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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

THE SEVENTH ROUND OF OFFSHORE PETROLEUM PRODUCTION LICENSING

Note by the Central Policy Review Staff

1. The Government is firmly committed to increased exploration for hydrocarbons on the United Kingdom Continental Shelf (UKCS). But to achieve this it is not clear that a very large Seventh Round is needed.

2. Exploration for hydrocarbons on the UKCS depends much more on what happens in areas allocated under previous rounds than on the size and timing of a Seventh Round (see Figure 4 of E(79)58). There has already been an increased rate of exploration in recent months. The reasons for this are:

(a) the election of a Government firmly committed to private sector activity;

(b) increased uncertainty in OPEC countries which has heightened the attractions of exploring in stable areas such as the UKCS;

(c) the increase in the real price of oil has stimulated increased exploration;

(d) the drilling programme under Sixth Round licences is beginning to build up.

3. The Government has already taken a number of decisions which should result in yet further increased exploration:

(a) the oil companies claimed that the previous Government's decision to give BNOC first refusal in respect of farm-ins was holding up exploration. This privilege of BNOC has been removed;

(b) BNOC are having to dispose of a number of their existing licensed areas, most of which have drilling obligations attached. 23 have already been offered for sale;

(c) the Department of Energy has begun to put pressure on oil companies to explore more actively on their existing blocks.

4. Under the Fifth and Sixth Rounds, BNOC was automatically awarded 51 per cent of licences as well as being appointed sole licensee in respect of a number of blocks. The Government has already announced there will be no 51 per cent participation for BNOC in the future. As far as private sector companies are concerned this decision will effectively double the size of the round in terms of financial responsibilities as well as increasing their drilling responsibilities even if the number of blocks offered under the Seventh Round were the same as under the Sixth Round.

5. The Government is already committed to having a larger Seventh Round although not to any particular size. The CPRS believes that there is a strong case for having a Round that is <u>at most</u> some 50 per cent larger than the Sixth Round, say 70 blocks, rather than 100 per cent larger as proposed by the Secretary of State for Energy in E(79)53 as:

(a) for the reasons indicated in paragraphs 2 and 3 above, the oil companies already face the need for a large increase in their exploration activities. There is a real danger that a large Seventh Round will detract from HMG's efforts to stimulate more exploration under existing licences which are likely to be a much more significant source of hydrocarbons. Other things being equal, oil companies generally prefer to drill on new acreage than on existing blocks.

(b) The Government has taken the decision to terminate BNOC's right to 51 per cent participation. The limited financial capability of British companies means that the share they can afford to take in the Seventh Round will be considerably less than under the Sixth Round (66 per cent) and the Fifth Round (74 per cent). The percentage will almost certainly be lower (perhaps less than 50 per cent) under a 100 block Round than under a 70 block Round. There should be sufficient blocks under a 70 block Round to meet the needs of all small British companies.

(c) The Secretary of State's paper on Depletion Policy (E(79)58) implies that if the Government uses the depletion control mechanisms available, a considerable amount of oil production would be pushed forward to the early 1990s. On a low economic growth scenario we might even be self-sufficient in oil until the late 1990s. There would therefore seem to be a much stronger case for larger Ninth and possibly Eighth Rounds, which would lead to production at the end of the 1990s and later, than for a large Seventh Round. Indeed, too large a Seventh Round will reduce our ability to offer attractive acreage in future rounds.

6. The oil companies will, of course, say that they do have the resources to undertake increased exploration on their existing blocks and on those blocks which they will be purchasing from BNOC as well as under a much large Seventh Round. The companies are, however, in a negotiating position vis-a-vis the Government. Their statements should be treated with some caution.

<u>Recommendarion</u>

7. The CPRS recommends that Ministers should agree to a Seventh Licensing Round of 70 blocks at the most.

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