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Production Licensing on the UK Continental Shelf: Ministerial Powers and Controls

Greg W. Gordon*

INTRODUCTION

This article examines the conditions present in the oil production licenses granted for work on the United Kingdom Continental Shelf (UKCS) from the perspective of the powers given to the state in order to influence or control operational matters—a perspective of particular importance at the moment. Since Margaret Thatcher’s Conservative governments of the 1970s and 1980s implemented the progressive phasing out of direct state participation in the British oil business, the United Kingdom’s approach has been one of “light-handed” regulation.¹ This model places the state in the largely passive role of a permitting authority assessing specific proposals brought to it by the licensees of particular blocks. Assumption of that role does not imply that the state and the industry have not at times worked collaboratively in the development of strategy, nor does it mean that the state hasn’t pursued policies or objectives—for a long time, the state has publicly avowed an interest in maintaining the UKCS as a productive petroleum province for as long as possible.² But the state has not proactively set the agenda for particular developments or assertively “bossed” the industry by requiring it, for example, to develop particular areas collaboratively through the use of a hub strategy. The *Wood Review* now proposes a change in strategy, with the government taking a much more hands-on role in the development and

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1. See generally Sean Rush, *Access to Infrastructure on the UKCS: The Past, the Present and a Future*, MEMERY CRYSTAL LLP (2012), <http://www.memerycrystal.com/uploaded/Articles/other%20files/Access%20to%20Infrastructure%20on%20the%20UKCS%20-%20SR%20-%20Feb%202012.pdf> [<http://perma.cc/RS6F-8GCL>] (the term is used in relation to the Minister’s regulation of third party access to infrastructure, but it is apt to describe the Minister’s approach more generally).

2. See, e.g., PILOT Progressing Partnership Working Group, *infra* note 34 and accompanying text.

regulation of the UKCS.³ The intention is to move beyond the individual, field-specific mindset into one that looks at the UKCS more holistically. The task of considering what new powers might be required to implement the *Wood Review's* proposal should surely begin with a close consideration of the powers that are already possessed, but this matter has hitherto received limited attention.⁴ This paper intends to address that omission, providing an overview of UKCS licensing in Part I and then delving into the specific terms and conditions of UKCS licenses in Part II. This exploration will show that the government is faced with a different set of challenges now as compared to those addressed in the early pioneer days when the current rules were created and that adaptation is imperative to progress.

I. LICENSING ON THE UKCS

A. The License: Historical Development and Character

The offshore British oil and gas production license is a curious creature. The offshore licensing system was hastily created by a government which had little experience with onshore oil and gas activity.⁵ At times the system exhibits eccentricities that hint at a troubled past, but some of its oddities are no more than harmless quirks. One example of the latter is the ineptly named “production license,” which is granted many years before production will commence and, in addition to production, governs most exploratory drillings and appraisal activities.⁶ Other

3. See generally Sir Ian Wood, *UKCS Maximising Recovery Review: Final Report*, WOOD REVIEW, (2014), <http://www.woodreview.co.uk/documents/UKCS%20Maximising%20Recovery%20Review%20FINAL%2072pp%20locked.pdf>.

4. See, e.g., Call For Views On How To Implement The Wood Review Recommendations To Maximise Economic Recovery Of The UK Continental Shelf, DEP'T OF ENERGY AND CLIMATE CHANGE, 20 (November 2014), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/371357/20141105_WR_autumn_document-draft_-_FINAL.pdf [<https://perma.cc/428S-N4UZ>]. There the Department noted that the process of considering what new powers would be required would be carried out “[i]n parallel with . . . a review of the existing powers.” The Department has not yet published the results of any review of existing powers, but the proposed new powers have been published in draft in the Energy Bill 2015-16, available for download from <http://services.parliament.uk/bills/2015-16/energy/documents.html> [<http://perma.cc/6694-B9E3>].

5. T. Daintith, et al., *United Kingdom Oil and Gas Law*, paras. 1-105–1-06 (3rd ed. 2010).

6. A non-exclusive exploration license also exists. Holders of such licenses—who may be oil and gas companies or commercial seismic contractors—receive the right—along with all other holders of such licenses—to shoot seismic and conduct other specified exploration activities anywhere within

peculiarities, such as the legal nature of the license, are more significant. Clearly, the license is not a lease; it is not drafted as such, and, in any event, a lease would not be appropriate under these circumstances. Contrary to the position onshore and within the territorial sea,⁷ the state does not purport to own either the Continental Shelf or the oil and gas in strata beneath it; instead, the state only purports to exercise “sovereign rights” relative to the oil and gas.⁸ But if it is easy to see that a license *is not* a lease, it is more difficult to determine precisely what it *is*.⁹ The license has both regulatory and contractual aspects,¹⁰ but the courts have not yet been called upon to determine whether it is a true legal chimera—simultaneously both a regulatory instrument and a contract—or an essentially regulatory instrument in the form of a contract. This important matter bears on a variety of issues, including the range of remedies that may be available in the event of breach.¹¹ One significant consequence arising from the contractual aspect of the license is that it incorporates the current Model Clauses at the time of its grant to provide its terms and conditions.¹² This characteristic makes it impossible, in the absence of mutual agreement or retroactive legislation,¹³ for the state to alter the terms

the territorial sea or UKCS, subject to a number of conditions, currently stipulated in the Schedule to The Offshore Exploration (Petroleum, and Gas Storage and Unloading) (Model Clauses) Regulations 2009 (SI 2009/2814). The licensee may only enter any area that is already subject to a production license with that licensee-holder’s consent and may not carry out operations so as to interfere unjustifiably with navigation or fishing or with the conservation of the living resources of the sea. This paper will focus upon the production license.

7. This position is also contrary to the position that is taken in relation to the exploitation of the Continental Shelf in other contexts. A person wishing to develop an offshore windfarm upon the Continental Shelf must obtain both a license from the regulator and a lease from the Crown Estate, who—in this context—seek to exercise what seem to be rights of ownership over the UKCS.

8. United Nations Convention on the Continental Shelf, art. 2.1, Jun. 10, 1964, 7302 U.N.T.S. 499 (the same right conferred upon the state by international law); *See also* United Nations Convention on the Law of the Sea, art. 77, Dec. 10, 1982, 1833 U.N.T.S. 397.

9. *See, e.g.*, the discussion in Daintith, *supra* note 5, para 1-323.

10. The form is contractual, insofar as both parties sign it and consideration passes, but the effect is regulatory insofar as it one-sidedly imposes obligations on the licensee while conferring a range of powers on the relevant government Minister.

11. *See* discussion *infra* Part. I.C.

12. The principal conditions which the Minister imposes on licensees are to be found in Model Clauses which section 4(1)(e) of the Petroleum Act 1998 provides shall be prescribed by Regulation incorporated into all petroleum licenses.

13. Retroactive legislation is rare, but for a striking example see discussion *infra* Part I.D; *See also* Greg Gordon, *Petroleum Licensing*, in *OIL AND GAS LAW: CURRENT ISSUES AND EMERGING TRENDS* 65 (Greg Gordon et al. eds., 2d ed. 2011).

of an individual license,¹⁴ a factor that has acted as a barrier to across-the-board reform and added considerably to the complexity of the system.¹⁵ In this regard, the UKCS's upstream licensing regime lacks the flexibility inherent in some other systems which use a purely administrative licensing model.¹⁶

B. Licensing and Regulation on the UKCS

Before considering the license conditions in detail, it is worth outlining some of the essential features of the production license and the broader system of governance of which it forms a part.

In the United Kingdom, licenses are not allocated by means of cash premium bid, with the highest cash bidder winning the acreage.¹⁷ Instead, when there is competition for the same acreage, the Minister of State for the Department of Energy and Climate Change (the Minister) will ordinarily grant the license area to the licensee or group of licensees proposing to conduct the more onerous work program in the initial term of the license. Although the license refers to "licensee" in the singular—a convention that shall be followed in this paper—it is common on the UKCS, as elsewhere, for the license to be obtained by a group of co-venturers. As far as the state is concerned, these co-venturers will be jointly and severally liable for any breaches of license conditions.¹⁸

14. *Oil and Gas Petroleum Licensing Guidance*, OIL AND GAS AUTHORITY, <https://www.gov.uk/oil-and-gas-petroleum-licensing-guidance#legislative-background> [<https://perma.cc/5KVH-NL76>] (last updated Jan. 28, 2015) (DECC's Guidance recognizes that "Model Clauses attached to existing licenses are not affected by the issue of subsequent sets of Model Clauses, except through specifically retrospective measures.").

15. There have been many occasions when changes have been made to the Model Clauses in order to address a particular problem. In the absence of rarely seen, and politically difficult primary legislation having retroactive effect, these changes will take effect only for licenses granted after the Model Clauses have been changed. This leaves many "historic legacy" licenses continuing to run, often for years after the issue was identified, in which the problem is not resolved. See *infra* part II.A.

16. Retrospective change is possible in, for instance, the Norwegian system, at least for some types of condition: Daintith, *supra* note 5, para 1-323.

17. Some particularly promising acreage in the fourth, eighth and ninth rounds were offered in this way, but the sums raised were disappointing and the United Kingdom did not preserve with this method. See *Oil And Gas: licensing rounds*, OIL & GAS AUTHORITY (Jan. 22, 2013), <https://www.gov.uk/oil-and-gas-licensing-rounds> [<https://perma.cc/9BYY-E9CM>], for the table available under the heading "Past Licensing Rounds."

18. The Petroleum Licensing (Production) (Seaward Areas) Regulations 2008, S.I. 2008/225, art. 1, ¶ 2 (U.K.) ("Any obligations which are to be observed and performed by the Licensee shall at any time at which the Licensee is more than one person be joint and several obligations.").

However, as between themselves, the co-venturers will use the Joint Operating Agreement (JOA) pertaining to the licensed area as a means of apportioning their liabilities, generally in accordance with each party's percentage interest in the asset.¹⁹

The production license is the means by which exclusive rights to “search and bore for and get”²⁰ petroleum within a certain area is given to the licensee. As noted, *supra*, the state claims rights in relation to oil and gas in its natural condition in strata, and hitherto the license has been granted by the Minister.²¹ While formal disputes between the Minister and licensees have been rare, the license stipulates arbitration as the means of resolving disputes that do arise, except where they relate to a matter “determined, decided, directed, approved or consented” by the Minister. The latter category of disputes—all of which could be characterized as disagreements about the manner in which the Minister has exercised his administrative function—may not be arbitrated. However, such matters would seem to be susceptible to judicial review before the courts.

C. The Licensee's Duties and Sanctions for Breach

Prior to obtaining a license, the licensee must show to the Minister's satisfaction that it has the financial and technical capability to undertake both the operations in contemplation and any environmental remediation measures that may be required in the event that such operations go wrong. A company that fails to carry out work that it has undertaken to conduct in its initial work program, such as the drilling of exploration wells, will have its license brought to an end at the initial period, unless the failure has occurred for good reason. Beyond that result, it would seem that the

19. See Scott Styles, *Joint Operating Agreements*, in OIL AND GAS LAW: CURRENT PRACTICE AND EMERGING TRENDS 359 (Greg Gordon, et al. eds., 2d ed. 2011).

20. Petroleum (Production) Act 1934, 24 & 25 Geo. 5, c. 36 (Eng.); Petroleum Act, 1998, c. 17, § 3(1) (U.K.) (this wording, which appeared in the Petroleum (Production) Act and was repeated in the Petroleum Act, is mirrored in the Model Clause entitled “Grant of License”; currently Model Clause 2).

21. The particular department responsible for licensing has changed repeatedly over the last twenty years or so. At various points, this function has been exercised by the Department of Energy, the Department of Trade and Industry, and the Department for Business, Enterprise and Regulatory Reform. At the time of writing (May 2015), some administrative functions are in the process of being transferred to the Oil and Gas Authority (OGA), a new, industry-funded regulator established in partial implementation of the reforms recommended in the *Wood Review*. As the precise detail of the relationship between the OGA and DECC has yet to be determined, reference throughout this piece will continue to be made to the Minister, although it may well be that many of the functions discussed will shortly come to be undertaken by the OGA.

licensee will suffer no immediate penalty—the Minister will not have sought a deposit or performance bond as security against the undertaking of the work in advance, despite the fact that the state stands to suffer adverse consequences if the promised works are not timely carried out.²² The contractual aspect of the license would suggest that an action could conceivably lie in the law of contract in the event of such breach.²³ However, it has not been the Minister's practice to seek damages in such instances. Beyond revocation of the license for breach, the only "remedy" which the state asserts is the legal right to discriminate in the future allocation of petroleum licenses against any applicant who has previously shown "a lack of efficiency and responsibility" in operations under a prior license.²⁴ Historically, this consequence has been seen as a powerful incentive to comply with Ministerial requests and meet license obligations,²⁵ and it may continue to be an inducement for at least some industry players. But as the UKCS becomes more mature, the licensees active within the province increase in number and become more diverse. It cannot be assumed that all oil companies currently active within the province will be interested in acquiring new licenses; some may be happy to produce from existing assets and then exit the UKCS. Some may also take the view that—with the majors realigning their asset base on the UKCS and becoming increasingly disinterested in obtaining new assets, at least within the mature areas of the province—threats by the British government are not credible; it may be grateful to secure such investment as it is offered.

Other license breaches raise similar problems. Revoking a license would appear to be a wholly disproportionate response to, for instance, a licensee inadvertently neglecting to appoint a fisheries liaison officer for a short period of time after the person previously holding that role left the

22. A failure to timeously carry out work will have the effect of delaying the time when potentially useful field data will be provided to the Minister and deferring, perhaps by years, if the license is revoked and the acreage recycled through a future licensing round, the point when production—and tax revenue on the profits thereof—will commence.

23. See Greg Gordon, *Oil, Water and Law Don't Mix: Environmental Liability For Offshore Oil and Gas Operations in the UK: Part 1: Liability In The Law Of Tort/Delict and Under the Petroleum License*, 25 EVTL. L. & MGMT. 3, 10 (2013), for further information.

24. This rule was initially part of domestic law but later confirmed at European Union level. See Council Directive 94/22, Conditions for Granting and Using Authorizations for the Prospection, Exploration and Production of Hydrocarbons, 1994 O.J. (L 164) (EC).

25. See Greg Gordon & John Paterson, *Mature Province Initiatives*, in OIL AND GAS LAW: CURRENT PRACTICE AND EMERGING TRENDS 128–29 (Greg Gordon, et al. eds., 2d ed. 2011).

licensee's employment.²⁶ Even if the Minister were minded to pursue such a matter under contract, he would seem to have no prospect of success, as he would not be able to demonstrate that he had suffered a loss as a result of the breach.

According to the government, the absence of a graduated scheme of sanctions for breaches of license conditions poses a potential problem in the context of implementation of the *Wood Review*. The government has consulted on the possibility of introducing an improvement notice and financial penalty system to assist the new Oil and Gas Authority in implementing its strategy to maximize overall economic recovery of oil and gas from the UKCS. It has also stated its intention to introduce a graduated sanctions system to that further that end.²⁷

II. LICENSE TERMS AND CONDITIONS

Having introduced the framework and setting within which license conditions operate, the time has come to examine the conditions themselves. This article primarily focuses on the license conditions that directly or indirectly provide the Minister with some degree of control or influence over operations.

A. Term Structure and Relinquishment

The term structure and relinquishment provisions particularly weakened the first generation of British production licenses. These licenses, granted in the first four licensing rounds between 1964 and 1972, pertained to some of the most prospective areas of the UKCS. However, at the time, only two terms comprised the license: an initial term of six years and a production period of forty years. The license contained limited relinquishment provisions and, as we shall see below, little in the way of other provisions that would allow the government to proactively force the pace of development. Instead, the state was cast in a more passive role, restricted to approving or rejecting specific proposals submitted by the oil companies. This approach was rooted in the belief that the industry's own commercial self-interest would lead to timely and efficient exploitation of assets. As Daintith has observed, "the idea that licensees might make significant discoveries but then not develop them does not appear to have

26. This obligation is contained in Model Clause 45.

27. *Implementing the Wood Review Recommendations*, DEP'T OF ENERGY & CLIMATE CHANGE, 20–23 (2015), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/414444/Call_for_Evidence_Govt_Response-FINAL_120315.pdf [<https://perma.cc/ADZ9-8GKG>]. See Energy Bill, 2015-16, H.L. Bill [62] cl. 41 (Gr. Brit.).

occurred to those who first drafted the offshore licensing arrangements.”²⁸ This fact is hardly surprising—such behavior would at first sight seem to be counter-intuitive. But in fact there are a number of reasons why an oil company might choose not to develop particular discoveries. Oil companies need access to oil—not just for development in the here and now, but for the purposes of forward planning. Not all of a company’s portfolio of assets can be developed simultaneously, and acreage in a geopolitically stable state—as the United Kingdom has historically been perceived to be²⁹—is perhaps more likely to be obtained but not immediately developed as compared to acreage in less stable provinces, where the need to press on with production quickly might seem to be more urgent.

The design of the system of direct state take from oil and gas operations also rendered the UKCS unusually susceptible to this sort of behavior. As has already been noted, no cash premium is paid in order to obtain the license,³⁰ and area rentals are low, particularly in the early years of the license. State take initially took the form of a royalty and taxation of the profits of production—both of which, of course, are payable only when the development enters into the production phase. The UKCS is, therefore, a relatively cheap province in which to “stockpile” acreage. If the fiscal system does not effectively discourage such behavior, then the term structure and relinquishment obligations contained in the license take on a particular importance.

Between 1972 and 2002, the Government experimented with various term structures, offering up a variety of two-,³¹ three-³² and even four-term

28. Terence Daintith, *Discretion in the Administration of Offshore Oil and Gas – A Comparative Study*, 4 OIL GAS & ENERGY L. 176, para 4104 (2006).

29. In fiscal terms, it has been particularly unstable, with tax rates changing frequently, sometimes with no or no adequate consultation with the industry. *See, e.g.*, Emre Üşenmez, *The UKCS Fiscal Regime*, in OIL AND GAS LAW: CURRENT PRACTICE AND EMERGING TRENDS 137 (Greg Gordon et al. eds., 2d ed. 2011).

30. The rationale for this is that demanding cash upfront diverts to the state money that would otherwise be used for exploration and production activities. There is logic in this, but if such payments are being made in other jurisdictions, a company may well be inclined to prioritize the development of the assets that it has already paid good money for than those that it obtained without up-front capital investment. That said, the amounts raised when this method was utilized in the fourth, eighth and ninth rounds were not considered sufficient to justify an ongoing use of this method.

31. *See* OIL & GAS AUTHORITY, *supra* note 17 (for a useful summary of the position.) The seventh to tenth offshore rounds were offered with a six-year initial period and 30-year production period.

32. Licenses granted in the fifth and sixth rounds, for instance, had an initial term of four years, a second term of three years and a production period of 30 years. Petroleum (Production) Regulations 1976, S.I. 1976/1129 (U.K.). There was no relinquishment requirement until the expiry of the second term, at which

licenses³³ with a number of different acreage surrender provisions. However, none of these models were entirely satisfactory. In the early 2000s, the joint industry and government organization PILOT Progressing Partnership Working Group (PILOT PPWG) assessed the state of the regulatory regime in the UKCS, concluding that lengthy initial and second terms and lax relinquishment requirements were among the factors contributing to “an environment where there is too little pressure on licensees to deliver value from their licenses” and in which “decisions on marginal or high-risk economic activities, or divestment [could] be repeatedly deferred.”³⁴ PILOT PPWG’s recommendations³⁵ led to the introduction, in 2002, of the three-term structure used in standard production licenses today.³⁶

The current production license commences with a four-year initial term during which the licensee must complete the work program it promised to undertake in its application. The activities described in the work program will vary from license to license, but are essentially concerned with exploration and appraisal.³⁷ The licensee must also surrender no less than one half of the licensed area back to the government. There is no strict obligation upon the licensee to carry out a full and comprehensive survey and appraisal of its block, but the surrender requirement is intended as an indirect incentive for the licensee to learn as much as possible about the block before the end of the initial term—a

point no less than two-thirds of the initially-licensed area had to be surrendered. *Id.* Licenses granted in the eleventh and twelfth rounds, by contrast, under the Petroleum (Production) (Seaward Areas) Regulations, 1988 had an initial term of six years, a second term of 12 years and a production period of 18 years. Petroleum (Production) (Seaward Areas) Regulations 1988, S.I. 1988/1213 (U.K.). The licensee was obliged to relinquish one-half of the license at the end of the initial period; there were no further relinquishment provisions. *Id.*

33. Licenses granted in the seventeenth round for instance, had an initial term of three years, a second term of six years, a third term of 15 years and a production period of 24 years: 1988 Model Clauses, as amended by The Petroleum (Production) (Seaward Areas)(Amendment) Regulations 1996 (SI 1996/2946) Reg 8. The amount of acreage that the licensee was required to relinquish varied depending on the amount of exploration work undertaken; the more wells drilled, the more acreage could be retained.

34. *The Work of the Progressing Partnership Work Group*, PILOT PROGRESSING PARTNERSHIP WORKING GROUP 2002, 7, available at <http://webarchive.nationalarchives.gov.uk/20101227132010/http://www.pilottaskforce.co.uk/files/workgroup/422.doc> (Other factors identified were the lack of exploration obligations beyond the initial license term and low area rentals. *See id.* at 8).

35. *Id.* at 9.

36. *See* OIL & GAS AUTHORITY, *supra* note 14.

37. Companies may, for instance, make a firm commitment to drill a certain number of wells, or make the undertaking to drill contingent upon the results of a specified form of seismic survey.

company would not wish to retain the “wrong half” of the block as a result of ignorance as to which part had greater prospective potential.

The second term of the standard production license also lasts for four years. The primary purpose of this term is to enable the licensee to formulate a field development and production program, which must be submitted to the government and approved before the end of the period in order for the license to continue into its third term. At the end of the second term, the licensee must relinquish all areas of the license not comprising the producing part.³⁸ A production period lasting eighteen years will then follow.

Thus, by the time that eight years have elapsed, the licensee will have explored and appraised the license area, will have produced a field development and a production plan, and will have been required to relinquish the overwhelming majority of the area initially granted under the license. The holder of a modern production license is therefore placed under significantly more pressure to explore and commence production than was the case before the new term structure was introduced in 2002. However, it should be recognized that many pre-2002 licenses containing different term structures continue to be valid³⁹—a factor which contributed to the introduction of the Fallow Areas Initiative, discussed further at section II.D, below.

B. Variant License Forms: The Promote License and The Frontier License

The standard production license is no longer the only production license available on the UKCS. Following consultation with industry experts, two variations on the standard production license were introduced in the early 2000s: the promote license and the frontier license.

The promote license was introduced to make obtaining licenses easier for small companies that may possess considerable geo-technical ability but only limited financial resources and technical capacity, to obtain licenses.⁴⁰ These types of companies present the government with both an opportunity and a challenge. The opportunity lies in unlocking the knowledge and skills held by the individuals who make them up. Many such companies are either formed by or employ persons who previously held senior positions in more established companies; they are aware of

38. I.e. the area to which the field development and production program pertains.

39. See *License Data*, DEP'T OF ENERGY & CLIMATE CHANGE, https://og.decc.gov.uk/information/license_reports/offshorebylicense.html [<https://perma.cc/P629-RUYS>] (last visited Aug. 22, 2015). All licenses from P1034 backwards pre-date the 2002 reforms. Around 280 such licenses appear to still be extant, including P1, the first production license to be granted on the UKCS.

40. See Gordon, *supra* note 13, for further information.

plays that were not taken up by their former employer that the have potential for current or future development.⁴¹ The government seeks to attract such players by offering significant discounts to the usual acreage rental.⁴²

The challenge lies in facilitating the entry of small companies without exposing workers, the environment and other industry players to excessive risk.⁴³ The dangers inherent in permitting such companies to obtain a license are mitigated by the term structure of the license. The initial term and its associated work obligation are divided into Parts I and II. Part I lasts two years, during which time the work obligation will normally be to carry out desk-based work on existing data. During this time, the licensee is not required to satisfy the usual technical and financial capability requirements—a position which can be justified because the licensee is not, at this stage, carrying out physical operations offshore. The technical and financial capability requirement does not need to be satisfied until Part II of the work program is reached. By this time, the promote licensee needs to either acquire the requisite technical and financial capacity itself or—what is more often the case in practice—to attract a purchaser, or one or more co-venturers, possessing that capacity by ensuring that work undertaken in Part I of the program is sufficiently complete. If, by either of these routes, the licensee succeeds in demonstrating technical and financial capability, the license will effectively convert into a standard production license. If not, the license will fail at the end of Part I of the initial term.

By comparison, the frontier license was introduced in 2004 and restructured in 2008. It was initially designed, again in consultation⁴⁴ with industry leaders, to facilitate the exploration and development of the area

41. There are many reasons why this might be so. Perhaps the modest scale of the development meant that it was not an attractive proposition for a major company, but is viable for a smaller player with smaller overheads and different expectations as to what constitutes an acceptable rate of return; or perhaps technological advances make the play technically feasible now when it previously was not.

42. It abates the area rental fee by ninety percent for the first two years of the license.

43. Workers and the environment could potentially be endangered if companies lacking technical capacity were to be granted a license, a fact both by the United Kingdom's government in the design of the promote license and by the EU in the provisions relating to capacity contained within the Offshore Safety Directive: Directive 2013/30, art. 4, 2013 O.J. (L 178) 66 (EU). Other industry players—whether oil companies or contractors—could face an increased chance of losses associated with default on the JOA or insolvency events, in the event that companies with a weaker financial covenant are permitted to enter the marketplace, although arguably this is an ordinary commercial risk against which they should take appropriate measures to protect themselves.

44. See Gordon, *supra* note 13, for further information.

west of Shetland, which has historically been less attractive to the industry due to its deeper water, difficult geology, and lack of infrastructure. The license is based on the rationale that oil companies⁴⁵ will value the opportunity to gain exclusive rights to explore relatively large frontier areas, but that they will need longer than the standard four years in order to conduct such work. Two forms of frontier license now exist: one features a six-year initial term followed by a six-year second term and an eighteen-year production period, while the other has a nine-year initial term but is otherwise identical to the six-year variant. The latter form is available only for the Atlantic margin area lying to the west of the Outer Hebrides—an area which has hitherto seen virtually no investment, and which might be described as the new frontier.⁴⁶ For both, area rental charges are significantly abated, but only for the first two years of the license. The *quid pro quo* for these benefits is a significant increase in the usual surrender obligation: the licensee must relinquish seven-eighths of the initial acreage at the end of the initial period. The frontier license is therefore granted over a very large area for a reasonably general initial period, permitting oil companies exclusivity over a large frontier area. These companies will be encouraged to take on these challenges insofar as they are allowed to obtain the exclusive right to a very large area, to explore it for a longer period and to pay a lower rental than would be the case with a traditional license.

The promote and frontier variants of the production license are generally regarded as success stories. Since the variant forms' introduction, over three hundred promote licenses have been awarded, and although the number of frontier licenses granted is much lower,⁴⁷ the acreage granted under these licenses is large. As a result, much of the area to the west of Shetland is either currently under license or has been licensed and relinquished at least once.

45. Historically, it is the majors who have shown most interest in the frontier area, but independents are now also starting to obtain operatorship in such licenses. For instance, Aberdeen-based independent Parkmead obtained frontier acreage West of Shetland in West of the Hebrides in the twenty-seventh round. See Mark Williamson, *Significant Gas Find for Parkmead Group*, THE HERALD (Sept. 24, 2014), http://www.heraldsotland.com/business/13181667.Significant_gas_find_for_Parkmead_Group/ [<http://perma.cc/X3PG-JKHX>].

46. "Frontier" is an increasingly misleading term to apply to the west of Shetland area. Although still under-developed relative to the mature North Sea area, the west of Shetland has now seen significant investment. Even a cursory examination of the field development map available on DECC's website discloses that much of the area is now licensed and that a network is now beginning to accumulate; See *UKCS Offshore Infrastructure*, Oil & Gas Authority, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/431078/UKCS_Offshore_Infrastructure.pdf [<https://perma.cc/3DZD-ACQJ>], for a map of the area. The west of Hebrides area is highly underdeveloped by comparison.

47. 33, by the present author's calculations.

C. Ministerial Power to Extend License Periods

The production licenses granted in the UKCS's early licensing rounds did not contain any provision expressly empowering the Secretary of State to extend such licenses when they reached the end of their term. In practice, however, the Secretary of State has been prepared to permit such licenses to continue, so long as the field continues to be productive,⁴⁸ and, given the broad discretionary powers conferred upon the Secretary of State by the Petroleum Acts, it would seem to be competent for him to extend licenses. Thus far, such extensions have generally been granted on a year-by-year basis by means of the issue of a side-letter to the license. A provision expressly empowering the Minister to extend the license beyond the end of the initially stipulated production period was not included in the Model Clauses until 1988,⁴⁹ but it has been included without amendment in all subsequent sets of Model Clauses.⁵⁰ The Minister is not obliged to offer the extension on the same terms and conditions as existed prior to the extension.

The power is essentially in the form of a renegotiation clause. It states that the Minister "may in his discretion agree with the Licensee" that the license shall continue in force "for such further period as the Minister and the Licensee may agree and subject to such modification of the terms and conditions of this license . . . as the Minister and the Licensee may then agree is appropriate."⁵¹ Theoretically, this provides the Minister with a useful window of opportunity in which to alter the terms on which the license is to be held; something he might do in order to facilitate a change in policy or to plug any lacunae that may have come to light since the original license was granted. This approach, however, has not been adopted by the Minister to date.

It is not just at the end of the license that extra time may be required. Factors such as over-runs in exploratory drilling operations may mean that the licensee requires extra time at the end of the initial term in order to complete the work program, while disagreements between the JOA co-venturers as to the optimal means of field development could delay the preparation of a production plan. Only in 2008 was a provision incorporated into the then-current Model Clauses expressly permitting an extension to the initial or second term.⁵² The provision has been repeated in all subsequent licensing rounds⁵³ and is markedly different from the one

48. See OIL AND GAS AUTHORITY, *supra* note 14.

49. Petroleum Regulations 1988, *supra* note 32, Model cl. 6.

50. See, e.g., Petroleum Regulations 2008, *supra* note 18, Model cl. 9.

51. *Id.*

52. Petroleum Regulations 2008, *supra* note 18, Model cl.7.

53. I.e., from the 25th round onwards.

governing extensions of time at the end of the license's production period. It does not extend the overall life of the license, but instead essentially envisages the licensee shifting time from one license term to another—borrowing from the second term in order to allow it time to complete the initial term's work program, or using up time from the production period to allow it to finalize the field development and production plan.⁵⁴ Neither the duration nor the conditions of the extension are a matter available for negotiation; the licensee applies for an extension of time and the application is determined by the Minister in such a manner as he may, in his discretion, see fit.⁵⁵ For instance, this provision was used to extend the deadline for the Field Development Plan in the Fyne field from June 2012 to August 2014 when, due to a proposed increase in costs, the operator decided not to proceed with its initial development concept of using an FPSO and sought additional time to work up an alternative program using a different production method. In that case, however, further application by the field's operators was rejected, leading to relinquishment of the field.⁵⁶

Thus, while the United Kingdom license contains no force majeure clause, a licensee who suffers a force majeure-type event that prevents it from timely carrying out its work program or submitting its field development plan would be well advised and entitled to make an application for additional time.⁵⁷ Indeed, the Fyne case illustrates that, although the Minister's patience is not limitless, Ministerial discretion might—at least initially—be exercised in the licensee's favor in circumstances falling short of what would be required to satisfy some force majeure provisions.

D. Ministerial Oversight and Powers to Direct the Licensee's activities

The term structure and relinquishment provisions discussed above provide the Minister with opportunities to direct and control the licensee to some extent. The need to satisfy certain criteria before the license may progress from one term to another—in particular the need to satisfy the Minister that the work program has been satisfactorily completed and a satisfactory field development plan produced—provide obvious checkpoints along the road to the development of a particular field.

54. Petroleum Regulations 2008, *supra* note 18, Model cl.7(6).

55. *Id.* at Model cl. 7(3) & 7(4).

56. *Fyne Area*, ANTRIM ENERGY INC., <http://www.antrimenergy.com/operations/fyne> [<http://perma.cc/9EWF-N93A>] (last visited Aug. 22, 2015).

57. The Model Clause 7 procedure is only available for licenses granted after 2008, but an appeal to the Minister's general discretion could potentially be made where the situation arose in a license granted prior to that date.

However, limits constrain that which can be achieved by a checkpoint system. Once the license has passed into the production period, the licensee is in the final phase; all of the checkpoints have been passed. So if, in the production period, the licensee—while operating the asset in accordance with the approved field development and production plan—is unwilling or unable to take further steps that would allow it make optimal use of its asset,⁵⁸ the term structure can do nothing to influence the licensee's behavior. In any event, even before the license enters into the production period, a model relying solely upon multiple terms and relinquishment would provide a fairly unsophisticated system. There may be a number of actions, not directly pertaining to the work program or feeding into the production of an acceptable field development plan, that the Minister would still wish the licensee to take because they are good in themselves.

The question then arises: what other provisions vest in the Minister the power to proactively demand that the licensee undertake certain operations? Under the licenses granted in the first four licensing rounds, the answer is “very little.” Those licenses provided—and still provide—the Minister with the right to regular returns of information, including statements of “all geological work, including surveys and tests, which has been carried out and the areas in which and the persons by whom the work has been carried out”⁵⁹ and “any petroleum, water, mines or workable seams of coal or other minerals encountered in the course of the said operations.”⁶⁰ This is a valuable provision, but data about operations does not equate to power to influence them. The Minister also had—and has—various powers to approve the licensee's proposals for key operations; the licensee, for instance, cannot drill a well without Ministerial consent.⁶¹ These provisions, too, are valuable, allowing the Minister an opportunity to exercise control and oversight of specific, planned operations. However, they cast the Minister in a passive role, awaiting the submission of documents prior to giving or withholding consent. Model Clause 21, entitled “Avoidance of Harmful Methods of Working,” imposed upon the

58. Perhaps this unwillingness or inability to make optimal use of the asset is because there is deadlock in the JOA over whether a particular EOR technique is justified, or perhaps simply because the license group cannot access sufficient capital to afford the technique.

59. The 1966 Model Clauses, MC 29(1)(a); the equivalent right is now contained in the 2008 Model Clauses, MC 30(1)(a). Petroleum Regulations 2008, *supra* note 18, Model cl. 30(1)(a).

60. The 1966 Model Clauses, MC 29(1)(d); the equivalent right is now contained in the 2008 Model Clauses, MC 30(1)(d). Petroleum Regulations 2008, *supra* note 18, Model cl. 3(1)(d).

61. The 1966 Model Clauses MC 17; *see also* Petroleum Regulations 2008, *supra* note 18, Model cl.19.

licensee an obligation to “execute all operations in or in connection with the licensed area in a proper and workmanlike manner in accordance with methods and practice customarily used in good oilfield practice.”⁶² However, any argument that this provision could be used as the foundation for a Ministerial right to demand that a licensee undertake particular actions would be weak. When seen in the context of its broader setting,⁶³ this provision appears to be directed towards the standard by which such operations undertaken will be performed—not the strategy dictating which particular operations will be undertaken and when.

So deficient did the Labour Government of 1975 consider the licenses to be at preserving the state’s interest in directing operations that it passed primary legislation that retroactively introduced a new suite of Model Clauses into all licenses then existing.⁶⁴ The Model Clauses introduced provided the Minister with significant rights relative to both exploration and production, and they have been included in every license granted since.⁶⁵

Model Clause 16 pertains to exploration activities. It provides that, not only is the licensee obliged during the initial term to undertake the activities in the initial work program stipulated at the point of the license’s grant, but that the Minister is entitled, at any time before the end of the license, to demand that the licensee provide it with an “appropriate work program.”⁶⁶ An appropriate work program is one that would be prepared by a licensee seeking to exploit its license rights to the best commercial advantage, unconstrained by a lack of either competence or resources. The only limitation envisaged is that the program must be one that the licensee could reasonably be expected to complete before the end of the license period.⁶⁷ This Clause embodies “an important and powerful provision”⁶⁸ that effectively means that the Minister is entitled to demand that the

62. The 1966 Model Clauses MC 21(1); *see also* Petroleum Regulations 2008, *supra* note 18, Model cl. 23(1).

63. The 1966 Model Clauses MC 21 is principally concerned with safety and preventing the escape of oil; *see also* Petroleum Regulations 2008, *supra* note 18, Model cl. 23.

64. Petroleum and Submarine Pipelines Act 1975, §§ 17–18 (U.K.). This was a controversial measure, not least of all as the Government provided no compensation, refusing to accept the argument that a license containing this somewhat greater level of state control was less commercially valuable than one giving the licensee a freer hand. Parliamentary debate was heated; *see, eg.*, 891 Parl Deb HC (5th ser.) (1975) cols. 486 & 503; Standing Committee D, Official Report, (1974-5), H.C. Vol V, cols. 1106 & 1146–72.

65. In discussing these provisions, reference will be made to the numbering in the current set of the Model Clauses. *See*, 2008 Model Clauses.

66. Petroleum Regulations 2008, *supra* note 18, Model cl. 16(2).

67. *Id.*

68. Gordon, *supra* note 13, para 4.46.

licensee carry out fresh exploration activities within the licensed area long after the initial term of the license. It formed the principal legal underpinning to the Fallow Blocks Initiative, one of the principal means by which the Minister sought to bring to an end the industry practice of accumulating acreage without expeditiously exploring it.⁶⁹

Production issues are addressed in Model Clauses 17 and 18. Model Clause 18 provides the Minister with a mechanism to place a limit on the rate of production from the licensed area. To modern eyes, the focus on the Minister's right to limit production seems peculiar; however, the provision was drafted in the pioneering phase of the industry when politicians were concerned by the fear that the United Kingdom's national interests would not be well served if international oil companies could produce all of the nation's oil within a very concentrated timeframe.⁷⁰

Of greater relevance today is Model Clause 17. This provision forbids the licensee from producing oil in contravention of an approved field development and production program without first obtaining written Ministerial consent. The wording of Model Clause 17 differs markedly from that of Model Clause 16, in that the rights it confers on the Minister are more tightly circumscribed. The Minister's grounds for rejecting the program are limited to only two possibilities: that the program is contrary to good oilfield practice, or that the maximum or minimum production level proposed in the program is not in the national interest. This may have serious implications for the implementation of the *Wood Review's* recommendations relative to collaborative working.⁷¹ Can the regulator refuse to consent to a field development and production plan, when the plan is a perfectly sensible means of developing the individual field, but is not in conformity with the regulator's desire to see licensees work together collaboratively to maximize overall recovery from the broader geographical area of which the field forms part? Is the term good oilfield practice specifically elastic to accommodate this? This must be doubted. As has already been noted, the term is directed primarily towards safety and the prevention of leaks. But assuming it can be extended sufficiently far to embrace matters such as efficiency, it is drawn at the level of the individual field. And, if what the licensee proposes is a perfectly sensible and responsible means of developing its oilfield, it is hard to see how that could be refused. If the regulator purported to do so, the refusal would

69. See Greg Gordon & John Paterson, *Mature Province Initiatives*, in OIL AND GAS LAW: CURRENT ISSUES AND EMERGING TRENDS 111, paras 5.12-22 (Greg Gordon et al. eds., 2d ed. 2011), for further discussion of the fallow blocks initiative.

70. See ALEX KEMP, *THE OFFICIAL HISTORY OF NORTH SEA OIL AND GAS, VOLUME 1: THE GROWING DOMINANCE OF THE STATE* 349, 351-52 (Routledge, 2012).

71. Wood, *supra* note 3, at 12.

really be on the basis of what one might term “good and collaborative oil province practice,” not “good oilfield practice.” Neither is the production level criterion a secure foundation for such a refusal. There may be nothing at all wrong with the production level that the licensee proposes; the problem may be that a different mode of working, such as a hub development, might permit *other licensees* to produce more, or at lower cost.

The drafting of Model Clause 17 is also less clearly expressed than that of Model Clause 16. The language has shades of the passivity already identified as existing elsewhere in the system. As Daintith notes, “the drafting of [Model Clause 17] assumes that the licensee, not the Minister, initiates the development process, and is not well designed to compel development.”⁷² This contention carries some force: Model Clause 17(2) states that it is for the licensee to prepare the program and submit it to the Minister. However, the Minister enjoys at least some power to direct the licensee—Model Clause 17(2) also provides that the program must be “in such form and by such time and in respect of such period during the term of this license as the Minister may direct.” Although far less clear than the right conferred in Model Clause 16, this provision gives at least some grounds for arguing that the Minister is entitled to demand—through the issue of a direction—the submission of a program.

If that is the case, however, a further issue warrants consideration. Model Clause 17(3) provides that the Minister may direct the licensee to prepare different programs relative to different areas of the license, or alternatively that the program cover a particular period in the license only, in which case the Minister may issue subsequent directions in relation to other time periods. But what if the Minister does not do this, and instead approves a generalized program covering the whole of the production area for the remaining term of the license, only later coming to realize that the approved program is deficient? Model Clause 17(3) would seem to suggest that the Minister would, in those circumstances, be barred from demanding an updated program. If so, this scenario would seem to seriously curtail the usefulness of Model Clause 17 as a means of exercising Ministerial control over production. And, given that Model Clause 17 is a major element of both the Fallow Discoveries and the Stewardship programs⁷³—the two principal means by which the Minister presently seeks to improve productivity on the UKCS—this result must be a cause for concern.

72. Daintith, *supra* note 28, para 4311.

73. For a further discussion of these initiatives, see Gordon & Paterson *supra* note 69, paras 5.23–5.49.

E. Unitization

As we have already seen, some aspects of the United Kingdom's offshore licensing regime have changed markedly over time. One feature that has remained constant throughout the offshore era is the Minister's right to demand the unitization of reservoirs that lie within more than one licensed area.⁷⁴

The relevant Model Clause empowers the Minister, at any time when the license is in force, to serve a notice upon the licensee, demanding that it cooperate with the licensees of the other parts of the shared oilfield.⁷⁵ The unitization provision therefore cannot be used as a means of compelling hub developments or some of the other species of collaborative work envisaged by the *Wood Review* involving geographical proximity but not shared geology.⁷⁶ But, while a shared field is a necessary condition for the Minister's use of the power, it is not on its own a sufficient condition. Before the Minister can serve a notice demanding production of a unit development plan, he must also be satisfied that other parts of the "single geological petroleum structure or petroleum field"⁷⁷ lie beneath the areas of other production licenses then in force⁷⁸ and that the field be developed by all interested licensees collectively, as a unit as "it is in the national interest in order to secure the maximum ultimate recovery of [p]etroleum and in order to avoid unnecessary competitive drilling."⁷⁹ All parties receiving such a notice relative to the same field are obliged to cooperate in the creation of a unit development scheme that must be submitted for the approval of the Minister.⁸⁰ If they fail to submit the plan within the

74. As early as 1917, when the United Kingdom was considering making its first, abortive, attempt at establishing an onshore licensing system, the dangers of uncontrolled competitive drilling were brought to the government's attention by Lord Cowdray of S. Pearson & Son, who had seen the problems caused by competitive drilling while involved in the oil business in the United States: Daintith, *supra* note 5, para 1–103.

75. In the 2008 Model Clauses, the relevant clause is MC 27. The equivalent Model Clause in earlier licenses is in essentially the same terms. *See e.g.* The 1966 Model Clauses, MC 25.

76. Wood, *supra* note 3, at 12.

77. Petroleum Regulations 2008, *supra* note 18, Model cl.27(1).

78. The Minister is not, however, powerless in the case of a field stretching beyond the licensee's acreage into an unlicensed area. If the Minister is concerned that the field development and production program is going to give rise to wasteful working practices, he could refuse to grant it on the basis that it is contrary to good oilfield practice: see the discussion of MC 17, above. There would also be a possibility of the licensee of the block making an out of rounds application to obtain the other area into which the field falls. For a discussion of out of round applications, *see* Gordon, *supra* note 13, paras 4.22–4.23.

79. Petroleum Regulations 2008, *supra* note 18, Model cl.27(1).

80. *Id.* Model cl. 27(2).

period stated by the Minister, or if, having done so, the Minister is not satisfied with the scheme and refuses to accept it, “the Minister may himself prepare a development scheme which shall be fair and equitable to all licensees.”⁸¹ Any licensee who objects to the Minister’s scheme has a right to arbitrate.⁸²

Although the Minister’s power to compel unitization has never been used, its existence has led to a significant number of voluntary unitizations on the UKCS.⁸³ Given the relatively small size of most new fields within at least the mature areas of the UKCS, Unitization and Unit Operating Agreements tend to be somewhat simpler than in many other jurisdictions, with redetermination rights, for instance, being either tightly circumscribed or wholly absent.

CONCLUSION

Viewing the matter from the standpoint of a regulator wishing to exert control over operations,⁸⁴ consideration of the United Kingdom licensing regime reveals a very mixed picture. At least for modern licenses, a relatively sound term and relinquishment structure exists that incentivizes exploration and—within eight years—requires relinquishment of all parts of the licensed area not required for the development of the field. Clear and well-designed powers exist to demand additional exploration throughout the life of the license and to unitize fields that straddle two or more blocks. These powers, although rarely exercised, have given a sound legal foundation for Ministerial requests for action. The ability to extend licenses—and to seek to negotiate new license terms when so doing—offers some welcome flexibility and a potential window of opportunity to have recalcitrant licensees accept any changes to the license conditions that the Minister may think necessary.

Nevertheless, serious deficiencies also exist. Outside of the particular context of unitization of shared oilfields, the Minister’s operational powers are directed solely towards the individual license group. Notwithstanding licenses that are nearing the end of their lives, change is hard to effect due to the contractual aspect of the license, the incorporation of the Model Clauses current at the time of the license’s grant, and the lack of

81. *Id.* Model cl. 27(4).

82. *Id.* Model cl.27(5).

83. Warwick English, *Unitisation Agreements, in UPSTREAM OIL AND GAS AGREEMENTS* 97, 100 (Martyn R. David ed., 1997).

84. At this stage I express no concluded view on the wisdom of such a regulatory intention, but would make two observations. I expect to return to this matter in future research when the implementation of the Wood Review is at a more advanced stage.

mechanisms available to alter the conditions of the license. As a result, many existing licenses do not possess the sound term and relinquishment structure discussed *supra*, but instead contain a much looser set of obligations. This problem is compounded by the fact that Ministerial controls over production are both more tightly circumscribed than those over exploration and much less clearly drafted. A clear power to compel collaborative working between licensees is absent. Refusal of a field development and production program on the basis of “good oilfield practice” would seem to be the only lever that the Minister possesses in that regard, and it must be doubted if the territorial scope of this term can be stretched beyond the licensee’s own field so as to impose an obligation to work collaboratively with the licensees of other fields. Moreover, the field development and production plans for many licensed areas will already have been approved by the Minister, and it is far from clear that he may return for a second bite at the cherry. There is some irony in the fact that, at the moment when the need to maximize economic recovery becomes ever more clear, the clearest power that the regulator possesses relative to production is the right to slow it down. And yet that was the power that seemed most important in the pioneering days of 1975; that is what the government fought and negotiated with the industry to obtain. The government is faced with a different set of challenges now.

