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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

SECURING THE UK'S OIL SUPPLIES : ROLE OF BNOC

MEMORANDUM BY THE SECRETARY OF STATE FOR ENERGY

I attach a paper by officials, on security of supply, for our discussion on Tuesday, 17 July, of the future of the BNOC.

D.A.R.H.

Secretary of State for Energy,

13 July 1979.

SECURING THE UK'S OIL SUPPLIES : ROLE OF BNOC

Note by the Department of Energy

Ownership of oil produced from the UK Continental Shelf (UKCS) vests in the licensee companies. This paper considers the options for securing the supply of such oil to the extent required for UK use.

2. Annex 1 indicates, for 1980, the limited extent of direct access by HMG to UKCS oil, in the form of royalty oil. BNOC's equity oil supplements this, to the extent that BNOC retains its current assets. But at best these categories of oil combined give us control over only 18% of the oil produced.

3. During the 1970s, most Governments of oil producing countries around the world acted to exert much greater control over oil previously in the hands of licensee companies. The most common means, eg in the OPEC countries, was the negotiation of participation agreements transferring equity ownership to the State and leaving operating companies with limited rights to lift oil for export. Production sharing arrangements achieved a similar effect. In the USA control over disposal of oil was effected by legislation. The Energy Policy and Conservation Act 1975 invoked, for oil, export control procedures in the earlier Export Administration Act.

4. Neither of these options is open to us. Participation on the OPEC model is ruled out on grounds of the cost of compensation for expropriation as well as being contrary to our whole approach to industrial enterprise. Legislation to direct the disposal of our oil (except in times of emergency and then under international constraints) is ruled out by the Treaty of Rome, which forbids actions by Governments to impede the free movement of goods within the Community. The Landing Requirement, under which licensees are required to land all oil produced in the UK, is not an effective control over final destination and is, in any case, already under EEC attack.

5. This leaves us reliant on less formal and direct means of securing our supplies. Participation agreements in producing fields

in the form negotiated by the last Administration are, essentially, one such means: a detailed description is at Annex 3. In these pre-5th Round arrangements, there is no element of equity ownership. The agreements consist, so far as the lifting of oil is concerned, of an option right to take 51% (usually) of the oil produced, at market prices. Disposal of this oil, whether back to the original producer, or to third parties, can then be used as a control mechanism on the use of the oil. There are still hazards in relation to the Treaty of Rome, but the control is less overt than direct regulation and so less open to attack.

Influence through BNOC

6. E(DL)(79)6 sets out some of the advantages in using BNOC to achieve security of supply and the figures in Annex 1 to this paper indicate the extent of control over UKCS oil open to us if participation oil is added to the other oil at the disposal of BNOC. Access to this volume of oil enables us to satisfy ourselves as to its destination, to exert influence on purchasers, and if appropriate to arrange swaps to secure other crudes required to satisfy UK refining needs. Although as a matter of commercial prudence much of this oil will be committed for sale in advance, it is also open to us to require the Corporation to hold some oil for last minute sale which, in time of crisis, can come to the UK. Moreover, a major crude seller with long-term access to oil has scope, in times of shortage, to renegotiate short term contracts, as BNOC has done in respect of the second half of this year with a view to providing the UK with an additional 100,000 barrels per day - 5% of our requirement. (This has been achieved despite the disposal strategy for 1979 agreed by BNOC with the last administration, when a slack market was foreseen, which involved the export of 76% of the Corporation's oil). There may also be a potential role for the BNOC to act as the Government vehicle for Government to Government trade with OPEC states, a course apparently increasingly favoured by OPEC Governments, as a further means of securing the imported crudes we need to operate our refineries in the most economic way.

Influence over Producers by other Means

7. In the absence of Government control, there will be commercial pressure on companies with heavy investment in the UK market to sustain their UK operations, but to no greater extent than their operations

elsewhere. In 1973-74 and again this year, multinational companies have responded to the world shortage of crude oil by seeking to apply at their own discretion a policy of international equality of misery, taking such account as they judge necessary of contractual obligations and pressure by consumer Governments. Whatever the apparent merits of this in international terms, it gives no benefit to countries, such as the UK, with indigenous production. The question is how far additional security of UK supply might be secured in the absence of a substantial state oil trading company.

8. Experience in 1973-74 was not encouraging. Very strong pressure on the companies, exerted by the Prime Minister downwards, bore little fruit. The UKCS was, of course, not then in production. The range of fields now in production opens up a wide potential source of leverage, for example as licensees need to apply for new production and gas flaring consents. This leverage has been used this year, with mixed results. Some additional commitments to UK supply have been secured; but in other cases the pressure has been successfully resisted. Companies know that it is not possible for HMG to discriminate by these means between different co-licensees in a single field according to their individual responses. Government action which has the effect of threatening to curtail production during a supply crisis is, moreover, a bluff which companies might well choose to call.

9. Experience over the period 1973-79 has shown that the strongest lever in Government hands is companies' desire to be well placed for future licensing rounds. Only one company, Amoco, put its standing with the last Administration at risk in this respect and, after failing to gain an award in the 5th Licensing Round, Amoco completely reversed its stance. On the other hand, this is a diminishing asset. It depends on the continuing attractiveness of the areas offered for licensing. For other reasons, the pace of licensing may be stepped up and in a few years the influence available by this means will be minimal, as by far the greater part of the prospective areas of the UKCS will then have been licensed.

10. International obligations remain an important constraint on the practice of pressurising multinational companies preferentially to improve the UK supply position. Companies can be pressed so far; but beyond that point, they will seriously consider the option of tabling a complaint, eg. to the European Commission. The legal constraints on the companies are real (in 1974 BP was subjected to proceedings before the European Commission, under the EEC competition provisions, over failure to supply a Dutch company) and the Commission threat may weigh more heavily than a national threat since very heavy fines can be imposed.

11. The attitude of companies to <u>additional</u> crude supply made available by HMG or BNOC contrasts markedly with their response to attempts by the means described above to influence their internal supply patterns. Almost all the majors have said they can and will deviate from the strict terms of their international allocation terms to accommodate such extra crude, supplying the resultant product additionally to the UK market. In practice, in times of world crude oil shortfall, such additional supply can come only from a state trading company, ultimately subject to Government direction as to its disposals.

Conclusion and Recommendation

12. Against the background of the policies adopted by the principal producer and consumer countries to control and save oil supplies and the dominance of international private sector companies in our market and the North Sea, the means of influence available to us as a producing country are not alone adequate to secure our national oil supply. Access to oil traded on a substantial scale by BNOC is an essential element in our security of supply.

Department of Energy,
13 July 1979.

ISPOSALS OF UKCS OIL 1980 - Percentage Share

	Without Participation		With Participation	
	No Royalty in Kind	With Royalty in Kind	No Royalty in Kind	With Royalty in Kind
r Multi- tionals	57	50	50(30)*	45(27)*
r International panies without refineries	27	24	15	13
ompanies	9	8	6	5
/BGC Equity	7	6	7	6
Participation	-	-	22(42)*	19(37)*
Royalty	-	12	-	12
	7	18	29(49)*	37(55)*

he figures in brackets indicate the additional extent of potential control ver major companies derived from the sale-back clauses of participation greements, which operate subject to the right of intervention of the ecretary of State.

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ANNEX 2

UK MARKET SHARES 1978

Majors		75.0 (of which BP, Shell = 38.2%)
Euro Minors ...	8.7	
US Minors	7.3	
UK Minors	4.7	
		20.7
Traders		4.3
		100

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PARTICIPATION AGREEMENTS

Introduction

1. The purpose of this paper is to outline the history of particiption discussions with the private sector oil companies, to summarise the main provisions of the resulting agreements and to examine the implications of changing them.

2. The broad policy objectives of the previous Government on participation were set out in the 1974 White Paper on "United Kingdom Offshore Oil and Gas Policy" (Cmnd. 5696). In order "to assert greater public control" and "to safeguard the national interest in an important resource which belongs to the nation", majority State participation was proposed in existing licences for commercial fields on the basis that "the State contributes its share of the costs, including past costs". It was indeed the basis on which discussions with oil companies on State participation in existing licences were opened, that the State would purchase a majority equity interest in each commercial field. This approach was later abandoned in view of the enormous costs involved and because it was considered that, in practice, the objectives of greater public control and the safeguarding of the national interest could equally well be achieved at no initial cost to the Government by providing the right for BNOC to acquire 51% of each company's petroleum at market price and to become members of Operating Committees.

3. In the early stages of negotiations, Ministers gave an assurance that it was not the intention that Companies would be either better or worse off financially as a result of their agreeing to participation. It became clear in the course of negotiations, that most companies set great store by this principle and in the majority of agreements, the broad intention contained in the assurance is explicitly referred to.

4. Over the period 1975-1978, participation agreements were negotiated between the Secretary of State for Energy, BNOC and the 62 companies listed in the Appendix in respect of the latters' pre-1975 licence interests in commercial fields. Negotiations were extremely complex and time consuming and at times took place in a heated atmosphere. In a few cases, there was a legacy of resentment but in a majority, the attitude of companies changed immediately agreements came to be put into effect. Negotiations took account of differences in the operating arrangements which had already been established between various companies in existing licence groups and for these and other reasons, which emerged in the course of negotiations, the detailed terms of each agreement vary considerably one from another. Broadly however, the agreements make the basic provisions set out in paragraph 5 below.

Rights Secured Under Agreements

5. (a) Licence Assignment

Where BNOC is not already a licensee by virtue of an existing equity interest, the participation agreements provide for it to be brought on to the licence. This confers on BNOC an undivided interest with the companies in the licences but the beneficial interest and the liabilities for all development and operating costs under the licences remains with the companies.

(b) Access to Petroleum

The agreements give BNOC the right to take, at market price, up to 51% of each company's share of petroleum from producing fields (the percentage is lower in a few cases where companies had already accepted a State partner before majority State participation was announced). The right is expressed as an option, normally exercisable on a year-to-year basis at six months' notice. Some of the agreements make provision, subject to the Secretary of State's discretion, for a proportion of participation petroleum to be sold back to producers having UK refinery capacity. BNOC's right to take natural gas under participation agreements is without prejudice to the statutory rights of the British Gas Corporation.

(c) Information and Voting

Under the agreements, BNOC becomes a full member, with an independent vote, of the relevant Operating Committees which manage commercial fields, pipelines and terminals. It thus has a right, supplementing its existing equity rights in certain fields, to all information concerning these facilities and full inside knowledge of how they are run. The size of the BNOC vote varies considerably from field to field, but the aim in every case was to secure for them an effective vote (ie one capable of modifying the number and/or identity of voting coalitions able to carry or block a decision). Where there is no Operating Committee (ie in those cases where, prior to participation, there was a single licensee) the agreement provides for consultation between the company concerned and BNOC during the course of field development. In some cases, it was possible to negotiate a right for BNOC to receive information about oil discoveries before a field is declared commercial, ie before BNOC becomes a member of the relevant Operating Committee or has the right of consultation in case of single company fields.

(d) Other Rights for BNOC

To enable BNOC to have opportunities to expand its UKCS operations, many of the agreements provide for BNOC to have the right to remedy a default in payment by one of the other licensees in return for part of the defaulting company's licence interest. In later agreements BNOC has acquired a first opportunity to negotiate for the purchase of the interest of a company that has decided to withdraw from a licence.

(e) Consultations

In parallel with the participation negotiations, separate agreements were reached between the Secretary of State and the majority of the oil companies that they should consult regularly on the companies' UK and UKCS petroleum operations, with emphasis on their plans for disposing of their UKCS crude. BNOC is not a party to these agreements but provision is made to enable BNOC to attend the consultations in its statutory role as advisor to the Secretary of State

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subject in some cases to its having provided a confidentiality undertaking. Some agreements make provision for BNOC to withdraw from consultations when sensitive topics, eg prices and exploration information, are being discussed.

Coverage of Participation

6. The main emphasis in negotiations was on securing participation arrangements covering commercial discoveries under existing licences, but the opportunity was taken in many cases to negotiate agreements relating to future commercial discoveries under these licences. Of the companies with whom negotiations were opened, only those with Total and Elf/Aquitaine have not been completed. These companies have not made any commercial oil discoveries under First to Fourth Round licences and none seems in prospect in the near future.

7. Coverage is not complete in other respects, since with a few companies we have agreements covering crude oil but not other petroleum, ie natural gas liquids and natural gas. With other companies, we do not have definitive agreements covering any new commercial discoveries they might make under pre-1975 licences.

Conclusion

8. The agreements which have been negotiated provide the legal basis for the exercise of Government participation rights. Changes in Government policy could be reflected in amendments to the documentation, but can only be brought about through agreement between the parties concerned. Most participation agreements are extremely complex and a delicately balanced interaction exists between one provision and another. Negotiation of the agreements absorbed considerable staff resources; approximately 20 to 25 Departmental officials were employed on this task at the peak of the three year activity (most have now been dispersed to other tasks). Negotiating major changes to the agreements would require similar painstaking effort and, because in the end there has to be a meeting of minds between the parties, it might be difficult in practice to reflect precisely the changes - and only the changes - which the Government wished to make.

9. As an alternative to negotiating changes in agreements, there could be some scope for bringing about changes in Government policy simply by instructing BNOC not to exercise rights which they have under the agreements. Whether this would work satisfactorily would depend on the particular change it was desired to make, but it might not work in all cases. For example, the non exercise by BNOC of a vote in an Operating Committee in some cases counts as a negative vote which could be contrary to the wishes of a majority of the other licencees.

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10 July 1979

APPENDIX

Companies with whom participation agreements have been signed

AGIP (UK) Ltd
Allied Chemical (Great Britain) Ltd.
Amerada Exploration Ltd
Amoco UK Petroleum Ltd
Ashland Oil (GB) Ltd
Blackfriars Oil Co Ltd
Bow Valley Exploration (UK) Ltd
British Electric Traction Co Ltd
British Petroleum Co Ltd
Canadian Ashland Oil (UK) Ltd
Can-Del Oil (UK) Ltd
CCP North Sea Associates Ltd
Century Power and Light Ltd
Charterhall Oil Ltd
Chevron Petroleum Co Ltd
City Petroleum Co
Conoco North Sea Ltd
Creslenn (UK) Ltd

Deminex Oil and Gas (UK) Ltd
Esso Petroleum Co Ltd
Fina Exploration Ltd
Gas and Oil Acreage Ltd
Getty Oil International (UK) Ltd
Gulf Oil GB Ltd
Halkyn District United Mines Ltd
Hamilton Brothers Oil (GB) Ltd
Hunt Oil (UK) Ltd
ICI Petroleum Ltd
Kerr-McGee Oil (UK) Ltd
Lochiel Exploration (UK) Ltd
LL & E (GB) Ltd

London & Scottish Marine Oil Co Ltd
Mesa (UK) Ltd
Mobil Producing North Sea Ltd
Murphy Petroleum Ltd
Norwegian Oil Co DNO (UK) Ltd
Occidental Petroleum (UK) Ltd
Ocean Exploration Co Ltd
Oil Exploration Ltd
Pan Ocean Oil (UK) Ltd
P & O Petroleum Ltd
Phillips Petroleum Exploration UK Ltd
Plascom Ltd
Ranger Oil (UK) Ltd
RTZ Oil & Gas Ltd
Saga Petroleum A/s & Co
St Joe Petroleum (UK) Corp
Santa Fe (UK) Ltd
Scottish Canadian Oil & Transportation Co. Ltd
Shell UK Ltd
Siebens Oil and Gas(UK) Ltd
Skelly Oil Exploration (UK) Ltd
Sunningdale Oils (UK) Ltd
Tenneco Great Britain Ltd
Texaco North Sea UK Ltd
Texas Eastern (UK) Ltd
Thomson North Sea Ltd
Trans-European Co Ltd
Transworld Petroleum (UK) Ltd
Tricentrol Thistle Development
Ultramar Exploration Ltd
Unocal Exploration & Production Co (UK) Ltd.