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Buyers and Sellers Should Plan for Close Scrutiny of North Sea Oil and Gas Deals

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Over recent years, there has been an increase in M&A activity in the UK's upstream oil and gas sector. The UK's offshore industry has attracted this investment for reasons including the recent oil price recovery, a relatively lower risk profile than some other jurisdictions, larger oil companies selling assets to rebalance their portfolios, which has created buy-side opportunities for private equity firms and other buyers, and access to existing infrastructure and the UK and European markets. The UK government has generally been supportive of this activity and the new investment that it brings.

However, on 3 December 2021, the UK's upstream oil and gas regulator, the Oil and Gas Authority ("OGA") issued an open letter ("Open Letter") to all licensees within the UK Continental Shelf ("UKCS"), stating that the OGA is "concerned" that "change of control" transactions may put at risk a licensee's ability to meet its licence commitments. Those commitments include securing that the maximum value of economically recoverable petroleum is recovered and taking steps to assist the UK Government in meeting its 2050 net zero greenhouse gas emissions target. The Open Letter states that such transactions therefore require "close scrutiny".

Preparing for increased scrutiny and "deal certainty" considerations

The Open Letter suggests that both buyers and sellers should plan for close regulatory scrutiny of transactions. That is particularly the case where the buyer's group will be taking control of the operatorship (rather than a minority non-operating interest) of significant infrastructure such as offshore platforms and main pipelines.

Consideration should also be given to the perspectives and contractual rights of third parties, including those which may be triggered directly by the transaction, as well as key third-party consents such as in respect of operatorship. The ability of the buyer, and its corporate group, to release the seller's group from any relevant parent company guarantees or other collateral that has been provided to third parties (or to provide back-to-back or additional security) is also a key commercial and legal matter for consideration.

Counterparty selection and legal, financial and technical due diligence at any early stage is critical to ensuring a smooth and successful transaction. In some instances, that could tilt competitive advantage further in favour of larger incumbents and further away from less well capitalised or supported buyers and newer market entrants.

Changes of control: OGA's powers

Unlike licence, or "asset" transfers, OGA consent is not legally required to complete a corporate sale. However, UK offshore licences prescribe that, following a change of control of a licensee:

- firstly, the OGA may serve notice on the licensee, requiring that a further change of control of the licensee is effected within three months of that notice; and

- secondly, if the OGA's required change of control is not effected within three months, then the OGA has the power to either revoke the licence completely, or partially revoke the licence in respect of that licensee only, with the licence itself continuing in the hands of the other participants.

The burden of obtaining the OGA's approval is on the applicant. The Open Letter states that the OGA will "normally" exercise its change of control powers unless a licensee demonstrates that the change of control has not prejudiced its ability to meet its commitments.

To address the OGA's change of control powers, it is customary for the terms of a share purchase agreement to include a condition precedent to completion that a comfort letter is obtained from the OGA confirming that the OGA is not minded to exercise its statutory powers to revoke the licence or seek any further change of control ("Comfort Letter"). The OGA is generally willing to provide such Comfort Letters (usually within three months of receiving any application) but the OGA will not fetter its discretion to exercise its change of control powers in the future.

OGA's assessment of corporate sales

When deciding whether or not to exercise its change of control powers (and whether or not to issue a Comfort Letter), the OGA will consider how any given change of control will impact the OGA's statutory functions and duties. The OGA will consider the applicant's technical and financial resources and assess its "fitness" to control a licence holding company. The OGA has issued guidance notes on the approach that it takes.

As part of this process, the OGA will "normally" seek representations from any affected joint venture parties and any other relevant third parties at the start of its process of considering the exercise of its change of control powers or the issuance of a Comfort Letter. Buyers and sellers would need to plan for their deal or negotiations to no longer be confidential at that point, which can render pre-SPA signing applications for Comfort Letters (which are rare in any event) impractical.

The OGA's decision will not necessarily be determined by joint venture parties' representations. The OGA's assessments are for its "own purpose" and not tied to the commercial considerations of third parties (see *TAQA et al v RockRose* [2020] EWHC 58 (Comm) at [94]).

There are examples of the UK Government declining approval of share deals. For example, in 2015, the Government notified DEA UK and LetterOne of its decision to revoke DEA UK's licences, unless LetterOne arranged for a further change of control of DEA UK. The decision was driven by the UK Government's concerns about possible future sanctions imposed on LetterOne (owned by a Russian oligarch) in the wake of the 2015 Ukrainian crisis. The OGA gave DEA UK

and LetterOne six months to make a change in ownership, and a sale to INEOS occurred at the end of 2015.

There are also examples of Comfort Letters being issued on a conditional basis, although that is the exception rather than the norm.

Considerations for joint venture or other third parties

OGA approval of a transaction does not mean that joint venture parties, or other affected third parties, cannot exercise any contractual rights which might be triggered by the transaction. For example, co-venturers may have pre-emption (or similar) contractual rights which are triggered by the change of control. Co-ventures may also wish to consider whether or not the party, which is subject to the change of control, should continue to act as the operator of a relevant joint venture. Finally, there may be considerations in respect of the provision or release of relevant financial security. Affected third parties would be well advised to closely consider their contractual rights and obligations before steps are taken.

Conclusion

There is a general trend in the oil and gas industry in the UK, and indeed globally, of larger and national energy companies selling upstream oil and gas assets to smaller, independent and in some cases privately owned companies.

The Open Letter is an indication that regulators are applying increased scrutiny to such transactions and that buyers and sellers should plan accordingly.