Introduction and context
The purpose of this note is to identify some of the issues which would need to be addressed following a positive vote for independence in order to ensure an effective transition to a separate oil and gas regulatory regime for Scotland and its continental shelf. This note is neutral on the independence vote which is a matter for the Scottish people.

The oil and gas industry involves the taking of high risks, and the investment of huge sums in search of high rewards: developments involve the expenditure of hundreds of millions of dollars, the application of cutting-edge technology and require personnel to work in isolated conditions amid rough seas in a potentially highly dangerous environment. In the UK Continental Shelf (UKCS) the industry is also highly taxed and highly regulated. The first offshore North Sea licences were awarded in 1964 and the UK Continental Shelf is now referred to as a mature province where, with some exceptions, new discoveries tend to be small and only marginally economic. Levels of exploration in recent years have hit historic lows and much existing infrastructure is now reaching the end of its design life and is operating at low levels of production efficiency, resulting in declining overall production. As Sir Ian Wood’s recent report has so clearly set out, the industry urgently requires increased investment both in discovering and developing new fields and in maximising production from existing fields in order to slow this trend. It also needs competent and well-resourced administration for the purposes of ensuring maximum safety of operations for people and the environment, and to ensure maximum efficiency of extraction. Finally, it needs continuity, clarity and stability in

---

1 Penelope Warne is Senior Partner and Head of Energy at CMS Cameron McKenna LLP. She is an oil and gas law specialist qualified for more than 20 years in both Scots law and English law and is an Honorary Fellow and visiting lecturer in oil and gas at the University of Dundee’s Centre for Energy, Petroleum and Mineral Law and Policy (CEPMLP). She established the CMS Aberdeen office in 1993 specifically to advise the oil and gas industry on the complex issues of the interaction of Scots law, English law and European law as they relate to such the regulation and operation of the industry. Judith Aldersey-Williams has been a Partner in the Energy team of CMS Aberdeen since 2007 and has 15 years' experience as an oil and gas lawyer advising operators and contractors on regulatory and contractual issues. Judith has also advised Oil & Gas UK on changes to UK regulation after the Macondo incident, and assisted Oil & Gas UK in its negotiations with the UK Government over the introduction of Decommissioning Relief Deeds.

The authors would like to acknowledge the assistance of Professor Pieter Bekker, CEPMLP Chair in International Law and partner in Steptoe and Johnson LLP, Brussels, in developing their thoughts on these issues but the views expressed here, and any errors or omissions, are their own.

2 CMS is a top 20 global law firm. Dundas & Wilson will join the CMS UK partnership from 1 May 2014. With the addition of Dundas & Wilson, CMS will have over 830 partners and 5,600 employees operating in 57 offices in 31 countries across the world including offices in Aberdeen, Edinburgh and Glasgow.

3 Marginal tax rates are between 62% for fields not subject to Petroleum Revenue Tax (PRT) and 81% for fields subject to PRT.

terms of taxation, operational consenting and regulation to ensure that the oil companies will continue to have the confidence to invest.

**General overview**

**What would not change**
The following matters have been the subject of separate Scottish jurisdiction since the Acts of Union and so independence would have limited impact in these areas:

- Criminal law;
- Contract law for contracts subject to Scots law;
- The law of tort (delict in Scots law) for civil wrongs committed within the Scottish jurisdiction;
- Family law and succession – but see below re immigration and citizenship;
- Law of real property;
- Court system and procedure (except that appeals would no longer go to the Supreme Court in London, with the Inner House in civil matters and the High Court of Justiciary in criminal matters together becoming the Supreme Court of Scotland.)

**What would not change immediately?**
It is assumed that if the result of the proposed referendum were to be in favour of independence, this would lead to the negotiation of an independence statute and/or treaty to achieve the result desired by majority of the Scottish people. In cases where former parts of the British Empire have been granted independence, the independence statute has provided that no future Westminster legislation will be binding in the relevant territory and that thereafter the legislature of that territory will have full power to legislate for that territory without any restriction by reference to incompatible UK legislation. However, in order to avoid a legal vacuum the independence statute has often also stated that this does not affect the continued application of existing Westminster legislation which was applicable in the relevant territory immediately before independence (subject to certain exceptions) unless and until repealed by the legislature of the newly independent state. While the independence of Scotland, an integral part of the United Kingdom for centuries, would be considerably more complex to achieve than the independence of a former colony, it would seem likely that, except to the extent expressly disappplied in the independence statute, all UK statute law currently applicable in Scotland (that would include all Acts of the pre-1707 Scottish Parliament, all Westminster Parliament statutes which expressly or by implication extended to Scotland and all Acts of the Scottish Parliament since 1998) would continue to be so unless and until repealed or amended by the new independent Scottish Parliament. However, it would be necessary to make consequential amendments to many of those statutes which would probably need to be done on a case by case basis rather than by using general rules of interpretation. For instance while references to the

---

5 See for example Nigeria Independence Act 1960, section 1(3).
6 See the White Paper – Chapter 7, page 259 "Following independence, existing laws, whether passed by the Westminster or the Scottish Parliament, will continue to apply until they are amended by the independent Scottish Parliament."
United Kingdom could after independence be read as references to Scotland, and that might work in the case of some straightforward statutes, for others more specific changes would be needed to specify, for instance, what Scottish Minister, department or agency would take over various statutory roles in those statutes. All relevant legislation would need to be reviewed and any independence statute might be expected to have very extensive schedules containing these consequent changes. In order to keep the task to manageable proportions, it might be necessary to focus on specific key pieces of legislation and to leave the task of amending other legislation to the Scottish Parliament post-independence.\(^7\)

So far as case law is concerned, the pre-independence decisions of the Supreme Court on matters of Scots law would remain binding until overturned by the new Supreme Court of Scotland while English case law on English matters would remain persuasive only in the Scots courts, as it is today.

**What would change?**
Currently under the Scotland Act 1998, the Scottish Parliament cannot legislate on reserved matters. Health, education and local government are already within the remit of the Scottish Parliament and Scottish Government but much of the rest of public law remains a Westminster remit - “reserved matters” include, most pertinently from our perspective, energy law including regulation of electricity generation, transmission and distribution, oil and gas exploration, production, and gas transmission and distribution, coal production and nuclear energy, with the exception of some environmental aspects.

Other reserved matters include:

1. certain constitutional issues, foreign affairs and defence;
2. fiscal, economic and monetary policy (other than local taxes to fund local authorities, such as council tax), the currency, financial services, financial markets and money laundering;
3. certain domestic matters ranging from national security, interception of communications, official secrets, terrorism issues and emergency powers to data protection and freedom of information, immigration and extradition;
4. issues relating to business including company law, insolvency, competition law, intellectual property law, import and export control, consumer protection and product standards, weights and measures, telecommunications and postal services;
5. most issues relating to road, rail and air transport;
6. certain issues in relation to health, social security and pensions;
7. employment law, industrial relations and health and safety law;
8. regulation of the media and of certain professions.\(^8\)

Following independence, it would be open to the Scottish Parliament to legislate on any of these matters.

---

\(^7\) See for instance the comments on the amendments which would be required to the Petroleum Act as noted at section 3.3 below.

\(^8\) For a full list see Scotland Act 1998, Schedule 5.
Status of European Law

The status of European law after independence would be more complex. While those directives incorporated into Scottish law by virtue of Acts of the Westminster Parliament would continue to be part of the law of Scotland (assuming the wholesale retention of existing statute law referred to above) those parts of EU law (for instance, the EU treaties themselves, regulations, some decisions and general principles of law) which are “directly effective” in Scots law would presumably be so only to the extent that Scotland remained a member of the EU, a matter which has been the subject of some political debate in recent months. If a new application for membership were to be required, and if that membership process was not fully resolved until some time after independence then there might be a period during which the status of directly applicable EU law would be open to some uncertainty. In practice, however, the key provisions of European law from the perspective of the oil and gas industry, such as the Hydrocarbons Licensing Directive, and those directives dealing with health, safety and environmental matters, are unlikely to be affected, as they are incorporated into domestic law and would continue to apply as a matter of domestic law regardless of any delay in Scotland joining the EU.

International treaties

The FCO Treaty database covers 2,900 multilateral treaties and 10,000 bilateral records dating back to 1835 – it is unknown how many of these are still in force and how many have relevance to Scotland but it is likely to be hundreds at least. Rules on state succession are not clear but it is likely that the UK would be a continuing party to these treaties whereas Scotland would be treated as new state and would have to enter into new treaties/accede to multilateral treaties. Inevitably this would take a number of years and it would be necessary to prioritise key treaties on independence.

Implications for the oil and gas sector

Introduction

In general, there seems to be no reason why Scotland could not successfully regulate its oil and gas resources separately from those of the remainder of the UK (referred to hereafter as “rUK”). There would however be the potential for a significant period of uncertainty during the transition and this could have a serious impact on Scottish oil and gas production, coming at a time when the remaining infrastructure for oil and gas production is at a critical juncture. The more information available in advance of independence as to how these issues would be managed, the less the potential for any damaging effect.

Powers relating to oil and gas exploration and production which would revert to Scotland

As noted above, oil and gas exploration and production are reserved matters under the Scotland Act 1998. This covers in particular:

(a) the ownership of, exploration for and exploitation of deposits of oil and natural gas;
(b) the subject-matter of section 1 of the Mineral Exploration and Investment Grants Act 1972 (contributions in connection with mineral exploration) so far as relating to exploration for oil and gas;
(c) offshore installations and pipelines;
(d) the subject-matter of the Pipe-lines Act 1962 (including section 5 (deemed planning permission)) so far as relating to pipelines within the meaning of section 65 of that Act;
(e) the application of Scots law and the jurisdiction of the Scottish courts in relation to offshore activities;
(f) pollution relating to oil and gas exploration and exploitation, but only outside controlled waters (within the meaning of section 30A(1) of the Control of Pollution Act 1974);
(g) the subject-matter of Part II of the Food and Environment Protection Act 1985 so far as relating to oil and gas exploration and exploitation, but only in relation to activities outside such controlled waters;
(h) restrictions on navigation, fishing and other activities in connection with offshore activities;
(i) liquefaction of natural gas; and
(j) the conveyance, shipping and supply of gas through pipes.9

Thus, currently, oil and gas regulation is a matter for the Westminster Parliament and the UK Government. In practice, oil and gas licensing is administered by the Department of Energy and Climate Change (DECC) while oil and gas taxation is a matter for the Treasury, offshore health and safety is a matter for the Health and Safety Executive and environmental matters are dealt with by a combination of agencies including DECC, the Marine and Coastguard Agency and the Scottish Environmental Protection Agency. After independence, Scottish institutions would need to be created to take over these responsibilities to the extent that they are currently conducted by UK agencies (see further below on administrative issues).

**Implications for Petroleum Act 1998**

As noted above, it is likely that the provisions of the Petroleum Act 1998, being the principal statute which regulates oil and gas exploration and production, together with related statutes such as the Pipelines Act 1962 and the Energy Act 2008 would continue to apply following independence unless and until repealed or amended by the new Scottish Parliament.10

Section 2 of the Petroleum Act states that Her Majesty has the exclusive right of searching and boring for and getting petroleum in Great Britain or beneath the territorial sea adjacent to the United Kingdom. Section 1 of the Continental Shelf Act 1964 also vests in the Crown petroleum on the UK’s continental shelf. The Scottish Government has stated that following independence the Queen would remain head

---

9 The Scotland Act provides only three exceptions to this which are:
(a) sections 10 to 12 of the Industry Act 1972 (credits and grants for construction of ships and offshore installations);
(b) the Offshore Petroleum Development (Scotland) Act 1975, other than sections 3 to 7; and
(c) Part I of the Environmental Protection Act 1990.

10 The Scottish Government established an Expert Commission to consider a fiscal and regulatory regime for oil and gas in an independent Scotland. Its report “Maximising the return from Oil and Gas in an Independent Scotland”, July 2013, page 42 comments that: “Despite these challenges, in general, the current licensing and regulatory regimes in operation on the North Sea work well and the intention of the Scottish Government is to adopt their current operation...... There will be a presumption in favour of adopting all other existing aspects of the offshore regulatory regime, in particular the world leading health and safety standards, as it is currently administered.”
of state in Scotland and it is therefore assumed that oil and gas reserves in Scottish waters and the continental shelf adjacent to them would remain vested in the Crown.¹¹ The key matter would be the division of those waters and their resources between Scotland and the remainder of the UK, a matter addressed at sections 3.5 and 3.6 below.

The Petroleum Act would need to be amended to apply separately in rUK and in Scotland. For Scotland the changes would include the following:

(a) Amendment or removal of references to Great Britain, the United Kingdom, the Secretary of State, the Treasury, the Commissioners of Inland Revenue, HMRC, the Gas and Electricity Markets Authority, the Minister of the Civil Service, the Health and Safety Executive;

(b) The process for passing regulations would need to reflect Scottish procedure, for example, in respect of licensing under section 4(3) and regulation of inspectors under section 20(5), the process is currently negative resolution by either House of Parliament, while for application of criminal and civil law, it is by way of Orders in Council under sections 10 and 11 and for defining relevant waters, Orders in Council under section 44(4) – appropriate Scottish procedures would need to replace these.

(c) Publication of licenses – would these be published only in the Edinburgh Gazette or also still in the London Gazette?

(d) Removal of specific references to other parts of the UK which will no longer be relevant including in sections 5C, 7(1), 12(3) and to the Scotland Act in sections 13(2), 20(4), 22(2), 22(3), 25(6), 28, 38(A), 41(1), 41(2), 42(6) and 53(2).

(e) Application of criminal and civil law – sections 10 and 11 currently deal with allocation of jurisdiction between parts of the UK, and could presumably be simplified to confer jurisdiction on Scotland within appropriate geographical parameters;

(f) Reference to the Framework Agreement between UK and Norway would need to be updated when a new agreement is put in place between Scotland and Norway.

(g) In Part IV – liability for decommissioning – detailed provisions may be required to establish liability under section 29 for decommissioning where licences across the median line are split.

(h) It may be necessary to agree and address sharing of licence revenue with Northern Ireland and Isle of Man under Section 46.

(i) Amendments to provisions for limits on development loans and the related reporting process under Section 47.

**Status of oil and gas licences**

However, even if there is little doubt as to the continuing application of the Petroleum Act 1998, the arguments, currently largely academic, as to whether oil and gas licences are administrative or contractual in nature would come to the fore: the leading text on oil and gas law states: “At first sight the licence appears to be mixed

¹¹ The White Paper - Part 4, Building a Modern Democracy - Chapter 10, page 353
in character. It is contractual in form, being executed as a deed by the Minister on one side and the licensee on the other. It displays certain elements of a commercial transaction—that is to say, the assignment or transfer by the Crown, over a defined period, of certain valuable rights, in return for annual payments, royalties on the produce of those rights, and, in the case of some licences, premium payments also. At the same time, the licence arrangements retain a strongly regulatory flavour, both by reason of the formal rules for the issue of licences laid down at the instigation of Parliament and by reason of the content of the licences themselves, which must normally accord with model clauses regulating such matters as working methods, pollution and training, and reserving to the Minister considerable powers of direction of the licensee’s activity.”

Licences are it appears of a hybrid nature but they are dealt with to a large extent as contracts (for instance they are assigned by Deeds of Assignment rather than by an administrative process of transfer or cancellation and reissue) and, therefore, any licences relating to the Scottish sector would need to be transferred from the UK Government to the Scottish Government in a manner appropriate to contractual obligations.

This could be done by means of a contractual assignment (or assignation as licences in Scottish waters are deemed to be subject to the law of Scotland), as indeed licences are assigned from time to time from one oil company to another, or more probably by operation of law, in an independence statute, transferring certain contractual rights and obligations of the UK Government relating to the Scottish sector of the UKCS to the Scottish Government. The detailed terms of any independence statute would doubtless be subject to close scrutiny by the industry to ensure that there was a clear transfer of such licences. Particular issues would arise in relation to the transfer of rights and obligations in relation to those licences (and in particular, producing fields) which straddled any putative delimitation line between the remaining parts of the rest of the UK and Scotland (discussed further below). It is also possible that there could be some resistance from licensees to a transfer by operation of law without the consent of the licensees. In most cases licensees will be keen for their licences to continue but there may be some who might seek to use this as an opportunity to escape from licences with work obligations which are viewed as onerous.

The Scottish Government Oil and Gas Expert Commission has suggested that:

- Under the principle of ‘continuity of existing law’, existing energy licences will continue to be in force in an independent Scotland.
- The Scottish Government will honour all licences granted by the UK Government in areas of the North Sea which form Scotland’s geographical waters after independence.

Establishing the median line
There are two current maritime boundaries in use to separate English and Scottish waters:

12 Daintith and Willoughby, UK Oil and Gas Law, Chapter 3, para 1-323
• “Scottish Area” Civil Jurisdiction Order 1987 – 55° 50’ N – this
determines which jurisdiction’s civil law applies to offshore incidents. It
seems unlikely that this would become the border as this would not be
consistent with the international law precedents.
• Scottish Adjacent Waters Boundary Order 1999 – fixed for fishing
purposes after devolution allegedly based on the median line concept
although this is contentious, particularly from the Scottish perspective.
Although this “domestic” arrangement has no standing in international
law, it may nonetheless give an indication of where the UK would begin
their negotiations and indeed, there has arguably been some implicit
acceptance of this boundary in the report of the Expert Commission\(^\text{14}\).

It appears that presence of oil reserves or oil fields and installations is not usually a
matter taken into account in setting boundaries. However, in practice, there may be
little to argue over – the vast majority of oil and gas resources will, wherever the line
is set, be likely to fall within Scottish waters and some have surmised that the
difference between various proposed lines is only a few percent of oil reserves\(^\text{15}\).

The issue is therefore not so much the substantive result but the period of
uncertainty until it is resolved. While some may therefore assume that the issue
could be resolved quickly this may be optimistic:

• First, neither side could be seen politically to be compromising on this
issue too easily. International law on this issue far from simple but in
practice the equidistance or median line principle appears to be
favoured – however, this is always subject to “special circumstances”
or “equitable factors” – each party would therefore raise the factors
(e.g. proportionality, particular features of coastline, impact of islands)
which favoured its case.
• Second, while the difference in resource terms might look insignificant
today, it is impossible to know what new discoveries might be made in
future years with new technologies and new approaches – while
currently shale gas and shale oil are largely developed onshore, it is
possible in future that methods to produce them commercially
offshore may emerge and the areas previously viewed as barren may
be worth a second look.
• The UK might be unwilling to compromise on giving in to Scotland on
a more southerly boundary, given that it is also contesting boundaries
with Argentina over the Falkland Islands and with Spain over
Gibraltar.

If the parties were unable to come to rapid agreement, one alternative would be a
joint development zone in the area of dispute (which would in turn create its own
boundary disputes) while the dispute was taken to an international tribunal – such
cases typically take five to ten years to resolve.\(^\text{16}\)

\(^{14}\) See Scottish Government Expert Commission report “Maximising the return from Oil and Gas in an
\(^{15}\) Ibid.
\(^{16}\) See also Legal Implications for the UK Offshore Oil Industry of an Independent Scotland By
Professor Pieter Bekker and Penelope Warne (CEPMLP) available at


Cross-median line fields
In relation to those licences or fields which straddled the median line, a new treaty would be required between England and Scotland to address cross-border issues similar to the existing treaty between the rUK and Norway\(^\text{17}\) which addresses jurisdiction, authorisations, HSE standards, access to infrastructure, decommissioning, cross border pipelines and cross-border unitisation of new fields. The Norwegian treaty would be a useful starting point for such negotiations.

Taxation would need to be addressed by a double taxation treaty between the two nations. In the absence of clear rules addressing these issues, investment in cross-border fields and licences would be inhibited and there would be the risks of competitive drilling or of licensees taking advantage of any arbitrage available between the two regimes particularly in fiscal terms.

Indeed, in addition to the treaty between the rUK and Scotland, a new treaty with Norway would be required as the treaty between the UK and Norway would no longer apply and there are fields which straddle the median line between the Norwegian North Sea and the Scottish sector of the UKCS.

Potential for amendments to legislation and licences
In principle, therefore, as discussed above, the Petroleum Act 1998, secondary legislation pursuant to it, and licences issued under it, would be highly likely to continue to apply following independence unless and until the Scottish Government chose to alter them. The White Paper states that “The current licensing and regulatory regimes in operation will continue, and existing energy licences will continue to be in force in an independent Scotland. This will provide operators and investors with certainty about the fiscal and regulatory regime on independence, whilst ensuring that the industry continues to make a fair and proper contribution to Scotland’s public finances.”\(^\text{18}\).

It would be interesting, however, to see whether, over time, given statements from Scottish Ministers about the significance of the oil and gas industry to the Scottish economy and the potential benefits of increased oil and gas production to that economy, a new Scottish Government would choose to place any increased obligations on oil and gas operators by means of changes to the Model Clauses incorporated into oil and gas licences. Any uncertainty as to the future policy of the Scottish Government in relation to oil and gas regulation would be certain to have a significant negative effect on investment in the Scottish sector of the UKCS and could potentially trigger early decommissioning of assets with the accompanying costs which, it is assumed, would be to the significant cost of the Scottish Government in terms of tax take and also decommissioning reliefs.


If there were to be any attempt to amend existing licences then this would again raise the question of whether such licences are administrative and subject to unilateral variation, or contractual and therefore subject to variation only by mutual consent. In the past, there are a number of cases where the UK Government has wished to ensure that new or amended provisions would bind existing, as well as future, licensees. Daintith and Willoughby posit three alternative methods to achieve this. The first is to secure the consent of all existing licensees to the desired alteration of their licences, the second is to legislate imposing new obligations outside the framework of the licences, and the third is to enact legislation effecting or empowering the unilateral alteration of the licence terms themselves. “Of these courses, the first is likely to be impossible to carry through consistently, or highly time-consuming and expensive. The second ... creates the risk of conflicts between the contractual rights and obligations of the licence and the obligations imposed by external regulations. Though the licensee cannot treat such conflicts either as nullifying the effect of the regulations or as breaches of the Crown’s contractual obligations, they may possibly provide a basis for arguing that the licence contract has been frustrated and thus allow the licensee to escape from its obligations on more favourable terms than would otherwise be possible. ... The third course, the most drastic in appearance, is the one which has actually been taken by the Government on most occasions when it wished to effect general alterations in licence obligations.” 19

If the Scottish Government sought to impose new regulatory provisions on holders of licences in the Scottish sector, such changes might therefore be challenged either on the basis that there is no ability unilaterally to vary the terms of a licence or, if the hybrid nature of the licence were accepted, on the basis of judicial review or breach of human rights. It is notable that when the First and Second Round licences were extended at the end of their original terms this was achieved by means of a Deed of Amendment executed by the Secretary of State and the relevant licensees.

The White Paper states that “The Scottish Government welcomes the contribution that Sir Ian Wood’s interim report makes to the debate. Particularly welcome is the proposal to create a new regulator. This will provide the necessary skills, knowledge and authority to ensure that we maximise the potential of the wealth of resources remaining. The Scottish Government’s Expert Commission will consider Sir Ian Wood’s report in full.” 20

In implementing the conclusions of Sir Ian Wood’s report the Scottish Government would need to consider (as indeed will the UK Government) the possibility of challenge on such grounds.

**Fiscal Policy**

The new Scottish Government would need to establish its own fiscal policy and the Fiscal Commission has published a series of reports on the principles which should underlie such a policy. It is assumed that initially Scotland would therefore simply keep in place UK revenue law (along with HMRC as the collector of taxes for a

---

19 Daintith, Willoughby and Hill, U.K. Oil & Gas Law Part 1, Chapter 3, para 1-329
20 The White Paper - Part 3, Environment, Rural Scotland, Energy and Resources - Chapter 8, page 302
transitional period) until its own policies could be developed. Specifically in relation to oil and gas, the White Paper sets out some overarching aims of such a policy which are very reassuring being to support and incentivise production, to provide long-term stability and certainty, including a commitment to formal consultation on future reforms, and to provide efficient fiscal incentives that encourage exploration and help maximise economic recovery rates. It also states that “The Scottish fiscal regime will also recognise factors central to offshore operations, including:

- Exploration periods with long time-lags and significant up-front costs
- Highly capital-intensive development requirements
- Significant geological, technical and economic risks
- Sophisticated business structures and specialised technology
- Costs of decommissioning.”

The White Paper also indicates that there is no aim to increase the overall tax burden on the industry on independence. However, while these are all encouraging statements, the industry will require a much greater level of detailed information as to the interaction of the new Scottish taxation system with the existing UK regime.

In particular, as oil and gas companies pay extremely high rates of tax (the current marginal rates being 62% and 81% for non-PRT and PRT paying fields respectively), they expect in return to be able to set off against those taxes, losses or expenditures that they may incur in their oil and gas operations, including the cost of decommissioning their assets at the end of the day. There are complex rules enabling the carrying back of losses against the various taxes for differing periods.

If companies have paid a great deal of UK tax in the past, they will be concerned as to whether they will still be able to set off costs against that tax in accordance with the current rules, even if, when incurred, those costs are incurred in relation to assets which are then in the Scottish jurisdiction. There are a number of ways in which this might be permitted, but addressing the interaction of the tax rules of the two jurisdictions would be extremely complex. We note for instance that the process of amending the UK tax code recently to allow for the introduction of decommissioning relief deeds (see paragraph 3.9 below) took two consultation papers, primary legislation and overall a period of 30 months to achieve – we do not imagine that the process of agreeing double taxation arrangements for the oil and gas industry would be any less complex. In this regard the Scottish Government has said that “…Following a vote for independence, the Scottish Government will seek a double taxation agreement with the Westminster Government. It will be in the interests of both Scotland and the rest of the UK to ensure that cross-border tax affairs for companies and individuals operating in both jurisdictions are as fair and simple as possible.”

…“The Scottish Government is committed to a tax system that will ensure fairness for cross-border taxpayers, including those due to pay tax in both Scotland and the rest of the United Kingdom. An independent Scotland will signal its intention to adhere to all international tax treaties in force between the UK and third

---

21 Ibid, page 303.
22 The White Paper - Part 5, Q&A Finance and the Economy, page 387
party states, so that these treaties can continue in force between Scotland and that state.\textsuperscript{23}

If losses incurred in exploring for oil or developing assets in Scottish waters can no longer be set against profits generated by assets in rUK waters, or vice versa, it may be expected that there would be some rationalisation of portfolios with some companies choosing to concentrate their assets in one or other sector. There might also be an impact on exploration unless and until parties had built up sufficient tax capacity in Scotland to set off exploration costs in Scotland against that capacity.

**Decommissioning tax relief and DRDs**

Another matter on which clarity is crucial for the oil and gas industry is the intention of any future Scottish Government with respect to decommissioning tax relief. The industry has devoted an enormous amount of time and energy over the past two years to the negotiation with the Treasury of a new mechanism to ensure certainty as to decommissioning tax relief through the use of decommissioning relief deeds (DRDs) – an effort matched only by the commitment of the Treasury to the process. This mechanism was implemented through the Finance Act 2013 and the first DRDs were signed in October 2013.

Many of the larger and more expensive installations to be decommissioned in future years are in northerly waters which would come under Scottish jurisdiction following independence. If there were to be any suggestion that the Scottish Government would not grant tax relief against the costs of decommissioning those assets and/or would fail to honour the guarantees given by the UK Government as to the amount of that relief pursuant to the proposed DRDs, then this could have serious implications in terms of a return to pre-tax security (which in turn could trigger defaults under security agreements) and possibly premature decommissioning.

The position of the Scottish Government has been made clear in the White Paper, which states that "The Scottish Government is committed to providing certainty and stability on the long-term treatment of decommissioning tax relief. ... Post-independence decommissioning relief will be provided in the manner and at the rate currently provided through the current fiscal regime."\textsuperscript{24}

The White Paper goes on to state "Responsibility for decommissioning tax relief will be the subject of a negotiation between the Westminster and Scottish Governments.... The Scottish Government will seek a commensurate contribution to meeting the costs of decommissioning from Westminster. However, the outcome of these negotiations will have no impact on the value of relief received by operators.\textsuperscript{25}

While encouraging, this position assumes that it would be possible for the UK and Scottish Governments to negotiate such an equitable apportionment and this would not be a straightforward exercise, going as it does to the heart of one of the most emotive issues in the independence debate which is the use of past North Sea revenues.

\textsuperscript{23} Ibid
\textsuperscript{24} The White Paper - Part 3, Environment, Rural Scotland, Energy and Resources - Chapter 8, page 304
\textsuperscript{25} Ibid
This position was reiterated in the report of the Expert Commission established by the Scottish Government to consider a fiscal and regulatory regime for oil and gas in an independent Scotland has said that “...the Scottish Government will provide the tax relief associated with decommissioning North Sea facilities in Scottish waters.

The Expert Commission also expressly addressed the question of DRDs stating The Scottish Government welcomes the long-term certainty provided by the introduction of Decommissioning Relief Deeds and will provide similar contractual certainty for decommissioning relief with respect to production undertaken post-independence.\textsuperscript{26} and “Scottish Ministers have repeatedly called on the UK Government to provide long-term certainty in the provision of decommissioning relief, and the measures set out in the Finance Bill 2013 are welcome progress on this issue. The Scottish Government recognises the importance of ensuring that the Decommissioning Relief Deed effectively reduces the costs of the provision of financial security from a pre-tax to post-tax basis.”\textsuperscript{27}

It would be necessary for clear and unambiguous language to be included in any independence statute addressing the transfer of obligations under DRDs to the extent that they relate to assets within Scottish territorial waters or the Scottish continental shelf.

**Administrative reorganisation**

One of the urgent tasks of an incoming administration would be to replicate the administrative organisations of the United Kingdom, including its own equivalent of DECC, the HSE and other institutions. DECC functions are currently divided between London and Scotland – licensing matters are dealt with in London and there are few, if any, staff with experience in these matters in Scotland, and vice versa for environmental and decommissioning issues. There would be a need to replicate a full organisation on both sides of the border. The staff at DECC dealing with oil and gas matters are, even on the basis of current responsibilities, often overstretched and it is unlikely that the department could be divided into two organisations capable of exercising the same functions in separate jurisdictions without significant additional recruitment. It is understood that recruitment is a challenge for DECC even now given that it is competing for staff with a very high paying industry.

Therefore, even if there were to be no immediate change in the legal regime governing oil and gas exploration and development, there would be the potential for a significant damaging effect resulting from the inability of the new administration to find the staff in Scotland to address matters such as licence applications, transfers, drilling consents and the like. Significant preparation would be required in the run-up to independence to address the need for as seamless a transition as possible.

However, this is not simply a question of trying to replicate an existing structure - those pressures would be heightened as the implementation of independence would coincide with two other significant changes in the overall regulatory regime:

\textsuperscript{26} Scottish Government, Expert Commission established to consider a fiscal and regulatory regime for oil and gas in an independent Scotland report "Maximising the return from Oil and Gas in an Independent Scotland", July 2013, page 37

\textsuperscript{27} Ibid page 46
• the introduction of the new more hands-on regulator in the UK as recommended by Sir Ian Wood in his review of oil and gas regulation. As noted above, the Scottish Government has indicated that it supports Sir Ian’s conclusions. Sir Ian has proposed a significant increase in the staffing of the new regulator compared to DECC – perhaps as much as fourfold. If that regulator then needed to be divided between the UK and Scotland, this would be likely to result in even more personnel being needed. Reviews of legislation and guidance are already underway but are likely still to be ongoing in 2015.

• DECC and the HSE are also currently involved in a very detailed review of UK legislative and administrative changes necessary to implement the EU Offshore Safety Directive – although this work is already well advanced it will take up a considerable amount of time for both organisations not only in the run up to the new legislation coming into force in July 2015 but thereafter in that many operators will need to amend and submit for approval revised safety cases over a very short period thereafter.

Adding independence implementation to these existing issues would be likely to lead to give rise to significant stresses on personnel at DECC and HSE over the twelve months following the referendum.

Governing law of contracts
The vast majority of contracts in the oil and gas sector in the UK are governed by English law, even when their subject matter relates to the Scottish sector. Historically, this stems from the choice of English law to govern the joint operating agreement (in part because the English law trust concept allowed particular tax efficient structures to be adopted within corporate groups and also because the English law concept of tenancy in common appeared particularly apposite to allow the severance of the joint interest granted by the licence). Other contracts within the sector are also usually governed by English law partly as a matter of convenience (since non-UK counterparties are usually more familiar with English law) and also for consistency (since the JOA is governed by English law and it therefore reduces the risk of inconsistent interpretation of liability and indemnity provisions in related contracts). Currently for many practical purposes there is little difference between English and Scottish contract law (although there are some differences in the analysis of liability and indemnity clauses where in the case of a serious offshore incident the impact could be very significant). While English cases have no formal precedent status in Scotland they are of persuasive value and are often considered in judgments on contract law issues while the ultimate court of appeal for civil cases in both legal jurisdictions is the Supreme Court of the United Kingdom in London. Following independence the Inner House of the Court of Session (currently the Scottish equivalent of the Court of Appeal) would become the final arbiter for Scots law purposes.

Although English decisions would continue to have persuasive value, over time, the case law of the two jurisdictions might tend to diverge as Scotland created a more distinct legal personality in contract as it has in other areas. The practical impact of
this would depend on whether current practice of using English law for most contracts continued. Particular difficulties could be caused if indemnities in offshore contracts were to be interpreted differently in English and Scots law, and different laws were to be used in different contracts all of which became relevant in relation to an offshore incident – in many cases it will be important to ensure that indemnities going up and down the supply chain are interpreted consistently to ensure that losses find their way to the person who was intended to bear them.

The oil and gas ministries of some jurisdictions specify that their local law is to be used for contracts relating to licences or concessions in those jurisdictions (for instance it is understood that contracts in the Norwegian sector must be governed by Norwegian law). If a new Scottish Government were to impose such a requirement in future it would increase the use of Scots law, and risk an increase in cases of conflict between the interpretation of similar clauses in different contracts relating to the same incident if older contracts were still governed by English law but newer contracts were governed by Scots law.

**Employment in the oil industry and oil services**

A key feature of the oil industry is the mobility of its workforce. Many of those who work in the oil and gas industry spend a large part of their year away from home, sometimes abroad, sometimes in another part of the UK. The industry has brought many English people (among many other nationalities) to Aberdeen, and sent many Scots to London and further afield. The Scottish Government has been keen to develop Aberdeen in particular as a global centre of excellence in oil services - key to this will be continued ease of movement for Scots workers, much of which will inevitably involve travel through England. This will require rapid resolution of the question of whether Scotland will be in or out of the Schengen area and what border controls will be necessary between England and Scotland, which will in turn require some agreement between the UK and Scottish governments on issues of immigration.

A key question for many of those working in the industry will be the impact of independence on their citizenship. Up to this point both Scots and English have been UK citizens and it has not been necessary to have any rules to determine to which of the individual jurisdictions an individual belongs for purposes of citizenship. (The law uses concepts such as domicile which determines which jurisdiction’s family law and succession law may be relevant to an individual, and the concept of residence which will, for instance, be the basis of determining who would pay a Scottish income tax but neither domicile nor residence necessarily implies nationality). Many Scots may wish to ensure that even if they are working in England they acquire Scottish citizenship for reasons of patriotic pride, culture and heritage – for many English people working in Scotland the converse may be true. This will be the case even if, as expected, Scotland and England are both in the EU and therefore there is freedom of movement between them.

UK citizens living outside UK can pass citizenship to their children but not subsequent generations – what is the impact of this on English people living in Scotland after independence – would they want to go home rather than risk having grandchildren who were not UK citizens? Will Scots working in England decide to come home to ensure their children have Scots citizenship? The impact of a positive
vote on the workforce, and the extent to which people feel the need to relocate to their “cultural” home, is a matter of speculation.

A further matter which would be of major concern to those who live and work between the two jurisdictions would be the impact on their tax positions and therefore, as noted above, early negotiation of a double taxation treaty would be required.

**Import/export issues**

If an independent Scotland became part of the EU there would be free movement of goods and services between Scotland and the remaining parts of the UK and, indeed, other EU/EFTA countries such as Norway. However, if this result took some time to achieve there would be a hiatus during which separate arrangements might need to be put into place. For oil and gas companies, and their related service companies, looking to invest, this would tend to generate uncertainty and would be a disincentive to investment.

**Location of licensee/operator**

Currently DECC imposes no requirement that a licensee or an operator must be a UK-registered company (indeed, to do so would be a breach of free movement rules). However, it does require that licensees have a place of business within the UK. This means at least one of the following:

- Having a staffed presence in the UK;
- Being registered at Companies House as a UK company; or
- Having a UK branch of a foreign company registered at Companies House.

To join a licence and take an interest in a producing field, licensees are required either:

- To be registered at Companies House as a UK company; or
- To carry on business through a fixed place of business in the UK (a ‘fixed place of business’ normally means a staffed presence).

Clearly some companies with assets in Scottish waters or the Scottish sector of the UKCS operate through a company registered in England and Wales, have their base in London and have limited or no Scottish presence. If the new Scottish Government were to apply the same rules and were to require a company to be registered in Scotland or to have a permanent presence in Scotland then this might necessitate the transfer of people north of the border, with potential property and corporate requirements to meet that requirement. The same might be true in reverse for Scottish companies with interests in the English sector.

**Conclusions**

None of the issues set out above is incapable of resolution. However, they will all take time, effort and the will of the relevant governments to resolve. Of these, the issues of the border and tax treatment are likely to be the most complex to resolve. The challenge for the oil industry will be the extent to which it is willing to invest in offshore oil and gas exploration and development until some of the uncertainties as to these issues are resolved. The challenge for the Scottish government, where a
decision is taken to invest, is to ensure that it will be capable of taking the administrative steps necessary to allow that investment to proceed. As Oil & Gas UK say in their paper on the Referendum “The industry cannot afford, at this stage of the basin’s advanced development, any interruption in the provision of operational consents, the honouring of fiscal reliefs, or in the ease of access to goods, services and people, irrespective of where they may come from or be situated in the British Isles.”

Penelope Warne and Judith Aldersey-Williams, CMS
April 2014