EXPLANATORY MEMORANDUM TO

THE HYDROCARBONS (TEMPORARY MANAGEMENT SCHEME) REGULATIONS 2013

2013 No. 1329

1. This explanatory memorandum has been prepared by the Department of Energy and Climate Change (DECC) and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 The instrument establishes a power for the Secretary of State to take a UK oil or gas licence into his control under a temporary management scheme, where the licence holder is designated under EU sanctions against Iran.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 **Use of novel or complex powers**. Article 43a of EU Regulation 267/2012 provides for a derogation from certain restrictions under that Regulation in relation to activities related to hydrocarbons production, where a Member States authorises the activities. The restrictions in EU Regulation 267/2012 apply to various contractual relationships of Iranian entities but these EU restrictions are not intended to deprive those entities of their assets. In the context of assets used in relation to a licence granted under section 3 of the Petroleum Act 1998 (or its predecessor Act) ("a petroleum licence"), the EU restrictions may risk the deprivation of assets, by the permanent destruction of the value of the petroleum licence, and may lead to risks to the environment where a petroleum field cannot be properly maintained. The derogation is intended to mitigate these adverse consequences and the powers in section 2(2) of the European Communities Act 1972 are used to make these regulations to implement this derogation.

3.2 A listed person cannot carry out any of the activities without third party contractors but contractors are very reluctant to deal with Iranian entities. In any particular case, it would not be certain that a listed person would wish to resume any of the activities to mitigate or avoid these adverse consequences. The Secretary of State must though ensure that risks to the environment are avoided. Therefore, a simple authorisation process available to a listed person or contractors is not appropriate in order to implement the derogation.

3.3 To perform the activities involved in the exploration for, or the exploitation of, hydrocarbons, a complex range of contractual relationships needs to exist. Infrastructure belonging to a number of third parties will usually be needed to transport petroleum, particularly from offshore fields, and contractors will often require longer term contracts to be in place before committing the necessary resources to the activities. The Secretary of State needs to have powers to re-activate these contractual relationships in order to carry out activities in relation to a petroleum

licence, where the licence-holder is listed in Annex IX to EU Regulation 267/2012 ("a listed person").

3.4 The Regulations establish a scheme of duties, restrictions and powers which as a whole the Secretary of State considers may be needed in order to prevent the permanent destruction of the value of a petroleum licence held by a listed person or to avoid or remediate environmental damage. Which powers the Secretary of State may need to use in a particular case may not be known until after a scheme is applied. However, the normal operation of activities pursuant to a petroleum licence requires contractors to act for the licensee and for bank accounts to process transactions. Therefore, the powers under a scheme include taking temporary control of contracts to which a listed person is a party and acting for the listed person under those contracts. It may be necessary to agree amendments to these contracts during a scheme. Certain necessary contracts may be found not to exist after a scheme is applied or it may not be possible or lawful to take control temporarily. Therefore, powers are included to agree amendments and to enter into new contracts. These powers are limited to ensure that such amendments and new contracts do not extend after a scheme ceases to have effect.

3.5 Before applying a scheme, a listed person and parties to contracts who may be affected by a scheme have the opportunity to make representations to the Secretary of State. Those representations must be considered before a decision is made whether or not to apply a scheme. Where a contract is to be taken over temporarily, the Regulations include a requirement that notice must be given to the contracting parties. At periodic intervals during a scheme and once a scheme ends, a listed person must be kept informed by reports on how their rights and property are managed. After expenses, funds arising from any petroleum production are beneficially owned by the listed person, though frozen in accordance with the EU Regulation.

3.6 The Regulations require a listed person to indemnify the Secretary of State where a scheme is applied to that person's interests. This is to ensure that a listed person is not put into a better commercial position than they would have been had they been able to exploit the petroleum licence themselves. However, the indemnity does not apply where the Secretary of State acts negligently.

3.7 The Regulations require the Secretary of State to review at regular intervals whether to continue a scheme and where its necessity under Article 43a ceases to exist, the Secretary of State is required to terminate the scheme.

3.8 The powers in the Regulations are those which the Secretary of State considers are necessary and existing contractual arrangements are preserved as far as possible. A fair balance is sought to be struck between the interference with the rights and property of a listed person, which are in any event restricted by reason of the EU Regulation, and preventing the permanent destruction of the value of the licence, and avoiding or being able to remediate risks to the environment as set out in Article 43a. A listed person is not deprived of their rights and property and indeed, without a scheme, those rights and property may have no value or be liabilities only.

4. Legislative Context

4.1 The instrument is made under section 2(2) of the European Communities Act 1972 to implement the derogation contained in Article 43a of EU Regulation No. 267/2012 concerning restrictive measures against Iran, as amended. Article 43a(1) permits a derogation from the restrictions listed in that paragraph where that is necessary to avoid or remediate environmental damage or to prevent the destruction of the value of a petroleum licence.

5. Territorial Extent and Application

5.1 This instrument extends to the whole of the United Kingdom and applies to licences granted under section 3 of the Petroleum Act 1998 or its predecessor, section 2 of the Petroleum (Production) Act 1934.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

What is being done and why

7.1 When an entity is designated under EU sanctions against Iran, any activities conducted by the entity within the EU must cease, along with supporting activities by its suppliers where these could bring it financial or technological benefit. This is to prevent any money or technology contributing to Iran's nuclear programme.

7.2 Where a designated entity holds a UK oil or gas licence, there are substantial negative impacts associated with a cessation of activities in the oil or gas field, especially if it has become operational (e.g. where production wells have been constructed):

- Environmental safety and system maintenance activities may be among those interrupted by the designation;
- Production facilities are designed to be run and may be less safe when production ceases;
- If the field is no longer deemed economic, the safe decommissioning of the facility may itself be hampered;
- Ceasing production may destroy the licence's economic value, including for any co-licensees who may not themselves be designated;
- The need for higher compensating imports of oil or gas reduces UK energy security; and
- Substantial tax revenues that would otherwise accrue to HM Treasury are deferred, or potentially lost entirely if production at the field becomes uneconomic due to its interruption.

7.3 This instrument allows oil and gas production to resume or continue, without undermining the sanctions regime, by establishing a power for the Secretary of State to take over the designated entity's interest in the licence and operate it on their behalf, paying the proceeds from oil and gas sales into a frozen account that is only accessible once the entity ceases to be subject to EU sanctions. Establishing the

temporary management scheme also allows the entity's suppliers to resume support activities and for operations to be conducted as normal.

8. Consultation outcome

8.1 Given the instrument's narrow scope and purpose, no consultation has been undertaken.

9. Guidance

9.1 Given the instrument's narrow scope and purpose, no guidance has been published other than this memorandum.

10. Impact

10.1 Where a temporary management scheme is applied to the petroleum related interests of a designated person, there may be a negative impact on that person. Their ability to exercise rights in respect of those interests is restricted by the statutory instrument. However, restrictions under EU Regulation 267/2012 prevent third parties from dealing with a designated person. In consequence, a designated person cannot in practice enjoy economic benefits from their petroleum interests. The application of a temporary scheme may though allow petroleum production to take place before the designated person's petroleum licence expires, production which could not otherwise occur. In accordance with the restrictions in EU Regulation 267/2012, any proceeds from petroleum production during a period of temporary management which are due to the designated person will be frozen.

11. Regulating small business

11.1 The legislation applies to designated UK oil and gas licence holders irrespective of size. However, because of the complexity and scale of these activities it is unlikely to be an activity in which SME's are actively involved.

12. Monitoring & review

12.1 The Secretary of State must review the effectiveness of these regulations and publish his conclusions at least every five years following their coming into force.

13. Contact

James Clarke at the Department of Energy and Climate Change. Tel: 0300 068 6829 or email: james.clarke@decc.gsi.gov.uk can answer any queries regarding the instrument.