



Oil & Gas
Authority

Response to the consultation on OGA Financial Guidance

Date of publication 8 August 2018

© OGA Copyright 2018

Published by Oil and Gas Authority

You may re-use this information (not including logos) free of charge in any format or medium, under the terms of the Open Government Licence.

To view this licence, visit www.nationalarchives.gov.uk/doc/open-government-licence/ or write to

The Information Policy Team

The National Archives

Kew

London TW9 4DU, or email: psi@nationalarchives.gsi.gov.uk.

Enquiries to:

Investor Finance Team

Oil and Gas Authority

21 Bloomsbury Street

London

WC1B 3HF

Email: investor.relations@ogauthority.co.uk

Contents

1. General information	4
2. Introduction and Background	5
3. Response to the consultation	6
4. Summary of responses	7
5. Next steps	28
6. Regulatory Impact Assessment	29
Annex 1: list of organisations responding to the consultation	30

1. General information

Purpose of this document

This document sets out the Oil and Gas Authority's (OGA) response to the consultation on the OGA's revised financial guidance, entitled "Guidance on the Assessment of Licensee Financial Capability". This consultation ran from 1 June 2018 to 29 June 2018.

Consultation reference: <https://www.ogauthority.co.uk/news-publications/consultations/2018/consultation-on-guidance-to-assess-financial-capability/>

This response issued

8 August 2018

Territorial extent:

The petroleum-licensing regime for offshore licences has UK extent, and the licensing regime for onshore licences has England extent. Offshore licences are awarded for areas in the UK's territorial waters and the UK Continental Shelf, and onshore licences are awarded for areas in England.

Additional copies:

Other versions of the document in Braille, large print, audio or Welsh can be made available on request. Please contact us using the 'enquiries' details to request alternative versions.

Quality assurance

This consultation has been carried out in line with the government's consultation principles.

If you have any complaints about the consultation process (as opposed to comments about the issues which are the subject of the consultation) please address them to:

OGA consultation co-ordinator
21 Bloomsbury Street
London
WC1B 3HF

Email: ogaconsultationcoordinator@ogauthority.co.uk

2. Introduction and Background

1. The OGA takes decisions in respect of various activities pertaining to the extraction and storage of petroleum on the United Kingdom Continental Shelf and onshore in England and Wales (Wales until its planned devolution of such matters on 1 October 2018). Many of those decisions are based on commitments made by a legal or natural person (an Applicant) to undertake certain activities in the future.

The OGA considers that it is important to understand the Applicant's financial capability, to be able to make a judgement as to the likelihood of that Applicant having the funds needed to meet the commitment on which the OGA's decision is based (the Commitment).

2. The OGA has identified the following activities as potentially including the making of a Commitment to the OGA, or the transfer of a Commitment from one legal or natural person to another:
 - (a) Licence award;
 - (b) Licence assignment;
 - (c) Change of control of licensee;
 - (d) Innovate licence progression;
 - (e) Well consent;
 - (f) Field Development (including extended well tests); and
 - (g) Pipeline Works Authorisation.

The OGA may also apply this Financial Guidance in any other circumstances where an application is made to the OGA in respect of the terms of a license or for an authorisation or consent required under the terms of a license or by statute.

3. The existing financial guidance for the above activities has been amended several times since originally published by the Department

of Energy and Climate Change (now the Department for Business,

Energy and Industrial Strategy), however it has not been updated since the OGA took over responsibility for such activities in October 2016. The OGA considers that the existing financial guidance should be updated as it is fragmented, and, in parts, repetitive and does not reflect the new and innovative sources of finance that licensees are now using. Therefore, the financial guidance has been revised to specify the OGA's requirements for assessing an existing or prospective licensee's financial capability, and to take into account the various funding models that licensees are using today.

4. The Financial Guidance sets out the factors that the OGA will usually take into consideration when reviewing the financial capability of an Applicant. Where an application is submitted on behalf of the legal or natural person who would assume the Commitment to the OGA, it is the person assuming the Commitment that shall be regarded as the Applicant. The Financial Guidance also sets out the steps that legal or natural persons seeking a decision from the OGA should take to facilitate those considerations.
5. In assessing an Applicant's financial capability, the OGA will assess two broad financial criteria. These are financial viability and financial capacity. Financial viability refers to an entity's current and historic solvency and provides assurance that the Applicant is currently solvent and is expected to remain so for the foreseeable future. Financial capacity refers to the Applicant's ability to meet all known and anticipated future commitments, including the Commitment, and will normally focus on the Applicant's financial forecasts.

3. Response to the consultation

Q1. OGA Analysis:

When assessing the likelihood of an Applicant having the funds needed to meet the Commitment on which a decision is based, should the OGA analyse other financial factors in addition to financial viability and capacity of an Applicant as set out in the Financial Guidance? If yes, what else should the OGA analyse?

Q2. OGA Approach:

In accordance with the Financial Guidance, the OGA will take a risk based approach to its recommendation; is this appropriate or should the OGA take an absolute, “pass/fail”, approach?

Q3. Financial Viability:

Are the tests set out in section 6 of the Financial Guidance the most suitable? If not, what tests should the OGA use?

Q4. Financial Viability:

Are the thresholds referred to in section 6 of the Financial Guidance set at an appropriate level? If not, what level would be appropriate?

Q5. Financial Capacity:

Are the tests set out in section 7 of the Financial Guidance the most appropriate? If not, what tests should the OGA use?

Q6. Financial Capacity:

Are the thresholds referred to in section 7 of the Financial Guidance set at an appropriate level? If not, what level would be appropriate?

Q7. Specific financing arrangements:

Section 8 of the Financial Guidance is intended to better reflect the different funding models now available to Applicants. It is not intended to be exhaustive, the OGA recognises the need for and is supportive of financial innovation. If there are other sources of finance being actively considered, the OGA will consider adding them to Section 8. Does the Financial Guidance include all key sources of finance available to Applicants? If not, what else should the OGA consider?

Q8. Information requirements:

Is the information required by the OGA as set out in the information requirement matrix in section 10 of the Financial Guidance the right information to perform the financial viability and financial capacity tests set out in sections 6 and 7 of the Financial Guidance? If not, what information should this include?

4. Summary of responses

OGA Analysis

Q1. When assessing the likelihood of an Applicant having the funds needed to meet the Commitment on which a decision is based, should the OGA analyse other financial factors in addition to financial viability and capacity of an Applicant as set out in the Financial Guidance? If yes, what else should the OGA analyse?

Eight respondents felt the financial guidance appears to be sufficient to allow the OGA to measure the financial strength of a company or groups of companies.

One respondent thought the OGA should analyse the future ability of an Applicant and Guarantor to raise further funds, equity or debt, to cover future liabilities including site abandonment, restoration, after care, contamination and damage/compensation. **OGA response:** The OGA's financial analysis of a company is undertaken at the time of the licensing event and cannot take into account an Applicant's future ability to raise further funds.

Two respondents stated that for applicants with robust credit ratings or who are subsidiaries of corporate Groups with robust credit ratings it should be unnecessary to request all the information required by OGA. A further three respondents felt that inter-affiliate licence assignments where the Group has a robust credit rating should not trigger

the full range of information requests and financial assessment as identified in the Consultation. **OGA response:** It is necessary for the OGA to be consistent in its approach to requesting financial information and data from applicants so all information shall be required. However, in some cases the OGA may be prepared to accept a high investment grade credit rating of an Applicant as evidence that the Applicant will be able to meet the Commitment; the guidance has been updated accordingly. Therefore, applicants are encouraged to engage with the OGA early to have a discussion about information and data requirements.

Three respondents commented that the OGA should introduce a de minimis cut-off value below which the financial guidance does not apply. **OGA response:** Article 5 of EU Directive 94/22/EC requires that the OGA take all necessary measures to ensure technical and financial capability of Applicants, and in this regard, a de minimis cut-off is not possible.

One respondent proposed that new entrants should provide independent reports of reserves and resources, scope and nature of insurance provision, and price hedging details. **OGA response:** Where applicable, the OGA expects applicants to include this information in their own due diligence and prepare their financial application accordingly.

One respondent stressed that the financial guidance should state clearly that where a licence transaction does not increase the Applicant's cumulative commitments there should be no requirement for financial capacity to be demonstrated. **OGA response:** The OGA is sympathetic to this comment and the guidance has been amended to give the OGA the option of not carrying out financial capacity tests where there is no increase in cumulative commitments.

One respondent felt that the OGA should clarify how it evaluates a company's overall legal entity structure as well as the cumulative commitments of the Applicant, i.e. to take into consideration the financial viability and financial capacity of all affiliate companies where cash flows move freely within a corporate group to fund their respective commitments. **OGA response:** The OGA is only able to enforce licence commitments against the legal persons who are legally bound to meet those commitments. Therefore, the OGA believes that in making judgements about financial capability it should rely only on its financial assessment of an Applicant, and if appropriate, that of a guarantor.

One respondent commented that the OGA should clarify that paragraph 3.9 of the guidance is not triggered where an existing licensee assigns some, but not all, of its licence interest to another existing licensee. With another respondent stating that paragraph 3.9 appears counter-intuitive where an assignor is reducing its

commitments via an assignment to another party. **OGA response:** The assignor or divesting licensee may be reducing its commitments but if the assignment or change of control involves producing assets the assignor or divesting licensee would also be losing positive future cash flow. The OGA needs to ensure the transaction is not detrimental to the assignor's or divesting licensee's capacity to meet its retained commitments.

One respondent stressed that the financial guidance should recognise more explicitly that the criteria needs to be adapted in the case of exploration-focused companies that are not yet making a profit and which will therefore fail the financial viability checks. **OGA response:** the new financial guidance removes the pass/fail criteria and is replaced by a risk-based analysis, which should better mitigate this concern.

One respondent believed that the OGA's financial analysis should cover the ability of operators to fund future decommissioning activities. **OGA response:** Decommissioning cost information is requested from an applicant as set out in the information matrix and this analysis does happen.

One respondent stated that the financial guidance should be applied to Applicants solely on their own merits without reference to the presence of financially stronger partners who could act as a back-stop. **OGA response:** The guidance explains that the OGA will assess the financial

capability of licensees to meet their share of commitments under the licence.

One respondent set out that under the existing financial guidance, for certain licence events, only financial viability is assessed and where deemed sufficient financial capacity is not assessed. The new guidance removes this two-tiered approach which increases the regulatory and administrative burden to Industry.
OGA response: This is not an accurate reflection of our current guidance. Under the existing guidance, financial capacity is not assessed only in instances where there is no work programme or other agreed CAPEX.

One respondent felt that financial capability of Groups should include investment values of their subsidiaries.
OGA response: Financial assessments of corporate groups are undertaken on a consolidated basis to specifically eliminate inter-company balances, such as investments in subsidiaries, as those investments are usually brought onto the balance sheet at market values. Market values are subject to price variation and do not have any effect on a Group's capacity to fund specific Commitments.

OGA Approach

Q2. In accordance with the Financial Guidance, the OGA will take a risk based approach to its recommendation; is this appropriate or should the OGA take an absolute, "pass/fail", approach?

Ten respondents agreed that a risk-based approach is more appropriate and fairer to applicants.

One respondent felt that an absolute pass/fail approach should be retained, unless the applicant is able to provide financial security to cover the liabilities that it is unable to demonstrate it can meet from its own financial resources or through the insurance market.
OGA response: The OGA believes a risk based approach is more appropriate.

Two respondents thought that more clarity is required as to the consequences where an Applicant is considered High Risk.
OGA response: This is sufficiently covered in paragraphs 2.3, 3.12 and 3.13 of the guidance.

Three respondents believed that further clarification as to how the risk based approach will be consistently applied in practice in terms of the decision-making process, for example, in relation to what risks would be assessed, how they would be assessed and what prioritisation identified risks would be given. Another four felt that more transparency of the actual processes involved is required to provide confidence to all stakeholders.
OGA response: The Investor Finance team's risk-based assessment is provided to the appropriate decision maker for the particular application made. How those decision makers weigh the financial assessment against other relevant considerations will vary by type of decision.

Where possible, the OGA will work with Applicants to ensure they understand the process.

Two respondents stated that coventurers are concerned about more than the ability of a party to fulfil a licence commitment and therefore those coventurers will continue to require a separate and different demonstration by a potential licensee of financial competence which is clearly different from the financial capacity concept in the Consultation. As such a recognition of the distinction between the concept of financial competence contained in the MER strategy and this consultation is requested. **OGA response:** The Financial Guidance is designed for OGA purposes only and is to assess the financial viability of Applicants and their capacity to finance specific licence Commitments. As set out in paragraph 1.6 of the guidance, the financial guidance is not to be viewed as a substitute for the coventurers' own due diligence processes. Separately the OGA is working with Oil and Gas UK to try and streamline these issues.

Two respondents believed that tests of financial viability and financial capacity for a subsidiary of an investment grade corporate parent should be unnecessary where the parent provides financial assurance. The same should apply when an asset is assigned from one subsidiary to another when they are both owned by an investment grade corporation; the OGA should use credit ratings. **OGA response:** The guidance will be amended to state that in instances where an Applicant provides

a deed of guarantee, and the guarantor satisfies the OGA's financial criteria, the OGA will not separately apply the financial criteria to the Applicant. However, for inter-affiliate assignments, where the corporate parent is an investment grade corporation, the OGA would still require a deed of guarantee, irrespective of credit rating, if the assignee will be reliant upon a guarantor for support and the OGA will need to assess the guarantor's capacity to provide financial support to its subsidiary.

Two respondents stated that the OGA should extend the risk based approach to the start of the assessment process rather than at the end so as to ascertain and direct the quantum and extent of the information to be provided for each specific licensing event. **OGA response:** This approach would be too administratively burdensome on the OGA.

One respondent felt that the OGA should take the materiality of the commitment into account, with another stating that the OGA should include monetary thresholds when setting information requirements. **OGA response:** Article 5 of EU Directive 94/22/EC requires that the OGA take all necessary measures to ensure technical and financial capability of Applicants, and in this regard, a monetary threshold when setting information requirements is not possible.

Two respondents thought that midstream infrastructure owners should be brought within scope of the Financial Guidance. **OGA response:** As stated therein the

guidance generally considers financial assessment in the context of licence events. However, where a person who is not a licensee applies for a pipeline works authorisation (PWA), the OGA will also carry out a financial assessment and in such instances the guidance will provide a general basis for that assessment.

Financial Viability

- Q3. Are the tests set out in section 6 of the Financial Guidance the most suitable? If not, what tests should the OGA use?
- Q4. Are the thresholds referred to in section 6 of the Financial Guidance set at an appropriate level? If not, what level would be appropriate?

Eleven respondents stated that the criteria thresholds are reasonable.

One respondent stated that the source of debt finance and the identity of lenders should be taken into consideration. If an Applicant is unable to source finance at standard market rates it would indicate difficulty to raise debt finance which should negatively impact OGA assessment. **OGA response:** This information is requested in the information matrix.

One respondent felt that a gearing ratio of over 50% should be considered high, with three others saying that the OGA should add a specific threshold to the gearing ratio. **OGA response:** Removing any reference to a gearing threshold reinforces the risk based approach concept by

removing what could be construed as a pass/fail criterion.

One respondent thought that a threshold is needed to define what OGA considers a significant Net Asset value relative to the scale of commitments. **OGA response:** This point was raised in reference to paragraph 7.6(a), however, paragraph 7.6(c) sets out the level at five times the estimated cost of all commitments. However, following comments from other consultees, we have reduced this threshold to 3.5 times.

Five respondents believed that criteria thresholds should be used for an initial high-level screening and not form hard pass/fail hurdles. **OGA response:** The OGA has proposed using a risk based approach so there will not be pass/fail criteria.

Three respondents stated that the OGA should consider offering companies the opportunity to come forward with alternative metrics. **OGA response:** The OGA is obliged to be consistent in its assessment and allowing Applicants to follow this alternative approach would not ensure assessment consistency.

One respondent believed that the OGA should provide feedback as to rationale of decision such that the Applicant can consider this for future assessments and potentially amend their funding and commercial structures accordingly. **OGA response:** The OGA will ordinarily give feedback if an Applicant is unsuccessful,

but there might be occasions, i.e. licensing rounds, when this is not possible.

Two respondents stated that net worth calculation exclude any recognition of the value of intangible fixed assets which should not be discounted from the financial assessment process; statutory audit will assert that there is a fair value to these items. **OGA response:** The OGA appreciates that intangible fixed assets may be brought onto an Applicant's balance sheet at fair value. However, for some types of intangible fixed assets fair value may not reflect their realisable value, for example capitalised exploration expenditure, and for this reason the OGA excludes all intangible fixed assets from the Net Worth calculation.

Three respondents thought that the OGA should consider detailed cash flow forecast using a price deck to be advised by OGA. **OGA response:** This is the case when the OGA requests cash flows to be re-worked based on a commodity price sensitivity as set out in paragraph 7.8(m). However, to minimise the burden on Applicants, in the first instance they will be asked to present cash flow forecasts based on their own model and assumptions.

Two respondents felt that the OGA should consider applying a standard set of sensitivities. **OGA response:** To minimise the burden on Applicants we will normally rely on the Applicant's model and assumptions (including their sensitivities). When the OGA deems it necessary to ask the Applicant to re-work their cash flow forecast on revised assumptions,

the OGA will apply sensitivities according to the nature of the licence event being considered and the funding risk presented by the Applicant.

Three respondents thought that proposed tests allow for the capture of a financial snapshot at a given point of time and therefore can only be used as an indication of future financial performance. **OGA response:** The OGA agrees with this statement.

One respondent stressed that the OGA should monitor Applicants' ongoing financial position and not rely upon an assessment conducted at a licence event. **OGA response:** Separate to the financial assessment the OGA undertakes at the time of a licensing event, the OGA conducts financial horizon scanning to monitor risks where a licensee's insolvency could have a direct impact on MER UK and/or the Exchequer.

Five respondents stated that metrics are sensitive to significant changes in accounting treatment. **OGA response:** Changes of accounting treatment will be picked up in the Notes to the Applicant's accounts as they are required to be disclosed.

One respondent welcomed the possibility of intra group debt not being included in gearing ratio calculations.

One respondent believed that borrowings must include debt due to other Group and related companies in the calculation of the gearing ratio. **OGA response:** This is the

case, but as set out in paragraph 6.5(d), the OGA will consider an Applicant's representations for a different treatment of such debt.

One respondent stressed that the OGA should provide a clearer definition of what constitutes a "strong and consistent profit". **OGA response:** Paragraph 6.3(c) has been updated accordingly.

Three respondents thought that the financial guidance needs to provide definitions for terms such as "debt" and "equity" as this would make a significant difference to the gearing calculation, e.g. hybrid bonds. **OGA response:** There are too many hybrid forms of debt and equity to arrive at a meaningful definition of debt or equity. To this end the OGA will not include any definitions in the guidance but will consider the substance, form of debt or equity variants on their merits.

Two respondents stated that clarification is needed as to whether derivative valuations, such as hedging, are defined as an asset or a liability in the gearing calculation. **OGA response:** The OGA will not be making any further clarification in this regard. A hedging arrangement is usually put in place as a response to risk, and as such, the OGA would consider it to be a mitigant and would treat it as such. With regards derivative trading, an Applicant would be required to declare derivatives as financial assets or liabilities in the Notes to the Accounts, in which case they will be defined in accordance with the Applicant's accounting policies and GAAP/IFRS.

Two respondents felt that due to limitations inherent with management accounts, their provision should be made optional and not mandatory. **OGA response:** The OGA disagrees. If an Applicant has not published any accounts, or if its most recent published accounts are too old for assessment purposes, the OGA needs accounting information, and management accounts are the generally accepted backstop.

One respondent was of the view that the OGA should clarify in paragraph 3.12 that the other relevant factors considered alongside financial capability are "covered in separate guidance, which can be found on the OGA's website". **OGA response:** Paragraphs 2.4 and 2.5 explain the context of the factors that the OGA considers.

Three respondents believed that the OGA should adopt a tiered approach where the OGA considers an Applicant has a strong track record and financial indicators support this, then they should allow for some reduction in scrutiny of financial capacity. **OGA response:** It is necessary for the OGA to be consistent in its approach to requesting financial information and data from Applicants so in the first instance all information shall be required. However, Applicants are encouraged to engage with the OGA early to have a pragmatic discussion about information and data requirements.

Three respondents felt that interest cover should be calculated using EBITDA and not operating profit. **OGA response:** The

OGA agrees with this comment and the guidance will be updated accordingly.

Two respondents stated that paragraph 6.6 provides comfort to new entrants that they will not be disadvantaged, the same comfort is not given to companies primarily engaged in exploration activities. In such cases the track records of shareholders, Directors and Officers in fund raising in current or previous roles should be considered. **OGA response:** This paragraph relates to newly incorporated companies, rather than new entrants. With regards newly incorporated companies, they are unlikely to have a track record or the financial records of their more established counterparts so the OGA is acknowledging that we would need to take a different approach with them.

Two respondents thought that paragraph 6.4 (b) should be amended to state that Applicants' financial statements should be prepared in accordance with UK GAAP, IFRS or GAAP of the jurisdiction in which they are registered. **OGA response:** The OGA agrees with this comment and the guidance has been updated accordingly.

One respondent felt a clearly stated commitment by OGA in this section to a risk based approach and clarity on the assessment processes and criteria used for the specific financial viability measures would provide the required certainty and transparency. **OGA response:** The OGA does not believe a statement to this effect is necessary, as the new financial guidance states that the OGA's financial assessment

will be based on a risk based approach.

One respondent said that the OGA should consider the Applicant's track record of delivering its forecasts in the past. **OGA response:** The OGA believes that this approach would place a disproportionate administrative burden on the Applicant and the OGA.

One respondent believed the OGA should consider an Applicant's investor and analysts' briefings and statements where appropriate. **OGA response:** The OGA has considered this in the past, however, due to confidentiality issues and not wanting to cross contaminate financial assessments this was not taken forward, and on the same basis was not included in the guidance.

One respondent stated that where an Applicant is unable to demonstrate a record of generating profits it should detail how it will achieve a return to profitability and how it will fund the Commitment in the interim. **OGA response:** The OGA's only focus in its financial assessment is that an Applicant is able to fund the Commitment.

Financial Capacity

- Q5. Are the tests set out in section 7 of the Financial Guidance the most appropriate? If not, what tests should the OGA use?
- Q6. Are the thresholds referred to in section 7 of the Financial Guidance set at an appropriate level? If not, what level would be appropriate?

Ten respondents said that the thresholds are appropriate.

One respondent stated that all Applicants should demonstrate a basic level of financial capacity irrespective of net worth.

OGA response: Net worth is being used as a proxy for financial capacity in cases where net worth is significantly in excess of total commitments. Therefore, this is demonstrating a basic level of financial capacity.

One respondent felt that the OGA should perform regular stress tests of each licence Commitment to assess the impact of joint and several liabilities in the event of a participant's failure. **OGA response:** Separate to the financial assessment the OGA undertakes at the time of a licensing event, the OGA conducts financial horizon scanning to monitor risks where a licensee's insolvency could have a direct impact on MER UK and/or the Exchequer.

One respondent believed that cash flow forecasts should be presented within an integrated model containing profit and loss and balance sheet forecasts. **OGA response:** The OGA feels that cash flow projections and debt structure/headroom are sufficient in this regard for its assessment.

One respondent stated that cash flow forecasts should also indicate for each year best and worst cash positions. **OGA response:** The OGA agrees with this comment and the guidance has been updated to reflect this point.

One respondent thought that when considering debt service cover, financial capacity tests should take account of any and all lender covenant requirements.

OGA response: Copies of loan agreements are included in the information matrix.

Seven respondents stressed that the OGA should reconsider its desire to receive each Applicant's integrated financial model. Each and every Applicant will hold and run a different model for which the OGA may not have the expertise to analyse. As a compromise Applicants can provide the outputs from their financial models and not the models themselves. **OGA response:** It was the OGA's intention to only receive outputs from these models and the assumptions and sensitivities applied to them, not the models themselves; the guidance will be changed to make this point clearer.

Five respondents felt that the OGA could utilise information already provided through the Standard Economic Template and Asset Stewardship Survey. **OGA response:** These do not provide the information the OGA requires to undertake a detailed financial assessment.

One respondent thought that the financial guidance should provide a cash flow template and the OGA should provide the key assumptions to be used in the cash flow forecast, e.g. oil price, interest rates and inflations rates. **OGA response:** The OGA is content for Applicants to provide their own template, and different

assumptions can be tested in the sensitivity work if required.

Four respondents stated that cash flow forecasts should be presented in accordance with the Applicant's internal reporting process, e.g. annually or semi-annually and not quarterly. **OGA response:** The OGA agrees with this comment and the guidance has been updated to reflect this point.

Two respondents felt that the format and structure of forecasts should be consistent with Industry practice. **OGA response:** The Applicant can provide its own cash flow forecasts, and if these are not consistent with industry practice the OGA will reserve the right to reject them or ask for them to be re-worked.

One respondent said that the time periods covered by cash flow forecasts should be relevant and proportionate to the potential obligation being entered into and should not unnecessarily extend into periods after the commitment has been met. **OGA response:** This is set out in paragraph 7.3 of the guidance.

Two respondents thought that criteria thresholds should be used for an initial high-level screening and not form hard pass/fail hurdles. **OGA response:** The OGA has proposed using a risk based approach so there will not be pass/fail criteria.

Two respondents believed that the OGA

should consider offering companies the opportunity to come forward with alternative metrics. **OGA response:** The OGA is obliged to be consistent in its assessment and allowing Applicants to follow this approach would not ensure assessment consistency.

Two respondents said that it should be stated in the financial guidance that a company without debt does not fail the debt related metrics but that such metrics will be deemed not appropriate. **OGA response:** The OGA has proposed using a risk based approach so there will not be pass/fail criteria.

Three respondents thought that a substantial net worth should be sufficient to demonstrate financial capacity without the need to provide detailed cash flow forecasts for both the parent and subsidiary. **OGA response:** This is set out in paragraph 7.6(c) of the guidance.

One respondent said that a robust credit rating of the parent should be sufficient to demonstrate financial capacity without the need to provide cash flow forecasts for the Applicant. **OGA response:** It is necessary for the OGA to be consistent in its approach to requesting financial information and data from applicants so all information shall be required. However, in some cases the OGA may be prepared to accept a high investment grade credit rating of an Applicant as evidence that the Applicant will be able to meet the Commitment; the guidance has been

updated accordingly. Therefore, applicants are encouraged to engage with the OGA early to have a pragmatic discussion about information and data requirements.

Two respondents believed that the financial guidance appears particularly onerous on companies where the Commitment is relatively minor for companies with significant market caps. **OGA response:** Market caps are not a good indicator of an Applicant's ability to meet its Commitment and for this reason the OGA does not use them. The OGA is interested in the Applicant's availability of cash and debt, amongst other things, to be used to finance the Commitment. The financial guidance does consider Net Worth which is a better indicator of financial capacity than market cap.

Two respondents felt that the financial guidance needs to provide definitions for terms which are not standard GAAP/IFRS concepts for example "Operating Profits". **OGA response:** The OGA has updated the guidance to state that interest cover should be calculated using EBITDA and not operating profit.

One respondent stressed that the reference to "all commitments" in the net worth test needs to be clarified. **OGA response:** The OGA agrees with this comment and the guidance has been updated and defines this as being all UK and non-UK licence commitments.

Three respondents said it should be recognised that the structure of shareholder funded companies can affect

the net worth calculation, e.g. a debt funded company will have a lower net worth than one funded through equity.

OGA response: The OGA notes this point.

In respect of paragraph 7.5, five respondents stressed that there should be an explicit statement that there will not be a consideration of the capacity of another party on the licence if they are particularly strong and a clarification that there will be absolutely no reliance upon joint and several liabilities in the assessment of the Applicant. **OGA response:** This paragraph has been updated to reflect this comment.

Four respondents felt that the financial guidance should clearly state that the monetary size of the Commitment is as per the Applicant's assessment in the cash flow forecasts. **OGA response:** The OGA may have its own view on the monetary size of the Commitment and if there is too much disparity between the OGA's views and that of the Applicant, the cash flow forecasts will need to be updated.

Four respondents said that decommissioning expenditure should be included in the forecasts. **OGA response:** The OGA agrees with this comment and the guidance has been updated to reflect this point.

One respondent thought that it would be reasonable for the OGA to validate any assumptions used by the Applicant with other parties to the same licence, e.g. production and cost forecasts. **OGA response:** As part of the OGA's internal

process, where relevant data is available (e.g. production and cost forecasts), the assumptions made by Applicants are validated against it.

Two respondents felt that it would be useful to include break-even and adverse tax events as sensitivities in asset acquisition scenarios. **OGA response:** As stated in 7.8(m), the OGA's list of sensitivities is not limited and appropriate sensitivities will be applied on a case by case basis.

Sensitivities should include cost overruns in respect of site abandonment, restoration, aftercare and contamination damage. **OGA response:** As stated in 7.8(m), the OGA's list of sensitives is not limited.

Four respondents said that the financial guidance should provide more clarity on the occasions where the OGA may require Applicants to run sensitivity analyses; they should be limited to where the OGA's initial assessment has thrown up concerns and the type of sensitivities run should be initially left to the Applicant. **OGA response:** The OGA agrees with the first statement and the guidance has been updated to reflect when sensitivity analyses will be used. However, the OGA believes that it is better placed to advise on the sensitivities it would like to be undertaken rather than the Applicant.

Four respondents stressed that the data requested by OGA is highly commercially sensitive information and there is no mention of how this information will be

kept or how confidentiality will be assured. As a preferred alternative, companies could provide basic details, for example of loans, and an assurance from the lending institution that the loan agreement has been executed. **OGA response:** The OGA agrees with this comment and the guidance has been updated to reflect this point.

Three respondents stressed that the net worth to commitment ratio should be returned to two times the Commitment and not five times the Commitment as in the new Financial Guidance. Such a hard threshold in an official document by the Regulator may pose funding problems, particularly for small/young E&P companies. Another respondent said that a net worth to commitment ratio of five times appears particularly onerous, and the ratio should be set at three times. One other respondent felt that the net worth to commitment ratio has increased significantly from previous guidance but as the financial guidance states that Applicants will not necessarily be rejected if they are below this threshold, so the respondent had no objections. **OGA response:** As a result of responses to the consultation the OGA has changed the net worth to commitment ratio to 3.5. The OGA notes that this threshold is only used to avoid the necessity of a full assessment of financial capacity, any failure to meet this threshold would not be directly reflected in the risk-based assessment.

Two respondents said that the Debt Service Cover Ratio would present an

undue barrier to companies not yet making a profit and should not be introduced or at least dis-applied in such cases. Where it is applied it should use EBITDA and not operating profit. **OGA response:** The Debt Service Cover Ratio is an important indicator of risk, more so if an Applicant is not making a profit, therefore, the OGA does not believe that it should be dis-applied in certain circumstances. However, the OGA does agree with the use of EBITDA and not operating profit.

One respondent felt that in addition to net worth, market capitalisation of listed companies should be compared to the estimated cost of the Commitment.

OGA response: Market capitalisation is too volatile to be use as an indicator for financial capacity.

One respondent thought that the financial guidance has two sentences which potentially conflict. The first address only the new Commitment as part of the Net Worth test, without stating a multiple and only a reference to “substantially greater” the second states that if cumulative commitments are more than 5 times Net Worth then cash flow analysis is needed. **OGA response:** The OGA does not believe there is a conflict between paragraphs 7.6(a) and 7.6(c).

Three respondents felt that the status of decommissioning security agreements should be clarified as the requirement to post increasing decommissioning security over time can represent demand on funding sources that is earlier in timing

to the associated decommissioning cash flows. **OGA response:** This is covered by the information matrix.

One respondent said that non-UK commitments should be taken into account if an Applicant has foreign interests. **OGA response:** The OGA agrees with this comment and the guidance has been updated accordingly.

Specific financing arrangements

Q7. Section 8 of the Financial Guidance is intended to better reflect the different funding models now available to Applicants. It is not intended to be exhaustive, the OGA recognises the need for and is supportive of financial innovation. If there are other sources of finance being actively considered, the OGA will consider adding them to Section 8. Does the Financial Guidance include all key sources of finance available to Applicants? If not, what else should the OGA consider?

Seven respondents thought that the list was comprehensive.

Two respondents stated that the OGA should take a pragmatic approach where a Commitment extends over a period of years during which time a debt facility may be refinanced; to assume no refinancing would be excessively onerous. **OGA response:** In practice, the OGA does take a pragmatic approach and will discuss with an Applicant on a case by case basis. These conversations would be reflected in the risk-based assessment.

Two respondents thought a catch-all paragraph to cover sources of funding not specifically cited in the financial guidance is required to leave it open to Applicants to come forward with information to make their case. **OGA response:** The OGA believes that paragraph 8.1 already covers this.

One respondent made a point regarding bonds and equity: Up until the closing of an IPO, the IPO and associated fund raise could be cancelled and neither of the assurances noted in the Financial Guidance would guarantee the funding. The OGA should seek advice of banks to provide more appropriate wording. **OGA response:** The OGA believes paragraph 8.2 provides sufficient cover in this regard.

With regards other suggested sources of funding to be specified in the financial guidance: Two respondents stated that vendor assistance or contractor financing, or infrastructure construction in association with a midstream company should be included; a further two thought that the extension of PCG to include security from unrelated parties (letter of credit, performance bond) should be added; and one respondent said that licence farm-outs and cost carries should be included. **OGA response:** The OGA's list is not meant to be exhaustive, however, farm-outs and costs carries will be added to the list.

Regarding paragraph 9.3, one respondent felt that acceptable forms of financial security for plugging and abandonment are not listed. They felt that the suggested forms of financial security could be bonds,

LoCs, PCGs or self-insurance. **OGA response:** Where an Applicant can demonstrate that a third party is bound to cover these costs, the OGA would take that into account. Paragraph 9.3 is concerned with the OGA's specific powers (under section 45A of the Petroleum Act 1998) where it is not satisfied as to a person's ability to plug and abandon a well. In those circumstances, the OGA considers that the most appropriate and robust form of security is to have the funds placed in a trust.

One respondent said that the providers of debt finance and PCGs should have strong credit rating. **OGA response:** The OGA notes that a full financial assessment will be made of any proposed Guarantor. The OGA also notes this comment in respect of providers of debt finance.

One respondent thought that the financial guidance should recognise that PCGs will be subject to the analysis set out in the financial guidance. **OGA response:** This is recognised in paragraph 4.4.

One respondent was of the view that the inclusion of vendor assistance or contractor financing introduces a new element of financial risk. These parties should be subject to the same financial assessment regime as the incumbent licensees. **OGA response:** The OGA will require an Applicant to demonstrate that their contractor is able to fulfil its share of the Commitment. However, we anticipate that this will be complex and bespoke and therefore not amenable to inclusion in this guidance.

Information requirements

Q8. Is the information required by the OGA as set out in the information requirement matrix in section 10 of the Financial Guidance the right information to perform the financial viability and financial capacity tests set out in sections 6 and 7 of the Financial Guidance? If not, what information should this include?

Two respondents said that the information requirements are sufficient to enable a thorough risk-based assessment to be made by the OGA.

One respondent felt that the wording regarding management accounts is unclear, and it should be specified that management accounts should be provided for the period since the period covered by the latest audited accounts. **OGA response:** The OGA agrees with this comment and the guidance has been updated to reflect this point.

One respondent thought that the details of any planned issue of share capital should be provided for every licence event, except where there is no work programme. **OGA response:** The financial guidance is clear that an Applicant must demonstrate funding for a Commitment, and that would include equity issues; this is specifically set out in paragraph 8.3(i).

One respondent believes that the details of planned/imminent issue of additional share capital would be relevant to licence award, licence assignment, well consent

or field development and it is unclear why the OGA considers that this information is not required in the first instance. **OGA response:** Funds or funding need to be in place to demonstrate financial capability for a Commitment and future equity issues are not guaranteed until the fund raise has closed.

One respondent stated that the breakdown of debt should include rates and security.

OGA response: The OGA agrees with this comment and the guidance has been updated to reflect this point.

Four respondents stressed that most information to perform a high-level assessment of an Applicant's financial position could be sourced from public information; such information should be sufficient to allow OGA to make an initial assessment without making specific information requests to the Applicant. **OGA response:** Most publicly available accounting information is historic can be 21 months out of date and would not be useful for the forward-looking nature of the OGA's financial assessment.

Six respondents thought that if an Applicant has previously provided information the OGA should be able to rely upon that information unless a significant change has happened that makes the previously provided information out of date. Only the out of date information should be required to be resubmitted.

OGA response: There is greater certainty for a robust financial assessment if the OGA gets a complete "information pack"

at the licence event rather than relying upon information the OGA may or may not already hold. Further, the OGA does not monitor Applicants in this way so would not know whether there had been a significant change in their circumstances so could undertake its analysis on incomplete information; this could be to the detriment of the Applicant.

Four respondents felt that the requirement for an assessment in the case of licence assignment should not apply in the case of inter-affiliate transfers which have no impact on the net funding position of the Applicant. **OGA response:** The OGA needs to ensure the assignee can fund its Commitment and that the assignor can fund its retained commitments post-transaction. The OGA is owed legal obligations by the individual licensee (and in some cases its Guarantor), not the licence group.

One respondent made a comment regarding Note 1 to the table in Section 10: As a minimum the submitted financial statements should be supported by an independent accountant's report but the expectation would be that financial statements would be accompanied by an independent auditor's opinion. **OGA response:** This would place an additional cost on the Applicant and the OGA is content for management accounts, projections, etc to be certified by a Director.

Three respondents said that the content and structure of the matrix do not translate across to the narrative of the main body of the document. The matrix requires greater clarity around when tests and the associated information are not required.

OGA response: The OGA believes that the information matrix is clear when the information is required and for which licence event.

One respondent thought that the narrative of the financial guidance needs to clearly reflect this approach throughout the document and provide clarity on which information requests are triggered and at which specific point in the assessment (if at all) for each specific licence event.

OGA response: The OGA believes that the information matrix is clear when the information is required and for which licence event.

Five respondents stressed that the information requested should be reasonable, proportionate and tailored to the potential obligations under consideration. **OGA response:** The information matrix does tailor the information being requested to each licensing event being considered, and the OGA believes that the information being requested is reasonable and proportionate.

One respondent said that the information matrix is directionally helpful but very burdensome and, in parts, imprecise.

OGA response: The OGA believes that

it is asking for the minimum information required to undertake a robust financial assessment.

One respondent said that where an initial assessment indicates high risk, additional information may be requested at the highest level sufficient for the purpose and to allow OGA to conduct other tests to come to a meaningful conclusion.

OGA response: The OGA believes that it is asking for the minimum information required to undertake a robust financial assessment. The OGA does not consider that a two stage process would be helpful.

One respondent believed it would be helpful to replicate the number of years of statutory accounts required of three years as per the information matrix into 6.4(b).

OGA response: The OGA agrees with this comment and the guidance has been updated to reflect this point.

One respondent asked whether there should be a tick in the FDP column for the financing section on the line "Provide details where future provision of financing is contingent upon award of a licence, approved FDP or key milestones?"

OGA response: The OGA agrees with this comment and the guidance has been updated to reflect this point.

One respondent believed that the first two columns are labelled licence award, but the reality is that the information is required at licence application for a licensing round.

OGA response: The OGA agrees with this comment and the guidance has been updated to reflect this point.

One respondent suggested that there needs to be a clear statement in the financial guidance that the information sources described are a list of all potentially requested information sources, but not that all of these have to be automatically provided at all times. **OGA response:** The OGA is seeking as much information as it needs to undertake a robust financial assessment.

Two respondents felt that there should be a ranking of information sources by superiority, e.g. where an entity has a published credit rating then this may be used rather than requiring some of the more detailed information. **OGA response:** It is necessary for the OGA to be consistent in its approach to requesting financial information and data from applicants so all information shall be required. However, in some cases the OGA may be prepared to accept a high investment grade credit rating of an Applicant as evidence that the Applicant will be able to meet the Commitment; the guidance has been updated accordingly. Therefore, applicants are encouraged to engage with the OGA early to have a discussion about information and data requirements. As the OGA will be completing a risk based assessment, there is no need to rank information sources by superiority.

One respondent said that there are no references to published credit ratings in the proposed guidance. This would seem to be particularly useful in the case of a guarantor. **OGA response:** The OGA believes that credit ratings are

not a substitute for a robust financial assessment. However, in some cases the OGA may be prepared to accept a high investment grade credit rating of an Applicant as evidence that the Applicant will be able to meet the Commitment; the guidance has been updated accordingly.

Other comments

One respondent thought that in the case where commitments are joint and several obligations it would be in the interests of joint venture partners for information on financial capacity to be shared. The OGA should therefore, when asking for financial data, consider making a request to share financial capacity information obtained from licensees with the operator of the relevant joint venture (save for certain information which may remain confidential). **OGA response:** The information provided by an Applicant will be used for the OGA's financial assessment and this assessment is for the purpose of the OGA's internal decision making only.

Two respondents believed that the OGA should extend the initiative so that Applicants whom the OGA considers financially acceptable for a licence assignment are also deemed to have passed the requisite tests to be accepted by the other joint venture partners on the licence. **OGA response:** Third parties cannot rely upon the OGA's financial assessments as a substitute for their own financial due diligence.

One respondent felt the OGA should recognise that, despite its best efforts,

it is unlikely to be able to do a better or more thorough job than credit rating agencies such as S&P in considering financial viability and capacity of certain companies. OGA should consider whether the provision of a suitable rating from such an agency could be sufficient instead of most, if not all, of the requirements set out in the discussion document. **OGA response:** The OGA believes that credit ratings are not a substitute for a robust financial assessment. However, in some cases the OGA may be prepared to accept a high investment grade credit rating of an Applicant as evidence that the Applicant will be able to meet the Commitment; the guidance has been updated accordingly.

One respondent viewed the draft guidance as more analysis heavy than the current approach. Given the number of consents required, the OGA should consider whether they have the appropriate manpower and expertise to perform the required analyses, reflecting the cost incurred against the benefit gained. **OGA response:** The OGA is aware of the increased manpower required to implement the updated guidance but considers that a robust financial assessment is necessary, and that the benefits justify any increased manpower requirements.

One respondent thought that when considering the needs of new investors, the OGA should avoid hard-coding particular standards or information requirements that appear daunting to meet as this may be perceived as an obstacle to investment. **OGA response:** Under

the MER UK Strategy the OGA must have regard to investor confidence and this guidance has been drafted with that in mind.

One applicant stated that in applying the financial guidance, the OGA should avoid giving the impression it is performing a commercial function such as due diligence or seeking to “regulate away” potential problems. In this context, it would be useful to clarify that the guidance is for use by the OGA only; other parties to transactions would have their own evaluation criteria and should not be expected to follow or entitled to rely on the position taken by OGA. **OGA response:** Paragraph 1.6 is clear that a third party should not rely upon any OGA decision concerning an Applicant’s financial capacity. However, for the avoidance of doubt all references to “due diligence” in the guidance have been replaced with “assessment”.

Two respondents made reference to the statement in paragraph 3.2 which says “The OGA may also apply the financial guidance in any other circumstances where a Commitment is made that will or may require material financial resource to discharge.” The language is too open-ended and as worded implies that the financial guidance can be applied at any time. To provide clarity the “other circumstances” should be better defined. **OGA response:** The OGA notes this response.

One respondent felt that paragraph 1.3 opens up the possibility of operators being

subject to financial checks from both OGA and MPAs for the same aspects of their operations, e.g. decommissioning. As well as being more onerous for the operator, this would:

- Breach the Energy Act 2016 matter (a) of “minimising future public expenditure” as the costs of administering duplicate financial checks would fall on the OGA and MPAs in addition to operators
- Breach the Energy Act 2016 matter (f) of “maintaining a stable and consistent system of regulation”, as the regulatory position would not be clear

OGA response: The OGA needs to undertake its own independent financial assessment of an Applicant, and cannot rely on any other assessment conducted by an interested party.

One respondent stated that there needed to be a clear delineation between the operational aspects covered by OGA financial checks and those that will be covered by MPA financial checks needs to be made in the guidance. **OGA response:** This is covered in paragraph 1.3 of the guidance.

One respondent suggested that the term “decommissioning” should be used rather than “plug and abandon” as it is the term the onshore industry now uses and it provides proper distinction from the surface restoration that is the regulatory responsibility of the MPA. **OGA response:** The OGA’s powers in the Petroleum Act 1998 relate to plugging and abandoning, and therefore, the OGA believes this is the right terminology to be used.

One respondent felt that at present the IPA is duplicating the role of the OGA as set out in the financial guidance. The assessment of financial strength, including decommissioning, at the stage of final consent for hydraulic fracturing, should be carried out by the OGA. **OGA response:** This is outside the scope of this consultation.

One respondent stated that a change of control of a licensee should not be a mandatory trigger where, for example, the change of control occurs as part of an intra-group reorganisation carried out on a solvent basis where the ultimate shareholder remains the same. **OGA response:** The OGA can request this information from a licensee in this scenario, but in practice this is generally unlikely to happen.

One respondent thought that there should be alignment with decommissioning liabilities analysis: there is reference to alignment with Offshore Petroleum Regulator for Environment and Decommissioning (OPRED) but, given the significant liabilities involved, this is viewed as a critical part of the analysis and a single common methodology and process is recommended. **OGA response:** With regards to decommissioning, the powers set out in Part IV of the Petroleum Act 1998 are generally within OPRED's jurisdiction, and not the OGA's. However, each Regulator has its own responsibilities and obligations so needs to implement the best methodology and process to ensure that these are discharged.

One respondent believed that the OGA's proposals may add to the administrative overheads of industry and OGA itself. The OGA should consider the extent to which increased regulation contributes to investment decisions given that many businesses are reducing their commitment to the UK. **OGA response:** Under the MER UK Strategy the OGA must have regard to investor confidence and this guidance has been drafted with that in mind. Furthermore, the OGA considers it is not requesting anything additional to what an Applicant would already be doing for its own internal due diligence or decision-making process.

One respondent thought that the proposed approach describes what the OGA expects and what the OGA will look at but is relatively silent as to how the OGA will apply the approach in practice. **OGA response:** There is an internal process associated with the financial guidance to ensure consistency of approach and, where appropriate, the OGA will work closely with Applicants to ensure they understand the process.

Two respondents stated that the regime is focused on licence events rather than an ongoing consideration of financial viability and financial capacity. Assessments should be applied:

- Routinely when annual financial statements are published
- When announcements are made which are required or regulated by the Stock Exchange
- When an Applicant makes a planning application for consent to explore or

operate. In such cases the OGA should make its assessment available to the planning authority

- If an Applicant fails to comply with Company House submission requirements
- If an Applicant reports financial difficulties or issues materially adverse trading statements

OGA response: The purpose of this Financial Guidance is to determine the probability of an Applicant being capable of meeting the Commitment it is proposing to make to the OGA through making that Application. In making that determination it is recognised that there is a small risk that the Applicant’s circumstances may change and that they may default on those commitments. Separately the OGA is developing a regular regime of “financial horizon scanning” that will be used in future to inform decisions where the insolvency of a licensee could have an impact on MER UK (offshore) or the Exchequer. This Guidance does not cover that work.

One respondent said clarity is needed on whether the decision that an Applicant needs to provide financial security will be taken by the OGA or the planning authority. Currently the latter appears to be the case, yet in all other aspects the OGA has been the decision maker; this has caused confusion. **OGA**

response: The OGA is not responsible for securing that oil and gas production operations are decommissioned once they cease production. Offshore this is the responsibility of OPRED and onshore it is the responsibility of the relevant Mineral Planning Authority.

5. Next steps

Where responses to the consultation have been accepted by the OGA, the Financial Guidance has been updated to reflect these. Once published in final form, the Financial Guidance will be used by the OGA to undertake its financial assessment where an Applicant has made a Commitment to the OGA, or there will be a transfer of a Commitment from one legal or natural person to another. This shall include:

- (a) Licence award;
- (b) Licence assignment;
- (c) Change of control of licensee;
- (d) Innovate licence progression;
- (e) Well consent;
- (f) Field Development (including extended well tests); and
- (g) Pipeline Works Authorisation.

6. Regulatory Impact Assessment

The proposed changes to the financial guidance are expected to have a minimal increased cost burden to business compared to the previous financial guidance as a result of increased information being requested from Applicants. The OGA believes that beyond familiarisation costs, any incremental costs to business will be small because the information being requested will not be additional to that which the Applicants will already be using for their internal approvals process and/or required by their finance provider(s). With the aim of contributing towards the principal objective of maximising economic recovery of UK petroleum offshore, and the OGA's objectives onshore, the intention is to provide a more pragmatic risk based financial assessment for all potential Applicants.

On average, the OGA receives around 300 applications a year for licensing events where the OGA's financial guidance is used.

Annex 1: list of organisations responding to the consultation

Oil Companies	Trade associations	Individuals
Repsol Sinopec	Oil & Gas UK	An individual
Premier Oil	UK Onshore Oil & Gas	An individual
ConocoPhillips	Oil & Gas Independent's Association	
Chrysaor		
Total		
ExxonMobil		
JX Nippon Exploration and Production UK Limited		



Oil & Gas Authority

Copyright © Oil and Gas Authority 2018

Oil and Gas Authority is a limited company registered in England and Wales with registered number 09666504 and VAT registered number 249433979. Our registered office is at 21 Bloomsbury Street, London, United Kingdom, WC1B 3HF

www.ogauthority.co.uk