

Two recent developments are set to ease the way for oil and gas companies seeking to develop onshore gas reserves through hydraulic fracturing (fracking).

## Onshore PEDLs

Firstly, [the Petroleum Licensing \(Exploration and Production\) \(Landward Areas\) Regulations 2014](#) have been laid before Parliament. The Regulations set out model clauses which will apply to landward petroleum exploration and development licences issued in the 14th and subsequent licensing rounds. The terms of existing licenses are unaffected.

Of particular significance for fracking are new provisions for Retention Areas and Development Areas, which, together with associated work plans and periods, may be agreed between the Licensee and the Secretary of State. Because shale gas is not concentrated in small, high-value fields like conventional oil and gas resources, but tends to be dispersed across wide areas, the traditional model, whereby at least half of the licensed area has to be surrendered after the exploration phase, is ill-suited to fracking. The normal requirement for 50% of the licensed area to be surrendered before the Second Term will not apply to the Licensee's Retention and Development Areas, however much of the Licensed Area they cover. There is also an option to surrender parts of the Licensed Areas within given depths, subject to approval from the Secretary of State. Moreover, DECC's Impact Assessment of the Regulations indicates that Retention and Development Areas will attract a reduced rental rate.

Licensees will be able to apply to the Secretary of State for parts of their licensed areas to be designated as Retention Areas. A Retention Area Plan describing the proposed exploration and appraisal activities and the timescales for conducting those activities must be submitted with the application. Retention Areas are designated as such for specified periods (or until they are converted to Development Areas) and the Secretary of State can terminate them earlier than the expiry date, where at the time of notice the Licensee has failed to comply with its Retention Area Plan.

At the same time as submitting its Development Programme, the Licensee must designate Development Area(s) stating the latest date by which it will recover oil or gas within the Development Area(s) and, where it intends to carry out well-based production from shale or other strata encased in shale or from coal seams, must also submit Development Area Plan(s) setting out a timeline of the activities that it intends to carry out in order to do so. Development Areas are subject to approval by the Secretary of State and may be brought to an end by the Secretary of State where the Licensee has failed to produce oil or gas by the specified latest date, or where, at the time of the termination notice, the Licensee has failed to comply with its Development Area Plan, or, in cases where there is no Development Area Plan in place, has ceased production.

The new more flexible regime is balanced by additional measures designed to avoid "land-banking", ensuring that Licensed Areas are appropriately exploited. The basic structure of the previous model clauses remains. A Work Programme must be completed within the Initial Term if the licence is to continue into the Second Term, although provision is also made for a "Drill-or-drop Period" so that the Licence may expire if parts of the Work Programme are not completed by specified times. Within the Second Term a Development Programme must be approved if the Licence is to continue into its Third Term (the Production Period). During the Production Period the Secretary of State will have the power to remove acreage outside of a Licensee's Retention and Development Areas and reoffer them. In line with Seaward Licences, the duration of the three different Terms will be specified in schedules to individual Licences, not in the model clauses themselves. DECC has indicated that for Landward Licences the Initial Term will be reduced from 6 to 5 five years, with the Second and Third Terms remaining, as at present, 5 and 20 years, subject to extension. There is also greater flexibility as to the conditions that may be attached by the Secretary of State to the Development Programme so as to restrict the use of production facilities in given circumstances.

DECC will also require greater transparency as to the fracturing of shale and the flow rates achieved. Licensees will be required to submit reports for each well to DECC, and the confidentiality period for this information will be reduced from four years to six months.

The most helpful of the changes is undoubtedly the introduction of Retention Areas. DECC's Impact Assessment indicates that these will be approved where the associated Retention Area Plans "represent an efficient proposal to exploit the shale gas potential of the area." Regrettably, the model clauses themselves do not include criteria for the approval of Retention Areas. Nevertheless the industry will be pleased with the greater flexibility offered by the new model clauses. Indeed DECC quotes UKOOG as saying "we believe there is much to be encouraged by in the proposed licensing approach. The approach suggested offers an increase in flexibility in terms of work programme and timing which will complement how shale and coal bed methane is likely to be developed."

## Onshore Exploration

The Regulations also introduce a new form of licence for onshore oil and gas exploration without development and production commitments. This new form of licence could be attractive to existing Licensees who want to undertake seismic surveys outside licenced areas to tie the results of wells together, or by specialists seeking to gather landward data for sale.

## Underground Access Rights

The second major development is DECC's current [consultation](#) on the introduction of a statutory right of underground access for shale gas operations below 300m. DECC has indicated that as the *quid pro quo* for overcoming well-publicised problems in obtaining access rights it expects the industry to enter into voluntary arrangements for a community payment of £20,000 per lateral well and to notify the public of the payment and the areas of land concerned. DECC is consulting on reserve powers for the Secretary of State to make Regulations making such arrangements compulsorily if they are not adopted voluntarily. Following consultation, appropriate measures will be incorporated into the Infrastructure Bill which was introduced to Parliament with the recent Queen's Speech.

## Impact

DECC estimates that the two initiatives in combination will see fracking activity pick up "quite quickly" and reach a plateau level of 6 shale gas well centres, or pads, per year from 2023 onwards. By contrast, under its do-nothing scenario DECC anticipates a much more gradual increase in the development of pads – at a rate of one a year in 2023.

In the absence of evidence as to the productivity of UK shale wells DECC has shied away from giving firm figures for the level of production that can be expected as a result of the changes. Based on confidential industry estimates DECC suggests that annual production of shale gas could be around 6 billion cubic metres (bcm) by 2035 with a cumulative total of around 70 bcm from pads started before 2035. These rates are significantly lower than the rates of production projected in the Institute of Directors' May 2013 report, *Getting shale gas working*, and Ernst and Young's April 2014 *Getting Ready for UK Shale Gas*, but double the IEA's estimate in its *World Economic Outlook 2013*.

## Next Steps

Although DECC states that the formal decision on whether to hold a new landward licensing round will not be made until it has completed its Strategic Environmental Assessment ("SEA") for Onshore Oil and Gas Licensing, the UK's 14th Onshore (Landward) Oil and Gas Licensing Round was notified in the Official Journal on 20<sup>th</sup> June.

The OJ notice confirms that applications will be assessed on the following criteria:

- the financial viability of the applicant and its financial capacity to carry out activities permitted under the licence during the Initial Term, including the applicant's proposed Work Programme;
- the technical capability of the applicant to carry out those activities, being assessed in part on the basis of the quality of analysis related to the area(s) applied for;
- the way in which the applicant proposes to carry out the activities and the quality of the proposed Work Programme;
- any inefficiency or irresponsibility displayed by the applicant in operations under other Petroleum Act Licences.

A licence will not be awarded unless the Secretary of State is also prepared to approve the applicant's choice of operator.

Applicants will be required to submit an Environmental Awareness Statement demonstrating their understanding of the UK's onshore environmental legislation and the broad environmental sensitivities of the acreage for which they are seeking a Licence.

Once DECC has finished considering the responses to its Consultation on Environmental Report for further Onshore Oil and Gas Licensing, a Post-Adoption Statement will be issued summarising how Government intends to proceed in relation to further onshore licensing. If, as appears more than likely, the Post-Adoption Statement concludes in favour of another licensing round, DECC will formally announce the opening of the 14th Licensing Round and set out the application period for new licences, subject to the Model Clauses obtaining Parliamentary approval, a process that is due to be completed by 17th July 2014.

DECC expects that the new Licences will be awarded next year.

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