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P.0711

PRIME MINISTER

An Eighth Round of Offshore
Licensing

E(82)32 and 33

BACKGROUND

In E(82)32 the Secretary of State for Energy invites the Committee to agree to the announcement later this month of an eighth round of offshore licensing of oil and gas blocks. His aim is to grant licences for about 85 blocks overall in early 1983. In E(82)33 the Central Policy Review Staff support going ahead with the eighth round subject to reservations on the timing of the gas round, on the financial arrangements for allocating blocks, and on procedure for future rounds.

✓ / 2. The seventh round was announced about two years ago. On 23 June 1981 the Committee decided to defer the introduction of the eighth round (E(81)21st Meeting, Item 2). The main reason was that the Chancellor of the Exchequer wanted to delay the eighth round while consultations were still in train with the oil companies on the new tax regime in the 1982 Finance Bill; he was concerned that the major companies might attempt to put pressure on the Government while the Bill was still under consideration by a deliberately disappointing response to the eighth round.

3. The 1982 Finance Bill recognises the case for a new tax structure to provide a more secure and stable regime for future development and exploration of the North Sea. The supplementary petroleum duty will be abolished from the end of 1982; the rate of petroleum revenue tax will be increased from 70 to 75 per cent from 1 January 1983 and new arrangements introduced for the timing of payments.

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MAIN ISSUES

4. There is likely to be general agreement with the proposition for launching an eighth round this year in order to maintain the momentum of exploration required to ensure adequate oil and gas supplies in the 1990s. If that is so, the main issues which the Committee will need to consider are likely to be:

- (i) the precise timing of the announcement of the eighth round in relation to progress on the Finance Bill;
- (ii) the timing of the gas round;
- (iii) the financial arrangements for allocating blocks;
- (iv) the arrangements for future rounds.

✓ The Department of Energy see no difficulty in meeting the points made by the Minister of Agriculture, Fisheries and Food, in his minute to you of 25 March, on the need to continue to take account of the interests of fishermen when developing the offshore oil industry.

Timing

5. Now that the Finance Bill has been published the Secretary of State for Energy is anxious to get ahead with the eighth round. He would like an early announcement to enable the companies to make use of the 1982 summer season for the preliminary surveys on which they will base their applications in the autumn. From soundings of the industry he judges that the companies will not be unduly deterred by the immediate prospects for oil prices.

6. You will wish to consider whether an announcement now would give the companies an opportunity to back their criticism of the Finance Bill provisions by threatening between April and July not to take up licences. I understand that the Chancellor of the Exchequer will

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probably agree to the announcement being made in April, rather than in late July when the Finance Bill is enacted, provided that the Secretary of State for Energy can assure him, on the basis of further soundings of the oil companies, that it is unlikely that the industry will try to threaten a boycott of the eighth round as a gesture of protest against the tax proposals.

The Gas Round

7. The CPRS argue, in paragraphs 5-7 of E(82)33, that assuming the oil round is announced this month it should be said that a gas round will be offered later in the year. They are worried that if the gas round was offered now there could be awkward questions on what were the Government's intentions on gas exports to Europe in advance of the report during the summer by officials on ways of controlling gas exports.

8. The Department of Energy and the Treasury do not agree with the CPRS on this. The Secretary of State for Energy has said publicly that there will not be gas exports while there is unsatisfied United Kingdom demand for gas but that he will reconsider this at such time as UK demand is met. It is unlikely that for the time being any clearer signal can be given to interested companies.

9. The Committee should be aware of the Secretary of State's intention that the British Gas Corporation should be allowed to bid for gas blocks if they so wish. There may well be a case for this but questions could be asked on whether it is consistent with the Government's privatisation policy and the decisions taken to force BGC to sell their oil interests.

Allocation of Blocks

10. The Secretary of State for Energy proposes, in paragraph 9 of his paper, that 'mature' oil blocks should be offered for auction by closed

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tender bidding. Under this procedure the companies submit sealed bids to the Department of Energy who select primarily on the basis of the highest bids but taking into account the technical and financial standing of the companies and their proposed work programmes for exploiting the blocks. There is likely to be general support for this procedure. It will be useful in bringing in some early money and it seems clearly better than asking for a fixed price with all the attendant problems of deciding where to pitch it.

11. The Secretary of State for Energy goes on to propose that the other blocks should be allocated by licence involving a sliding scale of rentals (as with the mature oil blocks) but no initial payments. In the case of oil blocks in the 'frontier' areas he fears that companies would be deterred from applying if they had to make a down payment and that those which did apply might not necessarily be the companies best suited to exploration and exploitation (paragraph 5 of E(82)32). He proposes similar arrangements for gas blocks (his paragraphs 6-8) because he is particularly concerned to get a very good response indicating support of the new policy following the passage of the Oil and Gas (Enterprise) Bill.

12. The CPRS argue, in paragraphs 8 and 9 of E(82)33, that the closed tender system should apply to all blocks. Bids for frontier and gas blocks would no doubt be lower than those for the less risky mature oil blocks but, nevertheless, they would bring in some useful early money. The CPRS suggest that the Department of Energy would not necessarily have to take the highest bid and that they could select the most suitable company.

13. The Secretary of State for Energy may well argue that in practice it will be very difficult for him not to take the highest bid - and the level of bids will become public knowledge once the tender takes place. He might go on to say that he will be vulnerable to criticism from the PAC if he did not take the highest bid. You may wish to probe

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him on this. The sliding scale of rentals charged on a block is the same whether or not there is an initial payment. The PAC, or other critics, might well ask why the Government did not take up the chance to secure some additional money, by way of an initial payment, for these blocks. Low initial payments would be more defensible than none. The Secretary of State for Energy would be vulnerable to criticism if he decided not to take the highest bid but it would be open to him to argue that he had chosen another company on the grounds that he had reason to believe that they would more effectively exploit the block. It might be possible for him to prepare the way for this by making clear in his preliminary announcement how the procedures would operate.

Future Rounds

14. The CPRS suggest in paragraph 10 of E(82)33 that consideration should be given to allowing two summer seasons between the dates of announcement and submission of applications for future rounds.

15. The Secretary of State for Energy and the Chancellor of the Exchequer will probably not be attracted by this idea. The companies can make up their minds more quickly than this. Extending the period could complicate the interaction between licensing rounds and budget decisions in future years and give more scope to the companies to use threats of non-participation as a propaganda weapon for relaxation of the fiscal regime. The CPRS idea could, however, be considered further or borne in mind if the Committee thought it worthwhile.

HANDLING

16. After the Secretary of State for Energy has introduced his paper it might be most convenient to break-down the discussion under the headings of timing of the eighth round, the gas round, the financial arrangements, and future arrangements. Subject to any general points which they might wish to make at the beginning of the discussion, the Chancellor of the Exchequer and Mr Sparrow could comment on the


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particular issues as they arose. The Secretary of State for Industry, Mr Fletcher (representing the Secretary of State for Scotland) and the Minister of Agriculture, Fisheries and Food may have comments from the point of view of the offshore oil supply industry and the fishing industry.

CONCLUSIONS

17. In the light of the discussion you will wish to record conclusions on:-


(i) whether there should be an eighth round of offshore licensing in 1982 on the scale proposed by the Secretary of State for Energy and, if so

(ii) whether there should be a preliminary announcement in April as proposed in paragraph 11(c) of E(82)32;

(iii) whether there should be any separate arrangements for the licensing of gas blocks as proposed by the CPRS;

(iv) whether the blocks should be all subject to the closed tender procedure or whether this should apply solely to mature oil blocks with the rest simply licensed;

(v) whether in future rounds there should be two summer seasons between the dates of announcement and submission of applications.


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