,000 EANDCB per annum, the BIT score (£21,630) associated with familiarisation cost is rounded to £Nil.

Through its consultation, the OGA received a number of responses directly from companies and aggregate responses submitted by the trade associations, Oil and Gas UK and the Oil and Gas Independents' Association (OGIA). All respondents supported the policy proposals.

**One-in, Three-out status**

The measure requires regulatory amendments and is therefore a Qualifying Regulatory Provision (QRP) and in scope of the One-in, Three-out rule. However, given the permissive nature of the key policy changes and that the regulatory changes to the Model Clauses to provide additional termination provisions are expected to be beneficial to business overall, it is considered reasonable to conclude that it is a zero cost measure i.e. the benefits from the policy are at least equal to costs. Familiarisation costs are expected to be very small and round to £Nil in terms of the EANDCB. Overall, EANDCB is therefore assessed as £Nil for the purposes of scoring under the Business Impact Target (BIT).

**Rationale for Validation IA Status**

Overall the proposed changes are not expected to lead to any material increase in net direct costs to business relative to the current arrangements. Therefore, as a 'low-cost', fast-track measure (i.e. gross costs to business of less than £1m per annum), it is considered suitable for a final stage Validation Assessment.

**BEIS Minister signoff: Jo Johnson**

Date 24 August 2017

## **Supporting Evidence**

### **1. The policy issue and rationale for Government intervention**

#### Overview

The Oil and Gas Authority (the OGA), a Government Company whose sole shareholder is the Secretary of State for Business, Energy and Industrial Strategy (BEIS), administers the oil and gas licensing system in England (and, until certain functions are devolved, in Scotland and Wales), in the UK territorial waters and on the UK Continental Shelf. Oil and gas licensing administration has been carried out by the OGA (first as an Executive Agency of BEIS and then as a Government Company) since 1 April 2015. The OGA became a Government Company and had certain functions regarding oil and gas licensing administration transferred to it via legislation on 1 October 2016.

Section 3 of the Petroleum Act 1998 ('the Act') empowers the OGA to grant licences to search and bore for and get petroleum. Section 4 requires the Secretary of State to make regulations prescribing (among other things) Model Clauses to be incorporated in any such licence.

Production Licences have a duration broken into several terms. Before the 29<sup>th</sup> Licensing Round (2016) the durations of the Initial Term and Second Terms were defined as part of the invitation to apply for a licence (both were four years in the case of a Traditional Licence, for example). The Initial Term is a period during which the licensee carries out an agreed exploration Work Programme, which always culminates in the drilling of a well. The Licensee will be entitled to continue into a Second Term if (among other things) that programme has been carried out; if not, the Licence will expire at the end of the Initial Term.

#### Rationale for intervention

Under the current regulatory regime, government intervention via the issuing of licences aims to address a market failure, that is, the quasi-public good nature of oil and gas exploration and production. Licensing grants companies exclusive rights to explore for, and produce, oil and gas within a specified area which is necessary to ensure companies make the requisite investments to develop oil and gas fields and to prevent other firms from 'free-riding' on their discoveries. Without exclusive licensing, the geophysical information that companies acquire by incurring the costs of exploration would be available to other firms at zero or low cost. It would not be possible to exclude other firms from exploiting the oil or gas resource discovered, that is, they would be able to drill and extract the resource without having incurred the exploration costs. Licensing grants exclusive retention or exploration rights for specified areas, which address the non-excludability problem and thereby removes the disincentive to incur exploration costs.

As Production Licences confer exclusivity on the licensee, they require (among other things) minimum amounts of progress towards first production to justify the continuing retention of that exclusivity. They expire or give grounds for revocation where sufficient progress is not made within the required period. These periods are fixed for a particular type of licence – in particular, the exploration work programme must be completed during the Initial Term and that lasts (for example) for four years on a 'Traditional' Licence.

Having reviewed the existing Model Clauses and discussed with industry on a number of occasions, the OGA identified several areas where licences could implement these requirements more effectively by better matching a licensee's particular circumstances. The changes would therefore help support the principal objective of Maximising Economic Recovery of UK petroleum (MER UK, set out in Part 1A of the Petroleum Act 1998). To that end, the OGA devised the 'Innovate' concept and included some of the basic features of the concept in licences offered in the 29<sup>th</sup> Seaward Licensing Round (2016). However, there are remaining elements that require amendments to the existing Model Clauses.

As set out in the Consultation Document of November 2016,<sup>3</sup> the OGA therefore intends to submit a proposal to the Secretary of State to amend the Regulations which set out the current Model Clauses<sup>4</sup> so that a single type of Seaward Production Licence – the Innovate model can be introduced in full. Several other changes to Seaward Production Licences are also proposed which are aimed at clarifying and updating the Model Clauses and simplifying their administration, in order to contribute to the principal objective of MER UK. It is intended that all amendments will apply to the 30<sup>th</sup> Seaward Licensing Round licences (expected later in 2017) onwards.

The changes have no effect on existing licences. Model Clauses for licences already held will not change, so that the proposed changes being consulted on are relevant only for licences not yet issued. Also, licences awarded for the 29<sup>th</sup> Round will be subject to the current Model Clauses.

#### Innovate model proposals

The intended effect of the ‘Innovate’ model is to improve the flexibility of the Seaward Production Licence and enable licences to be tailored to each applicant’s circumstances and stated plans, reducing the burden that is created by the current one-size-fits-all approach.

1. The Initial Term Work Programme may be divided into up to three phases:
  - a) Phase A for activities other than seismic surveys and drilling, such as the purchase of existing data;
  - b) Phase B for the shooting of new geophysical (e.g. seismic) data;
  - c) Phase C for drilling.

Of these Phases, only Phase C is mandatory. This reflects long-standing policy that a well is the minimum acceptable content of a Work Programme and in this sense there is no change.

2. The applicant for a licence will propose the length and content of the Phases (and therefore the overall length of the Initial Term). This will mean the applicant can propose these parameters to accommodate its particular plans, whereas previously the duration of the Initial Term was fixed for all licences of a particular type and the licensee had to fit his plans into that duration.
3. The existing provisions in the Model Clauses will be amended in order to introduce the necessary safeguards to accompany the above policy change. The changes will provide for termination of the licence at the end of Phase A and Phase B if the associated part of the Work Programme for that Phase is not completed, unless the OGA decides otherwise.
4. In fairly exceptional circumstances, the OGA may also include additional deadlines in the Work Programme that do not coincide with the end of a Phase. This would be where a Licensee seeks an unusually long Phase; for example, a five-year Phase C (drilling) might include a deadline to prove a new technology within the first two years of the Phase. An amendment of the Model Clauses is therefore proposed so the licence will terminate if the Licensee fails to meet the agreed intermediate deadline, unless the OGA decides otherwise.
5. The proposed changes to the Model Clauses would also allow for phases and deadlines to be extended by notice in response to a request from the Licensee where the Licensee has valid reasons for not being able to meet the original deadlines.
6. In addition, it will be necessary to amend the Petroleum Licensing (Applications) Regulations 2015 so that applications for licences reflect the Innovate Model. The requirements for applicants proposing a Work Programme with a Phase A and/or a

---

<sup>3</sup> Oil and Gas Authority, Consultation on proposed changes to model clauses for seaward production licenses, November 2016.  
[https://www.ogauthority.co.uk/media/2975/oga\\_consultation-on-seaward-production-licenses11-2.pdf](https://www.ogauthority.co.uk/media/2975/oga_consultation-on-seaward-production-licenses11-2.pdf)

<sup>4</sup> The Model Clauses for Seaward Production Licences are set out in the Petroleum Licensing (Production) (Seaward Areas) Regulations 2008.



Phase B will be the same as those previously applying to applicants for a Promote Licence; those for applicants proposing a Phase C alone will be the same as those previously applying to applicants for a 'Traditional' Licence. An applicant for a Traditional or 'Frontier' Licence (or in future a Phase C-only licence) must submit more information than an applicant for a Promote Licence (or in future a licence with a Phase A and/or a Phase B). In the past a majority of applications have been for 'Traditional' or 'Frontier' Licences. In future, it is expected that there will be a relatively small number of applications for Phase C-only licences as this would require a firm commitment to drill a well and the necessary evidence of financial and technical capacity, without first having completed earlier Work Programme phases (e.g. in the 29<sup>th</sup> Round, only three out of 25 awards were for Phase-C only licences). Overall therefore, fewer applicants will have to provide the greater set of documentary evidence, so the overall effect on business is expected to be a reduction in the requirement to be met.

### Other proposals

At the same time as proposing changes to implement the Innovate concept in full, the OGA is proposing a number of other changes aimed at clarifying and updating the Model Clauses and simplifying their administration, to contribute to the principal objective of MER UK.

In particular:

1. Amendments to the Work Programme, where agreed between licensee and the OGA, by Direction, will be implemented promptly by the OGA in writing. This will remove the need for a separate stage in which the OGA drafts a Deed of Variation to the Licence which must then be executed by all the parties to the Licence. Not only does this new approach save time and money – for both the OGA and the licensees – it also removes the risk to licensees that, in spite of OGA agreement to a variation, they will nevertheless lose their licence because it expires before they can all execute the amending deed; and
2. References to definitions in Tax Acts that have been repealed will be updated to refer to the Corporation Tax Act 2010. There is no substantive change in the effect of these references; the amendment is made only to ensure that changes to repealed legislation is replaced by up-to-date references. This change will be made not only for Production Licences, but also for Landward Licences and Gas Storage and Unloading Licences. The Model Clauses for these licences are set out at Schedule 2 to the Petroleum Licensing (Exploration and Production) (Landward Areas) Regulations 2014 and Schedule 1 to the Offshore Gas Storage and Unloading (Licensing) Regulations 2009, respectively.

## **2. Policy objectives and intended effects**

The intended outcome is a Seaward Production Licence that:

- Allows a more flexible, phased approach for the Initial Term Work Programme that grants the licensee an appropriate amount of time to implement his plans (achieved via policy change);
- Provides additional termination provisions during the Initial Term so that the OGA can, in a timelier manner, reoffer acreage where the existing licensee fails to make an agreed amount of progress towards production (to be achieved via amendment of the Model Clauses).

This supports the OGA's principal objective of MER UK by ensuring that the right licences are in the right hands.

### 3. Policy options considered, including alternatives to regulation

Two main policy options were considered:

- Option 1: The 'do nothing' option, not introducing new termination provisions to Model Clauses would prevent the OGA from awarding Licences with longer Initial Terms, because there would be insufficient safeguards against valuable exclusive rights lying unexploited for correspondingly longer periods. This approach was ruled out as it would not achieve the policy objective.
- Option 2: Amend the Model Clauses for Seaward Production Licences in order to introduce a single type of Seaward Production Licence that provides necessary termination provisions in the Initial Term that will allow the OGA to be more flexible regarding the length of that Term. This is the preferred option as it will support the principal objective of MER UK.

### 4. Expected level of business impact

In summary, the policy changes made and the proposed regulations are not expected to lead to any material increase in costs to business. With the aim of contributing towards the principal objective of maximising economic recovery of UK petroleum (MER UK), the policy intent is to provide flexibility regarding the length of the Initial Term for all potential applicants for Seaward Production Licences. This requires additional termination provisions during the Initial Term in order to ensure sufficient safeguards. Other amendments clarify the Model Clauses and simplify their administration.

The proposed amendments to the Model Clauses are relevant only for licences not yet issued. The changes will have no effect on existing licences.

The measure requires regulatory amendments and is therefore a Qualifying Regulatory Provision (QRP) and in scope of the One-in, Three-out rule. However, it is considered reasonable to conclude that it is a zero cost measure i.e. the Equivalent Annual Net Cost to Business (EANDCB) is £Nil for the purposes of scoring under the Business Impact Target (BIT). Therefore, as a 'low-cost', fast-track measure (i.e. gross costs to business of less than £1m per annum) it is considered suitable for a final stage Validation Assessment only.

#### Innovate model proposals

With the aim of contributing towards the principal objective MER UK, the policy intent of the Innovate model is to provide flexibility for all potential applicants for Seaward Production Licences, reducing the burden that is created by the current one-size-fits-all approach.

In particular, the Innovate concept allows for greater flexibility in timings of Initial Term Work Programmes, better suited to accommodate each applicant's individual requirements. For example, an applicant may specify three years for seismic work (Phase B) and two years to drill (Phase C), allowing a five-year Initial Term, rather than a fixed four-year Initial Term which is the current standard.

As a consequence, the cost to business of complying with the licence's requirements are expected to be reduced or stay the same. A licensee must complete its Work Programme during the Initial Term, whose duration until now has been fixed. That may impose costs and risk where the standard duration is too short for the licensee's requirements; either the additional cost of work that must be done faster than is optimal or the risk of relying on the OGA's agreement to an amendment of the licence to accommodate the optimal timescale. The Innovate Licence will from the start have an Initial Term that is expected to be of the right length.

For example, there is a category of applicants whose proposal would be to acquire new seismic data and then choose whether or not the results justify drilling a well. Such applicants would previously have applied for a Traditional Licence, but under the Innovate Model they will propose a Work Programme with a Phase B and a Phase C but no Phase A. The burden on these applicants will be reduced because they will no longer have to demonstrate the

financial or technical capacity to drill a well unless and until they make a commitment to do so. It also reduces the risk that a licensee has to drill a well (with illustrative cost of £30-40m) before they are ready, potentially compromising its value.

The cost to business of preparing and submitting an application for a licence is not expected to change. An applicant must already submit a proposed work programme as part of an application and such a programme already routinely contains timings of its different elements. That is the information that the OGA will need to draft an 'Innovate' Work Programme, so no additional burdens are expected. In order to secure the continuation of a Licence from one Phase to another, the Licensee must submit a written request. The cost of preparing and submitting the written request is not significant. In order to enter Phase C, the Licensee must also provide supporting information to demonstrate its financial and technical capacity. This is not a new requirement. Previously every applicant had to provide it either when applying for a licence or two years later if the licence was a Promote Licence. Under the Innovate concept a licensee will have to provide this information either when applying for a licence or later to enter Phase C. While the words may have changed there is no net change in the requirements on the Licensee.

To accommodate more diverse companies with more diverse plans, the Innovate concept will allow the OGA to offer greater flexibility to licensees in the timings associated with their Work Programmes, but to do so requires greater granularity. Therefore the OGA proposes up to three Phases, with provisions allowing the OGA to terminate the licence at the end of each one if the Licensee has failed to complete the Work Programme associated with it. In fairly exceptional circumstances, the OGA may also include additional deadlines in the Work Programme that do not coincide with the end of a Phase. An amendment of the Model Clauses is therefore also proposed so the licence will terminate if the Licensee fails to meet the agreed intermediate deadline. The OGA will then be able to offer the acreage to other companies. Where a Licensee fails to carry out its agreed Work Programme and the licence terminates, there will be no administrative burden on business; the OGA will write to the Licensee to inform it. It must also be noted that the OGA may use its discretion to provide that the licence will not terminate where appropriate, in accordance with its objective of maximising economic recovery. The proposed changes to the Model Clauses would also allow for phases and deadlines to be extended by notice in response to a request from the Licensee where the Licensee has valid reasons for not being able to meet the original deadlines. Where a licence is terminated, other companies will then have the opportunity to seek a new licence over the acreage thus freed up. As such, it is expected that there would be a benefit to business and society overall from acreage being transferred to companies that are more likely to maximise economic recovery of oil and gas resources.

The flexibility provided by the Innovate model allows an applicant to choose from a range of permutations of timings and Work Programmes, and three of these permutations correspond to the three patterns of licence previously offered (Traditional, Promote and Frontier). The change can therefore be considered as permissive, in the sense that a company that wanted a licence on one of the old patterns will be able to apply for an Innovate Licence of that pattern, and will not be obliged to apply for something different. It is therefore expected that businesses will adopt an alternative timetable or Work Programme under the Innovate model only if they are expected to result in benefits to that business. As it is not possible to monetise the potential benefits, for the purposes of this analysis it is assumed that benefits are at least equal to costs and therefore overall the proposed changes can be considered a zero cost measure (i.e. the EANDCB is estimated as £Nil).

#### Clarification proposals

The other proposed changes are intended to clarify the Model Clauses and simplify their administration so they do not materially impact on business.

The option to amend Work Programmes by notice following a request from the Licensee, without the need for Deeds of Variation, will speed up and simplify the process of amending licences, but the monetary benefit to licensees is not readily quantifiable.

The updating of references to legislation that has been repealed is required in accordance with good practice, but there is no change to policy. There is no expected monetary cost or benefit to licensees from these changes.

#### Familiarisation costs

It is expected that there will be very small administrative burdens for business associated with companies familiarising themselves with the Innovate concept and the increased flexibility afforded to them in proposing Work Programmes. The familiarisation costs relate to the estimated time it would take for a representative in an applicant company to read the amendments that will be made to the licencing guidance document when submitting an application via the OGA's online energy portal. The future cost to business as a whole will in part be determined by the number of companies submitting applications in future licensing rounds. The number of applications in any given round is uncertain as it will depend on the acreage being licenced off and the perceived attractiveness of that acreage to commercial oil and gas companies.

The number of companies involved in applications received is highly variable and unpredictable, and at recent opportunities has ranged from 19 (in the 2016 Supplemental Round) to 104 (in the 28th Round, after a two-year gap since the 27<sup>th</sup> Round). Based on OGA data relating to previous licencing rounds, it is estimated that 50-100 companies may submit an application and will thus need to familiarise themselves with the Innovate concept. Therefore, for the purposes of this analysis a central estimate is assumed that 75 companies on average could submit applications in any single future round - which are assumed to be held annually. It is further assumed that it takes one representative from each company a maximum of 2 hours to read and familiarise themselves with the licencing guidance - of which only a subset will refer to the proposed changes - which at an assumed average wage rate of £31.88 per hour (including a 20.2% uplift for non-wage costs) results in an annual cost to business of £4,782 (2017 prices) ( $2\text{hrs} \times 75 \times £31.88$ ). The resulting NPV over an appraisal period of 10 years is £4,1158 (2017 prices, 2017 present value base year, 3.5% discount rate), and the EANDCB is £4,326 (2014 prices, 2015 present value base year, 3.5% discount rate). In rounding to the nearest £100,000 (EANDCB) for Business Impact Target (BIT) scoring purposes, the calculated score (£21,630) is rounded to £Nil.

It should be noted that the estimated familiarisation costs may overstate the potential administrative burden on business relative to current arrangements. This is because it is considered likely that applicants will read the prevailing guidance document when preparing a submission, regardless of whether any changes have been made since their previous application, assuming the company is not applying for the first time. In addition, while it has been assumed that the costs will be recurring on an annual basis, it is likely that familiarisation with the principles of the new Innovate model will be largely one-off in nature for companies that make repeated applications in licensing rounds.