EXPLANATORY MEMORANDUM TO

THE OIL AND GAS AUTHORITY (LEVY) REGULATIONS 2017

2017 No. 323

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Business, Energy and Industrial Strategy ("DBEIS") and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 The purpose of this instrument is to impose a levy on holders of offshore petroleum licences for the period 1 April 2017 to 31 March 2018 to fund the carrying out of certain functions by the Oil and Gas Authority (the "OGA") and the provision of tribunals by the Lord Chancellor to consider appeals against decisions of the OGA.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 As this instrument is subject to the negative procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

4.1 These Regulations follow on from the Oil and Gas Authority (Levy) Regulations 201(S.I. 2016/318) ("the 2016 Regulations") which were made under the Infrastructure Act 2015, and imposed a levy for the period beginning on 1st April 2016 and ending on 31st March 2017. Regulation 7 of these Regulations requires the amount of levy under the 2016 Regulations to be adjusted if amount to be recovered exceeds the costs which can be recovered through a levy under the power in section 13 of the Energy Act 2016. The OGA is required to refund any overpayment of the levy under the 2016 Regulations, or offset this overpayment by reducing the amount of levy payable under these Regulations.

4.2 Some of the costs during the period to which the 2016 Regulations relate were incurred by the Secretary of State. This is because the OGA only became a government company with separate legal personality on 1st October 2016. Prior to this date the OGA was an executive agency. The Energy Act 2016 (Commencement No. 2 and Transitional Provisions) Regulations (S.I. 2016/920) include a transitional provision, the effect of which is to allow costs incurred by the Secretary of State to be treated as costs incurred by the OGA for the purposes of the regulation 7 reconciliation process under these Regulations.

4.3 Consistent with section 13(2)(b)(i) of the Energy Act 2016, the levy set under these Regulations has been calculated to exclude costs incurred in relation to matters for

which fees may be charged by the OGA, which are set out in the Oil and Gas Authority (Fees) Regulations 2016 (S.I. 2016/904).

5. Extent and Territorial Application

5.1 The extent of this instrument is the United Kingdom.

5.2 The territorial application of this instrument is Great Britain and outside Great Britain in relevant waters (i.e. the territorial sea adjacent to the United Kingdom and any area designated by order under the Continental Shelf Act 1964).

6. European Convention on Human Rights

6.1 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 The Energy Act 2016 formally established the Oil and Gas Authority as an independent regulator. The Act empowers the Secretary of State to make regulations enabling the OGA to recover its costs from companies benefiting from its services in line with established practice across regulation and service delivery.

7.2 Some of the OGA's costs are recovered through fees for the delivery of specific services to individual companies. The remainder of the OGA's costs are recovered through a levy. Consistent with the principal objective set out in Part 1 of the Petroleum Act 1998, the OGA's focus is primarily on the offshore sector. The levy has been imposed on offshore petroleum licence holders since 1st October 2015. Holders of licences relating to the unloading and storage of carbon dioxide and onshore petroleum licences do not currently pay a levy.

7.3 The costs of the OGA and Lord Chancellor which may be recovered by levy ("leviable costs") are apportioned between licences which entitle the holder to produce oil or gas ("in-production licences") and those that do not (or do not yet) provide such an entitlement ("pre-production licences"). Around 89% of the OGA's leviable costs are allocated to in-production licences, and 11% to pre-production licences. The apportionment of costs between production and pre-production licences is based on an assessment of the costs the OGA incurs in relation to each group, and has also been used to calculate the levy payable by different classes of licensees in previous years. Apportioning the levy in this way is consistent with Managing Public Money which recognises it can be appropriate to charge different levies to different kinds of licences depending on what is being provided by the regulator.

7.4 Under these Regulations the licensee of each in-production licence pays the same rate of levy: £65,444.77 (being an equal share of the costs apportioned to this class of licence.) The levy for pre-production licences is determined based on the type of licence held and the size of the licensee. The licensee of most pre-production licences, including exploration licences, pays a pre-production levy of £9,341.76. However, micro enterprises (i.e. enterprises with fewer than 10 employees and whose annual turnover and/or annual balance sheet total does not exceed €2 million) which hold a promote licence that is still within its "Promote Period" (generally a two year period commencing immediately after a promote licence is granted) are entitled to pay

a lower pre-production levy of £934.18. Where a promote licence is held by more than one person all of these people must be micro enterprises to qualify for the lower pre-production levy rate. This will align the treatment of the levy with the rentals for this licence type and will remove a disincentive to exploration. The intention is lower pre-production levy rates will be also be charged in relation to micro enterprise innovate licences in phase A and B once they become subject to the levy.

7.5 The levy has been set at a rate designed to recover the leviable costs it is anticipated the OGA and Lord Chancellor will incur in respect of period to which the levy relates. To secure that the levy does not recover more than this amount, regulation 8 of the Regulations requires any overpayment to be repaid once the actual costs incurred by the OGA and Lord Chancellor during the period covered by the levy are known. Regulation 7 requires a similar reconciliation to be undertaking in relation to the levy paid under the 2016 Regulations.

Consolidation

7.6 There are no plans to consolidate this legislation at this time.

8. Consultation outcome

8.1 Pursuant to the requirements of the Energy Act 2016, the Secretary of State consulted with the OGA regarding a change to the levy calculation methodology. To inform their response the OGA held a consultation exercise between 7th November 2016 and the 5th December 2016 to seek the oil and gas industry's views on a new methodology to calculate the industry levy.

8.2 The consultation sought views on a new methodology to calculate the industry levy for pre-production licences by aligning the treatment of the licence rental fee discounts and the levy rates. The split of the levy between in-production and pre-production would remain as currently apportioned to reflect the on-going resource input of the OGA to each group, with in-production licences paying 89% and pre-production licences paying 11% of the levy, it was proposed that the pre-production levy will have varying levels.

8.3 The OGA proposed in the consultation exercise that licensees that are micro enterprises which pay a reduced rental on a pre-production licence should qualify for an equivalent percentage reduction of the pre-production levy. There were 15 responses to consultation.

8.4 There was overwhelming support for the proposal to introduce a reduced levy to support exploration with 13 (87%) of respondents in favour of the revised methodology. As a result of these comments the OGA proposed that BEIS amend the methodology to calculate the levy on the basis proposed in the consultation document.

8.5 The consultation also asked if the definition of a micro enterprise as set out in EU recommendation 2003/361 was an appropriate delineating factor for determining who should attract a lower level of pre-production levy.

8.6 Nine respondents (60%) supported the proposed definition of micro enterprises. One respondent (7%) neither agreed nor disagreed with the proposed definition. Five (33%) respondents disagreed with the proposed definition of micro enterprises. The main reasons for disagreeing with the definition included:

- discounts to the levy should be based on the size of the operations

- the EU definition is too generous
- the turnover limit should be in pounds not euros
- they were opposed to cross subsidisation

8.7 The OGA considered the responses and, after consulting with HM Treasury, proposed using an existing definition of micro enterprises as this was preferable for simplicity and certainty. The EU definition was considered appropriate as it is well understood and includes a headcount and turnover test.

8.8 The OGA's proposals were considered and adopted by the Secretary of State.

8.9 A summary of the responses to the consultation and the OGA's response dated March 2017 is available on the OGA's website.

9. Guidance

9.1 The OGA will communicate directly with licence holders around the time that the levy regulations are laid before Parliament to inform them that the levy will be coming into force on 1 April 2017, subject to Parliamentary approval, and to give them an indication of the rates they will be required to pay. Once the levy comes into force, the OGA will issue invoices to licence holders with relevant instructions on payment.

10. Impact

10.1 There is no impact on business is restricted to existing offshore petroleum licence holders (as at 1 April 2017). The amount of levy paid by offshore licence holders under the 2016 Regulations is not significant different to the amount of levy payable under these Regulations.

10.2 There is no impact on charities or voluntary bodies.

10.3 The impact on the public sector is minimal.

10.4 An Impact Assessment has not been prepared for this instrument.

11. Regulating small business

11.1 The legislation applies to activities that are undertaken by small businesses.

11.2 The basis for the decision on what action to take to assist small business was based on a consultation with a wide range of stakeholders to ensure that their views were taken into account in the development of the OGA's Activity plan and levy. BEIS and the OGA intend to keep the levy methodology under review to ensure that it remains fair and proportionate.

12. Monitoring & review

12.1 A review provision is not appropriate. A "levy" is qualifying exemption in section 28(3)(a) of the Small Business Enterprise and Employment Act 2015.

13. Contact

13.1 Jessica Mackenzie at DBEIS Telephone: 0300 068 6935 or email: jessica.mackenzie@beis.gsi.gov.uk can answer any queries regarding the instrument.