



Law Society
of Scotland

UK Government Consultation Response

Future of the oil and gas industry inquiry- Call for
evidence

8 June 2018



Introduction

The Law Society of Scotland is the professional body for over 11,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland's solicitor profession.

We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom Governments, Parliaments, wider stakeholders and our membership.

Our Energy Law Sub-committee welcomes the opportunity to consider and respond to the UK Government's call for evidence by the Scottish Affairs Committee which is investigating the future of the oil and gas industry. We have the following comments to put forward for consideration.

General Comments

Importance of the oil and gas sector in Scotland

The oil and gas industry is of considerable importance to Scotland. Scotland is estimated to be the largest oil producer and second largest gas producer in the EU on an internationally comparable basis. There are over 2,000 companies operating in the Scottish energy sector making Scotland a hub of leading legal expertise in oil, gas and renewable energy, including the legal expertise required to support the sector. This supported 115,000 Scottish oil and gas supply chain jobs in 2017. Oil and gas production was estimated to be worth £17.5 billion to the Scottish economy in 2016/17. £8 billion of capital investment is committed to oil and gas production from beneath Scottish waters in 2016/17.

Energy policy is reserved to the UK Government. However, since devolution, under the Scotland Act 1998, the Scottish Government has retained and does still retain considerable interest in the oil and gas industry.

There is a cross over between the UK Government on energy and the Scottish Government in relation to areas of devolved responsibility such as environment, property and planning.

For instance, in planning, the Scottish Government has a role in shaping and influencing the future and direction of the oil and gas industry, such as its forthcoming decision on fracking.

With regard to the practice of investigation, it is the same for both England and Scotland where inspectors use the same powers, guidance and techniques. They gather evidence, take statements, seek specialist advice and prepare reports. As the legal systems differ in relation to the processes and procedures between Scotland and England, this affects how the law applies and is enforced. Having consulted with the public over fracking earlier this year, the Scottish Government is now considering its response and will set out its recommendation to the Scottish Parliament on unconventional oil and gas extraction. The Scottish Government has promised to take a '*cautious, evidence-led approach*' on fracking but its preferred position is that it does not support the development of unconventional oil and gas. It has stated that:

'As we have made clear, this position is subject to a Strategic Environmental Assessment. It remains inappropriate to comment further during the judicial review process'.¹

The decision has clear implications for the future of the oil and gas industry in Scotland.

In December 2017, the Scottish Government published the Future of Energy in Scotland: Scottish Energy Strategy². It identifies the importance of the energy sector to the Scottish economy and that the energy sector provides high quality jobs as well as opportunities to innovate.

The Oil and Gas Innovation Centre (OGIC) situated in Aberdeen was established in 2007 by the Scottish Government. It is an important centre in developing innovation, bringing together more than 2,300 oil and gas operators and service companies, 12 Scottish universities, and includes academic staff and researchers. The OGIC supports industry, aims to increase production and reduce costs in the UK Continental Shelf by enabling the delivery of ground-breaking technical solutions, and uses the skills and expertise of Scottish universities and industry. There are a number of projects which have prioritised enhanced oil recovery, subsea, seismic and reservoir characterisation, decommissioning and health and safety. Its members include all companies active in the UKCS. It also engages with governments and other external organisations interested in the oil and sector.

The Scotland Act 2016 (2016 Act) has provided for a further range of devolved powers to Scotland which has implications for the UK energy industry. Section 47 of the 2016 Act has an impact on oil and gas in relation to Scotland's regime for licensing onshore exploration

¹ <https://www.telegraph.co.uk/news/2018/05/10/scottish-government-accused-alice-wonderland-approach-fracking/> 10 May 2018

² <https://beta.gov.scot/publications/scottish-energy-strategy-future-energy-scotland-9781788515276/> December 2017

and extraction of oil and gas. Under the 2016 Act, the Scottish Government can grant and regulate licences to search, bore for and get petroleum that, at the time of the grant of the licence, is within the Scottish onshore area, except for any consideration payable for such licences. Consideration is still reserved to the UK Government. As exploration is only permitted by parties awarded licences in the current UK Government's licensing rounds, they can decide upon the application process for licensing and any conditions that should be imposed³.

How decisions are made regarding the future of the oil and gas industry will be vital whether such decisions are made by Scotland or the UK. Consultation and discussion between both countries is essential. Decisions in the energy sector will of course affect future generations living and working in Scotland.

Effect of Brexit

The Brexit issue cannot be ignored as it is an important aspect facing the oil and gas industry given its highly regulated regime. The outcome of that process is uncertain as the UK Parliament is currently debating clause 11 of the European Union (Withdrawal) Bill and the Scottish Parliament debates the UK Withdrawal from the European Union (Legal Continuity) (Scotland) Bill.

In late 2017, the Cabinet Office published a list of 111 points where EU Law intersects with devolved matters. This has been supplemented by the publication of the UK Government's Frameworks analysis: breakdown of areas of EU law that intersect with devolved competence in Scotland, Wales and Northern Ireland on 9 March 2018. The UK Government's analysis focuses on the EU legislation which applies in the devolved areas.

We have surveyed the powers in the list, which includes details of the implementing legislation for Scotland and, where appropriate, for the UK (occasionally on a GB basis) and for England and Wales. The areas highlighted are complex, very technical and do include energy⁴. They comprise highly regulated areas of policy implemented by EU Directives, Regulations and Decisions and transposed by UK Acts and subordinate legislation, Scottish Acts and Scottish subordinate legislation; as well as a number of administrative, non-statutory arrangements. Uncertainty as to what powers will be devolved after Brexit produces uncertainty for the sector.

Post Brexit, there will be a number of choices for the UK to decide what the legal and regulatory framework governing UK (and Scottish) oil and gas industry outlined above will

³ <http://www.stronachs.com/news-insights/insights/54-oil-gas/250-the-impact-of-the-scotland-act-on-the-oil-and-gas-sector>

⁴ <https://www.lawscot.org.uk/media/359818/ministers-111-paper-final-12-mar.pdf>

look like⁵. The UK could join the European Economic Area or the European Free Trade Association (EFTA). The UK may retain access to the Internal Energy Market (IEM).

'National and EU energy policy are usually influenced by a so-called 'energy trilemma': competitiveness, security and sustainability, and how to reconcile these priorities through the regulatory process'⁶.

These will be relevant when ascertaining how the regulatory process will work on exit. The extent of any immediate legislative changes may be limited in relation to upstream oil and gas activities. The UK is currently subject to relatively light EU regulation in respect of UKCS activities as the UK has maintained control of its energy policy, working via the Oil and Gas Authority. That has included taxation, licensing and regulation of exploration and development and production activities. Other than ancillary legislation relating to areas such as competition and environmental issues, EU law has little impact on UK upstream operations.

The UK, as a well-established hub in the Global Liquefied Natural Gas market has strong trade links to the EU in importing and exporting gas. Any trade barriers will have a significant impact on both the UK and EU and will necessitate a widespread regulatory change. The UK has also been deeply involved in the liberalisation of European cross-border gas markets (such as the Third Energy Package which it will most likely continue to support). The UK may have a less direct say in Europe. The regulatory framework of the industry may change with the removal of EU state aid restrictions, merger restrictions and health and safety and environmental regulations.

There may be the chance of greater legislative and financial support to UKCS infrastructure after EU state aid restrictions are removed, but it would remain subject to the regulatory regime of the World Trade Organisation.

What is clear is that the relationship will look different.

Legal expertise and experience

Scottish solicitors provide support to those firms and organisations involved within the oil and gas sector with appropriate and relevant legal advice and expertise. This includes:

⁵ <https://www.lawscot.org.uk/news-and-events/news/public-policy-highlights-april-2018/>

- Supporting investment and infrastructure:

Scotland has developed a hub of leading legal advice and expertise in oil, gas and renewable energy. Our members work for a number of the Scottish legal firms who have Scottish, UK and international clients who have a range of interests in the oil and gas industry and in the waters offshore and onshore in Scotland. Legal experience and practice has been frequently developed from work as in-house legal representatives within these large companies who operate globally in this sector.

- Providing advice:

This includes to the operators and services-sector clients in all aspects of their businesses with a background that '*enables the teams to provide advice that is accurate and practically useful*⁷. Their work includes drilling *contracts* such as Transocean Onshore Support Services who provided advice on the Sedco 704 semi-submersible to a small independent operator to facilitate the drilling of an appraisal well.

- Experience:

Our members have substantial experience of UKCS and international sales and acquisitions of onshore/offshore oil and gas assets, oil and gas share transactions, and decommissioning and licensing matters, knowledge of a wide variety of sector-specific commercial contracts, including joint operating agreements, gas sales agreements and supply and service contracts. Scottish solicitors' legal practices have attracted praise for their knowledge and understanding of the more technical and commercial aspects of the industry. Although the UK is the main area of focus of the practice, work inevitably includes an international perspective in handling agreements concerning oil and gas interests in and among other jurisdictions. They are well placed to handle a full range of matters on which legal advice is required and, as there are ongoing developments in the oil and gas sector, can support their high caliber client base as well as providing specialist legal advice as required.

- Legal interests:

The legal interests are also recognised in supporting collaborative projects and research work, such as those being undertaken at the Centre for Energy, Petroleum and Mining Law at Dundee University which is well located to support the oil and gas industry⁸. It delivers higher education to international academia, industry, government and ministries which includes both theory and practice. Training covers a wide variety of areas for the energy

⁷ <http://www.legal500.com/firms/471-brodies-llp/4520-edinburgh-scotland>

⁸ <https://www.dundee.ac.uk/cepmlp/study/>

sectors, including negotiation, petroleum regulation and licensing, managing contracts and agreements and arbitration and dispute management skills. Courses are accredited so that lawyers will be contributing to as well as being in receipt of these academic qualifications to support their commercial practice.

The Scottish legal profession provides expert legal advice and has a particular role to play in relation to dispute resolution without the need for lengthy and costly court processes.

- Dispute resolution:

The international energy industry can frequently give rise to complex, high-value disputes. As economic and commercial circumstances change, joint venture partners may disagree over the way to operate, seek to change pricing or attempt to improve their investment return from their projects. These disputes are not easy to resolve. They have significant implications for the companies operating in this sector if they cannot be resolved. Such disputes may and can involve governments, multinationals and financial institutions in relation to exploration rights, production platforms, pipeline capacity rights, oil storage facility and pipeline failures.

The establishment of the International Centre for Energy Arbitration (ICEA) - a joint venture between the Scottish Arbitration Centre and Dundee University's Centre for Energy, Petroleum and Mineral Law and Policy - has made Scotland a more attractive place for global energy firms. It represents works with law firms in the energy sector has allowed Scotland to become an international specialist in resolving energy disputes. In October 2013 when opened by then First Minister, The Right Honourable Alex Salmond he stated that:

'Scotland is a leading international energy centre, being home to a global oil and gas hub and some of the best renewable resources and technologies on the planet. we have built on Scotland's distinguished legal system to develop a world-class legal framework for cost-effective arbitration services. It is fitting, therefore, that we are opening an [(ICEA)], a development that will further enhance Scotland's attractiveness to global energy companies, associated professional service providers and investors.⁹

This built on Scotland's existing expertise as there already was 'a clustering of legal [our emphasis] and technical energy expertise that is not readily found in any other part of the world¹⁰. Their programme of work involves consultation in the energy sector and work with relevant representative bodies to establish current trends and desired requirements in

⁹ <https://news.gov.scot/news/international-centre-for-energy-arbitration>

¹⁰ Brandon Malone, Chairman of the Scottish Arbitration Centre and Director of the ICEA

respect of dispute resolution within the industry. This research supports the preparation of bespoke energy arbitration rules. It promotes:

- the use of Scottish arbitration under the Arbitration (Scotland) Act 2010 as the law to apply in energy disputes and
- Scotland as the place to arbitrate such disputes and the Scottish Arbitration Centre as an appointing body in ad hoc arbitration.

Scottish lawyers will be required to support such arbitrations using their expertise and professional background. Looking to the future, there is a clear role for the ICEA in resolving disputes in a timely and appropriate manner.

In 2016, the ICEA's research was recognised internationally when shortlisted for an innovation award by Global Arbitration Review. This is the world's leading arbitration law journal and news service. It received its nomination for its work in the energy sector, including its publication of the Initial Report on Dispute Resolution in the Energy Sector¹¹ which set out the dispute resolution preferences of the sector. Andrew Mackenzie, Chief Executive of the Scottish Arbitration Centre said, stressing the importance to Scotland:

'... Again we face stiff competition for senior individuals and established institutions from around the world, including London, Switzerland, the USA, Hong Kong and China, but we welcome this opportunity to promote Scotland and our work on energy arbitration.'

1. What challenges does Scotland's oil and gas industry face, and how can they be addressed?

We refer to our comments above.

The challenges faced by the Scottish oil and gas industry are similar to those generally faced by the UK. We have identified that the UK's oil and gas industry makes a substantial contribution to this country's energy security and economy. However, UKCS has been badly affected by the sustained period of low oil and gas prices since 2014. There has been a reduction in the workforce supported by the oil and gas industry though it still supports over 300,000 jobs of which many are highly skilled and well paid. The International Energy Agency has stated that:

'The fall in oil prices since 2014 has exacerbated concerns about the future of North Sea production. Its demise has been predicted on several occasions before, including during the

¹¹ <https://scottisharbitrationcentre.org/?p=1695>

last decade, when the area was perceived as “slipping into history.” Yet the region has proved surprisingly resilient, as shown by its recent increase in oil output for the first time in more than a decade¹².

There continues to be a significant uncertainty so planning for the future is challenging recognising the difficult time in recent years with weak demand and relatively low prices. There remains uncertainty on the impact of Brexit and what the landscape will look like post Brexit as highlighted above.

We outline what we consider are the main challenges as follows:

- **Global competition for investment in oil and gas**

The UKCS, including the UKCS offshore Scotland, is now at a stage in its life where the average discovery size is substantially smaller than in the past and there are much larger fields being discovered in other basins across the world. The UK's latest offshore licensing round has attracted 96 applications covering 239 blocks in the main oil and gas producing areas of the UKCS. The number of applications received in respect of the 30th round came from 68 companies ranging from multinationals to new country entrants (closed 21 November 2017). Though this was good, there is very little happening in terms of exploration drilling activity or new projects being sanctioned¹³.

Operating costs in the UK have been cut dramatically over the past years but are still reasonably high by international standards. That weighs heavily on the outcome of investment decisions.

Companies and the UK Government have been co-operating on the tax front where the UK Government has made a number of changes to the tax regime. Furthermore, further changes are planned in respect of decommissioning later this year in the form of the transferrable tax history. This '*world first*' policy, which forms part of the 2017 UK Government Budget, means that purchasers will be able to offset some of the costs of decommissioning against tax paid by the previous owner. This will encourage the purchase of late life oil and gas assets and should bring fresh investment to the UKCS. This will make the UKCS basin more competitive from a tax perspective and will open it up to new entrants. Draft legislation on transferable tax history is expected to be published to allow the new regime to come into force on 1 November 2018. Exactly how that legislation will work in practice remains to be seen but as Bob Ruddiman of Pinsent Masons has indicated:

¹² <https://www.crystolenergy.com/assessing-future-north-sea-oil-gas/>

¹³ <https://www.ogauthority.co.uk/news-publications/news/2017/strong-response-to-30th-offshore-licensing-round/>

'this is a highly complex matter that requires careful thought and detailed implementing legislation. If this complex legislative landscape is navigated correctly, the prize is of course extracting natural resource – which contributes to better security of supply in a post-Brexit environment, whilst continuing to develop world-class export capability in people and technology for Scotland and the wider UK¹⁴.' (The underlining represents our emphasis in relation to Scottish interests.)

The UK Government has indicated its intention to publish a technical consultation on allowing a deduction against petroleum revenue tax for decommissioning costs incurred by a previous licence holder. This will, we expect, also support the sale of late life oil and gas assets where the seller, rather than the buyer, retains the decommissioning liability.

Upstream and service companies have managed to bring down their production costs substantially. This has in turn caused financial difficulties and pressure for many service companies. One would expect that their charges will have to increase in the medium term as we hear that some companies are working for fees which are not sustainable. Investment in technology in the future may bring costs down and the use of new digital technologies that allow new applications (such as the development of robotics to replace the performing of repetitive tasks and the development of databases and sensors which can identify equipment breakdowns that will allow for the improvement in production efficiency).

As highlighted above, in dealing with the challenges there is a clear role for the legal profession in advising its clients.

Personnel

A large number of skilled personnel left the industry during the downturn and some companies continue to shed experienced staff. Given the age profile of workers in the industry, many of these were/are experienced staff who took early retirement packages. In the current upturn, it may be difficult for companies to recruit sufficient staff. There are also issues with attracting the next generation into the industry given the negativity of job losses during the downturn.

Public perception of the upstream industry is poor where a large part of the Scottish population seems to have a negative view of the oil and gas industry. There seems to be little public acknowledgement by the Scottish Government that gas, in particular, will play a crucial part in the energy mix going forward and that it will not be possible to have a wholesale move to renewable energy in the short or medium term. Such negative perception

¹⁴ <https://www.out-law.com/en/articles/2017/november/budget-2017-uk-to-enable-world-first-transferable-tax-histories-for-late-life-oil-and-gas/>

is a blocker to recruiting new staff to the sector. Greater acknowledgement of the importance of the upstream sector by the Scottish Government would help.

2. How can the economic return from Scotland's oil and gas reserves be maximised?

Given the Wood Review¹⁵ and the Scottish Government's own review,¹⁶ there is little that we can add. The outcome of the Scottish Government's fracking decision is currently awaited.

3. What action is the UK Government taking to support the long-term future of the oil and gas industry in Scotland, and how effective has this been?

The UK Government has been taking forward a number of actions towards implementing the findings of the Wood Review¹⁷ in 2014 which identified a number of key recommendations in order to maximise economic recovery from the UKCS. These have included:

A move from 'light touch' regulation to the 'more hands on' approach of the Oil and Gas Authority (OGA), being the regulatory authority created in response to the Wood review, which has helped encourage companies to be more collaborative. Newly updated guidance (May 2018) has been published to support the industry deliver successfully the next generation of UK oil and gas field developments. The OGA's new '*The Requirements for the planning of and consent to UKCS field developments*'¹⁸ guidance should help achieve consistent delivery of successful high quality, high value projects. This guidance emphasises the benefits of early project planning and supply chain collaboration, including the use of supply chain action plans which outline that:

*'The new guidance puts a stronger focus on front-end planning, early engagement with the supply chain and making the right choice at the concept select stage. Successful projects don't happen by chance. They need careful planning, proactive management and strong collaboration.'*¹⁹

¹⁵ <https://www.gov.uk/government/groups/wood-review-implementation-team#the-wood-review>

¹⁶ <http://www.gov.scot/Topics/Business-Industry/Energy/onshoreoilandgas>

¹⁷ <https://www.gov.uk/government/groups/wood-review-implementation-team#the-wood-review>

¹⁸ https://www.ogauthority.co.uk/media/4870/fdp_guidance_requirements-document-may-2018.pdf

¹⁹ Gunther Newcombe, Director of operations at the Oil and Gas Authority

The OGA has been involved in facilitating resolution of commercial disputes between companies. This work is supported by their role in considering formally a range of disputes that occur within the upstream oil & gas industry with the aim of bringing about a collaborative solution that will help to maximise the economic recovery of petroleum that is found in the UK. (The Energy Act 2016 supported by Dispute Resolution Guidance)²⁰

Tax changes such as Petroleum Revenue Tax becoming permanently zero-rated from 1 January 2016 benefitted the industry. Other tax incentives that are to be introduced have been highlighted above.

4. How well do the different stakeholders (UK Government, Scottish Government, companies) work together? Does the current devolution settlement enable all stakeholders to support the sector?

No comment

5. How can Scotland maximise its expertise, technology and infrastructure in oil and gas industry to secure the industry's future as reserves decline? What support is needed from Government to maximise these opportunities?

We have already mentioned the introduction of the²¹ OGTC in Aberdeen. The OGTC was established as part of the Aberdeen City regional deal and which is supported by the Scottish and UK Governments, Aberdeenshire Council and Opportunity North East (ONE). OGTC describes itself as an:

*'industry-led research and knowledge organisation, backed by both the UK and Scottish governments to fund and direct projects that help to unlock the full potential of the UK North Sea. We aim to be the go-to technology centre for the oil and gas industry in the UK and internationally.'*²²

²⁰ https://www.ogauthority.co.uk/media/2711/oga_dispute_resolutions-guidance.pdf

²¹ <https://theogtc.com/media-centre/news/2018/the-oil-gas-technology-centre-annual-review-2017/>

²² <https://theogtc.com/about-us/at-a-glance/>

OGTC is recognised as having made a positive start but there is much more to do to galvanise the industry where it:

*'[continues] to work with [its] partners to help unlock the full potential of the UK North Sea, anchor the supply chain in North-East Scotland and create a culture of innovation in the region.'*²³

*'will clearly play a pivotal role in maximising the remaining North Sea oil and gas opportunity, looking at diversified energy opportunities, while stimulating local economic and employment opportunities for [the] region'*²⁴.

This is crucial to maximising the economic return for Scotland from the oil and gas industry, which will help provide employment and training opportunities and to bring products to market which can be exported worldwide.

As far as infrastructure is concerned, there have been various examples of interests in infrastructure (such as pipelines and terminals) being acquired as investments by companies such as NSMP (Operations) Limited (a subsidiary of North Sea Midstream Partners Limited) which bought interests in the FUKA and SIRGES Pipelines and in a terminal at St. Fergus. CATS Management Limited (backed by Antin Infrastructure Partners) purchased the Central Area Transmission System and SAGE North Sea Limited bought an interest in the SAGE pipeline system and an interest in a terminal at St. Fergus.

Purchasers to date have been predominantly companies that are backed by investment funds which are attracted by tariff revenue streams. This is good for future economic returns as it should ensure the longer life of some infrastructure where the purchasers are hungry to find new third party tariff business. Companies might be more willing to sell such infrastructure to third parties if current owners could be confident that if purchasers failed financially, they would still retain rights to produce through such infrastructure to maximise economic recovery.

In conclusion, we consider that the oil and gas industry is seeking stability in all areas that affects its work which include economic, fiscal, and political. The UKCS is an ageing basin where future significant finds may be unlikely, which compounds the uncertainties presented by Brexit on the horizon. There may not be the opportunities or stability to attract large scale investment in the future. The question raised by the OGUK Business Outlook identifies issues with growing US production, the threat of OPEC quota compliance and fears over the global economic growth as currently limiting new contracts in respect of future delivery²⁵.

²³ Colette Cohen, Chief Executive Officer

²⁴ Sir Ian Wood GBE, Chairman, Opportunity North East

²⁵ <https://cld.bz/c41vNPT/8/>

These are all significant factors affecting the future which must be brought into considerations affecting Scotland.

We trust this is helpful for your purposes. We would be happy to provide any further information that may be required.

Gillian Mawdsley
Policy Executive
Law Society of Scotland
Atria One
144 Morrison Street
Edinburgh
EH3 8EX