

UK

Brexit – a challenge too far?

While there are some signs that confidence may be slowly returning to the North Sea oil and gas sector, there is a question of whether recovery might be stopped in its tracks by the UK's decision to leave the European Union and the recent resurrection of the issue of Scottish independence, write Haynes and Boone CDG, LLP Partner Glenn Kangisser and Associate Phoebe Anderson.

Investor confidence in the UK offshore oil and gas industry was drastically affected by the oil price crash in 2014. E&P activity has been low over the past few years, with a lack of new projects, maturing fields and the implementation of cost-cutting measures as companies have sought to remain competitive and survive the downturn. According to Oil and Gas UK, this drive to improve competitiveness has resulted in the halving of average unit operation costs from \$29.70/b to \$15.30/b within two years. However, it remains to be seen whether the industry's efforts and signs of returning confidence will be undone by the impact of the UK's exit from the European Union (EU).

According to a government document leaked earlier this year, the oil and gas industry is ranked as a 'low priority' during Brexit negotiations. However, the announcements in the Spring Budget of possible tax incentives with respect to decommissioning liabilities has been welcomed by Oil & Gas UK as sending a 'clear message to investors that the UKCS is a great place to do business' (see *Petroleum Review*, April 2017, p3). Whether or not the industry receives the clear leadership and support that it desires from the UK government, the future contains significant unknowns for the industry, some of which are highlighted below.

The Scottish question

When the UK referendum on Brexit was held in June 2016, 62% of the Scottish electorate voted to remain in the EU. Scottish First Minister Nicola Sturgeon says this gives her a 'cast-iron mandate' to call a second referendum for Scotland to leave the UK and remain in the EU. Prime Minister Theresa May has indicated that there will be no Scottish Independence vote before Brexit. While falling oil prices have undermined the economic case for an independent Scotland since the first referendum, a second referendum would cause further uncertainty for the offshore oil and gas industry until after the vote and well into the future if Scotland voted to leave the UK.

With the majority of the oil and gas industry's infrastructure located in Scottish waters, a split with Scotland would mean reserves would also be split. This would require agreements between the Scottish and UK governments as to how the industry will be regulated moving forward. The focus on decommissioning in the recent Budget could be seen as an attempt by the government to address the North Sea's substantial decommissioning needs, which might largely fall to Scotland if it leaves the UK.

Trade tariffs

The government says it will 'prioritise securing the freest and most frictionless trade possible in goods and services between the UK and the EU'. However, it is unclear exactly what trade arrangements the government will seek to negotiate with the EU and countries further afield, and indeed what outcome will be achieved.

Post-Brexit UK is likely to see some barriers to the free movement of goods and services in the form of tariffs, resulting in increased costs and administrative burdens for companies operating in the UK North Sea. The loss of the flexibility in transactions currently enjoyed by the industry has the potential to cause friction, with a possible result that supply chain companies may choose to relocate into the mainland European market.

Reduced employee mobility

Loss of access to the European single market may also mean the loss of access to a mobile, flexible workforce.

The North Sea relies heavily on highly-skilled workers who can be relocated swiftly from one project to the next. Upon exiting the Single Market, freedom of movement of employees with the UK will become more regulated. New visa and work permit requirements will likely complicate operations and increase bureaucracy, and increase costs. This additional red tape may cause some multinational oil and gas companies to think twice about investing in the North Sea. There is also a question as to whether

this would affect the UK's ability to attract highly skilled labour to the North Sea, when the availability of such labour is already falling.

A new regulatory landscape?

One area over which Brexit seems to pose little threat is the regulatory landscape that governs oil and gas operations in the North Sea. The UK has sovereignty over the areas of licensing, regulation and taxation, and domestic laws in these areas will not be affected.

The UK Petroleum Act and the international agreements to which the UK is a signatory, such as the UN Convention on the Law of the Sea, will not change.

However, environmental regulations may be a different story. More than 90% of the UK environmental laws are derived from EU law. The government's 'Great Repeal Bill' means that these EU regulations will initially remain in place upon the UK exit. Thereafter, the UK will have the right to make its own laws and be at liberty to repeal or amend the EU regulations that currently apply. In the short to medium term, we do not expect that the government would seek to make radical changes to the environmental laws that apply to the offshore industry, and so a level of stability can be expected in this area.

In the dark

With Brexit negotiations set to take two years and no guarantee of arrangements being agreed within this period, the oil and gas industry will remain in the dark for some time as to how trade agreements, labour mobility and regulatory requirements associated with the UK's departure may affect operations in the UK sector of the North Sea.

However, recent improvements that have been made in the industry to make it more profitable mean the industry is well placed for the recovery of the oil and gas market, which may well coincide with the UK's departure from the EU. ●

