Article

Legal form and independence of specialist regulators: the case of the Oil and Gas authority

by Terence Daintith

INTRODUCTION

The business of exploring for and producing oil and gas in the United Kingdom has always been regulated differently from other sectors of the energy industry. Functions like electricity and gas distribution, once the province of nationalised industries, have since the 1980s been regulated according to the pattern for public utilities developed in consequence of the Thatcher government's programme of privatisations, under which monopoly powers of the resulting private companies have been controlled by independent regulatory agencies established by the privatisation statutes. Since 2000, the regulator for gas and electricity distribution has been the Gas and Electricity Markets Authority, acting through Ofgem (the Office of Gas and Electricity Markets). Since the UK's petroleum deposits were nationalised in 1934, by contrast, their exploitation has been organised though a system of licences granted to oil companies by government as owner of the resource, and the licensing authority has at all times – until the developments to be discussed here – been a government department, most recently the Department of Business, Energy and Industrial Strategy.

While the system of Departmental licensing worked well in the good years of the UK oil industry, when major offshore finds first of gas and then of oil attracted high levels of investment and produced petroleum self-sufficiency and large fiscal returns, its limitations appeared as UK offshore production began to decline and the need was identified for a more aggressive, better informed and resourced regulatory approach that would ensure the highest levels of recovery of petroleum from the deposits that remained. In 2014 a government inquiry led by Sir Ian Wood made the case for the transfer of licensing powers to a specialist regulator, and the conferment on it of extensive new powers aimed at securing maximum economic recovery of offshore petroleum resources. Enthusiastically welcomed both by government and by the industry, the proposals were enacted first by the Infrastructure Act 2015, setting up "maximum economic recovery (MER)" as the primary obligation of participants in the upstream industry, and then the Energy Act 2016, transferring licensing functions to a new regulator, the Oil and Gas Authority (OGA), and adding new and extensive powers to enforce the MER obligation: settling disputes, attending licensee meetings, enforcing collaboration, and imposing sanctions including fines, loss of operating rights, and even licence revocation.

On the model of utility regulation one might have expected this new regulator to be created by the statute that was the source of its functions and powers. In fact OGA began in 2015 as an executive agency of the Department, with defined functions but no separate legal personality, and was transformed, on passage of the Energy Act, into a company limited by shares under the Companies Act 2006, in which the Secretary of State was the sole shareholder. This legal form had never before been used for a specialist regulator in the UK, so it is worth asking:

- why this was done;
- what government companies normally do;
- what were the closest precedents;
- what were the effects of the choice in relation to the control, accountability, and independence of the regulator; and
- what might be the implications for the future.

WHY A COMPANY?

The Wood report asked for an arm's length regulator but did not specify the legal form it should take. There was brief discussion of the issue in Parliamentary debate on the Energy Bill, in which the Minister justified arm's length status by reference to familiar considerations like expertise, industry respect, resources (OGA is funded by industry fees and levies), and recruitment freedom. None of this demands company status: statutory arm's length bodies can be structured so that their staff are not part of the civil service and may be given (subject to Treasury approval) distinctive terms and conditions. Most such regulatory bodies are classified as non-Departmental public bodies (NDPBs – a category that also includes many bodies with executive or advisory functions), though some, including all the utility regulators (except the Office of Communications – Ofcom) are instead constituted as non-Ministerial Departments (NMDs).

The impact statement on the Energy Bill prepared by the Department claimed that it was necessary to choose the Companies Act form because other forms were unavailable. OGA could not be an NDPB because the policy was not to create any more of these, and it could not be a so-called public corporation (like, for example, the Post Office) because European and UK public sector classification rules demand that these be mostly funded by sales of goods and services at economic rates. While the second reason was perfectly correct, the first was blatantly wrong: the Cabinet Office has made it clear both that save in exceptional circumstances all "arm's length" bodies, not forming a part of a core Department, must be classified as either unincorporated executive agencies, NMDs or NDPBs, or public corporations; and that the legal form of bodies with corporate status (statutory, Royal Charter, Companies Act) is irrelevant to their classification.

The real reasons for the choice, though nowhere publicly acknowledged, seem to have been twofold. First, companies can be created very quickly and quietly, without needing to bother Parliament (though obviously Parliament will need to be bothered at some point if coercive powers to be conferred). Second, company status for OGA may have been thought likely to produce more freedom in recruitment, pay and financial capacity generally than a "statutory" NDPB could enjoy, thus helping it to operate on more equal terms with players in the rich and well-funded oil and gas industry.

PRECEDENTS AND THE USE OF COMPANIES BY GOVERNMENT GENERALLY

If it still seems remarkable to have a company acting as a public regulator, perhaps there are precedents? In Parliament, the Minister cited in this respect the Financial Conduct Authority (FCA), the Prudential Regulation Authority (PRA), and Highways England (until 2015 an executive agency of the Department of Transport). But Highways England is not a regulatory body, and PRA was a short-lived subsidiary of Bank of England with responsibility for the prudential regulation major financial institutions, which was reabsorbed into the Bank itself after only five years of life. FCA, our main financial regulator, is indeed a company, established in 1985 as the Securities and Investments Board in the first round of financial regulation reforms. SIB was set up as a company limited by guarantee, not shares, reflecting its origins as an essentially self-regulatory operation under government control, overseeing the activities of established regulatory bodies like the Stock Exchange, which would have representation on its board of directors. The self-regulatory aspect of financial regulation has fallen away with successive reforms over the years (the Financial Services and Markets Act 2000 and the Financial Services Act 2012), but the regulator's legal status remains the same. OGA, by contrast, has no self-regulatory or representational rationale, and is limited by shares, not guarantee. This format has never before been used for a regulatory body.

We find it being used in a range of circumstances:

- as a vehicle for government rescues of key private enterprises, like the banks ruined by the 2008 financial crisis;
- as a step between nationalised industry and privatisation, where a public corporation like British Gas transfers all its assets to a company owned by the Secretary of State, whose shares can then be sold into the private sector;
- for new government initiatives that might eventually be ripe for privatisation: a recent example is the Green Investment Bank;
- to meet short-term quasi-commercial needs such as organising Commonwealth Games;
- to discharge quasi-commercial functions with strong public interest, often previously in the hands of executive agencies: Royal Mint, Ordnance Survey, Highways England.

There also exist a number of companies limited by guarantee but effectively controlled by a Department, which usually operate in the not-for-profit sector (like museums) or function as a forum for interest representation (the UK-China Centre).

CONTROL, ACCOUNTABILITY AND INDEPENDENCE

All these companies, including OGA and FCA, are subject to the disciplines of the Companies Acts. Their core instrument of governance is their Articles of Association. While these are filed at Companies House and may easily be inspected, there is no obligation to communicate them to Parliament, nor is there any Parliamentary control over their content. The Companies Acts regulate reporting and auditing: there is, again, no link with Parliamentary accountability. The emphasis of the Companies Act rules is on protection of the members of the company, on controlling directors, and on assuring financial transparency. This is an appropriate discipline where government involvement is driven by financial and economic considerations, as in rescue operations, but the link is much less obvious where government is seeking to advance other interests like energy policy or consumer protection. Changes in Companies Act reporting requirements in 2013 have however widened the scope of companies' annual reports: all but the smallest companies must now provide an annual strategic report, not just providing financial information, but assessing the performance of the company in relation to its objectives. Clearly this enables company reporting to be linked to the public interest concerns that justify the existence of government companies, though it should still be noted that these reports are primarily for company members: any Parliamentary accountability needs to be secured through separate arrangements.

Before looking at how this may be done, we should note the significance of Companies Act status for the independence of the regulator and the extent and means of ministerial control. Where regulators are constituted by legislation, there will be provision, sometimes highly detailed, about the appointment of Board members, their tenure, the staffing of the body, its procedures, its reporting arrangements, and the extent to which Ministers may issue directions to it. Such provision may be made even if the regulator has Companies Act form: the Financial Services Act 2012 contains detailed provisions of this type for the FCA (and formerly, the PRA also). Such provisions represent Parliamentary endorsement of a particular balance, appropriate to the functions of a given regulator, between independence, accountability arrangements, and control by Ministers.

OGA offers a remarkable exception. The Energy Act provides only for a limited power of direction by the Secretary of State (ss 9-10), and to for the separation of investigatory and decision-making functions in the exercise of OGA's sanctions powers (s 59). It says nothing about the board, about staffing, about reporting to Parliament. All this is to be determined by OGA's Articles and by the framework document that – as is now the practice both for executive agencies and for NDPBs – sets out the relationship between OGA and its sponsoring Department. These both refer to the intention of the Secretary of State that OGA should control its own day-to-day business, but the Articles give the Secretary of State, as sole shareholder, power to give instructions to the directors of OGA on any matter. This power, moreover, is expressed to be separate from and additional to the statutory directions power, and is not subject to the constraints of publicity, and only exceptional applicability to individual regulatory decisions imposed by the Act. If it is further noted that the tenure of all directors may be determined by the Secretary of State, it will be apparent that OGA does not meet the criteria for independence that have, for example, been promulgated by the European Union in respect of national energy regulators.

While the Energy Act, in strong contrast to other legislation about regulators, is totally silent on the issue of OGA's Parliamentary accountability, it is important to realise that general legislative and other rules may fill the gap. Thus the Chief Executive of OGA, like almost all other heads of arm's length bodies, is its Accounting Officer for the purposes of the system of control of public expenditure, and as such is responsible for its performance both to the head of the sponsoring Department, as the Departmental Accounting Officer, and to Parliament, where he may be called upon to appear before the Public Accounts Committee. OGA also falls within the structure set up by the Government Resources and Accounts Act 2000, under which it has been designated – along with other arm's length bodies with the exception of public corporations – as a body whose accounts are to be consolidated with those of its parent Department, and which is to provide accounting information for the purpose of preparation of "whole of government" accounts by the Treasury. In addition, the Treasury has directed that OGA's accounts should be audited by the Comptroller and Auditor-General, rather than by commercial auditors. (Before amendments were made to companies legislation in 2006, the Comptroller and Auditor-General was not qualified to audit the accounts of bodies constituted as companies under the Companies Acts.)

As a result of these general rules, the main disparity, in terms of Parliamentary accountability, between OGA and other regulators is that it has no legal obligation to lay an annual report before Parliament. Even its framework document requires only that the report be published on OGA's website. In fact OGA's first annual report as a company was laid before Parliament along with its accounts, but "by command of Her Majesty," a formula that reflects the absence of an obligation to do so. Doubtless this practice will continue, but the lacuna in accountability obligations is to be deprecated.

IMPLICATIONS AND SIGNIFICANCE

OGA's Companies Act status may thus have only a marginal impact on its Parliamentary accountability, but represents a significant departure from general norms and expectations relating to the independence of industry regulators. This has not worried the upstream oil and gas industry: up to now, it has given, through its representative body, Oil and Gas UK, a broad welcome to OGA, despite the additional controls and costs that have accompanied its creation. These appear to be outweighed, for the industry, by the greater expertise and regulatory resource associated with OGA, though it is not apparent that these could not have been provided by a statutory regulator. Some such regulators have, like OGA, obtained modifications to the general civil service pay and conditions structure, though all remain subject to general government pay policy.

Lack of industry concern about independence doubtless reflects the fact that, because licence regulation was previously carried on in-house in the Department, any transfer to an arm's length body, however constituted, provides greater distance from political decision-making. There is a further special factor. In contrast to other energy sectors, the government is present as the effective owner of the relevant onshore and offshore oil resources. Unlike other regulators, OGA may thus be seen as the manager of a public resource as much as a regulator, a job often done in oil-rich states by a national oil company allocating contracts to international oil companies and supervising their work. Objectively, this consideration might provide a good reason for adopting a distinctive vehicle for OGA, but it has never been referred to by government, which has instead stressed that OGA's Companies Act status does not imply any intention that it should in the future engage in commercial activities.

Even if the industry is content, OGA's status gives cause for concern in relation to the general public interest. Civil servants have acknowledged that there is currently an "appetite" in government for organising arm's length bodies, whether with regulatory or other functions, in the form of government companies. Examination of OGA's case demonstrates, however, the scope such companies offer for exercise of "proprietary" and extra-statutory Ministerial influence, and for evading Parliamentary discussion of their establishment and organisation. Future proposals of this type should receive more searching scrutiny.

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