

CONFIDENTIAL

CENO

NDPM

AF 8/2



Treasury Chambers, Parliament Street, SW1P 3AG
Rt Hon Peter Walker MBE MP
Secretary of State
Department of Energy
Thames House South
Millbank
London
SW1P 4QJ

7 February 1985

PETROLEUM BILL

You wrote to Nigel Lawson on 21 December seeking his agreement to the proposals for a Petroleum Bill set out in your draft E(A) paper.

I am content with the majority of those of your proposals in which I have an interest and positively welcome proposals (b), (d), (e) and (i) together with that aimed at easing the privatisation of the GPSS.

I have some difficulty, however, with your proposals on the financial aspects of abandonment; I am concerned that your proposal to legislate on the rights of the Crown Estates Commissioners should not bring an end to the search for an administrative solution; and finally I believe you should use this legislative opportunity to solve the cash flow problem from moving from Royalty in Kind to Royalty in Cash. These points are set out in more detail in the rest of this letter.

Abandonment

Given the large sums at stake on abandonment, I am concerned that your proposals at 3a(iv) and to a lesser extent 4c may pre-empt decisions we still have to take on how to deal with the whole question of the treatment of abandonment costs.

3a(iv) proposes imposing a duty on operators to satisfy you that finance will be available at the end of field life. The introduction of measure of this sort risks increasing pressure for current tax relief for future costs, and bringing forward general pressures to make decisions (with large Exchequer complications) on tax treatment of

CONFIDENTIAL

CONFIDENTIAL

abandonment costs before we are ready. We need to be able to set this risk against an assessment of the consequences of not including your proposed provision - to what extent are companies likely to default on their removal obligations? Such information has not so far been made available. In addition, I understand that, despite preliminary work by officials, it is far from clear how such a statutory duty would be applied in practice. Considerably more work is therefore needed before I can give policy approval to this proposal. However, if you can provide an assessment of the risk of default, and proposal for a viable means of applying the duty, I would be happy to look at the proposal again.

If, in the light of this, I did feel able to agree that such a provision was needed, I would much prefer to see the Bill provide enabling power rather than impose a duty. Your draft implies the latter. An enabling power could lessen the immediate pressures to resolve the tax treatment. It seems, in any case, too early to impose a duty: we cannot yet assess with any precision what the costs of abandonment will be, and hence could not calculate what financial provision would be needed.

Proposal 4c would allow abandonment costs to be offset against past royalty payments. It therefore appears to assume that we will want to go down the fiscal route in sharing the costs to companies of abandonment. Although this is implicit in current PRT and CT legislation, a number of important matters have not yet been resolved, and UKOOA, in representations made last year which still have to be properly discussed with them, seem now to be favouring a non-fiscal approach (on the lines of that being adopted in Norway). Thus we have yet to decide on this and I would not want to pre-empt the outcome of further consideration of the issues in the light of further discussion with the industry.

I would be prepared to accept this proposal if, in bringing it forward, you could make clear that we retain an open mind in these matters and would be prepared to reconsider it in the light of any wider discussion with the industry in the period before the Bill is introduced.

Crown Estate Commissioners

I hope that the Law Officers can give us their opinion quickly. In the meantime, I think we should continue to try for an administrative solution. I regard legislation as being very much a last resort. In view of the sensitive nature of the proposal I also hope that you will discuss it with Robin Crawford, the First Crown Estate Commissioner, at an early stage.

Royalty in Cash

As you know, switching from payment of Royalty in Kind to Royalty in Cash involves a substantial once and for all PSBR loss (as well as a smaller continuing one). It needs primary legislation to remedy this and I hope

CONFIDENTIAL

you could agree that this Bill provides a suitable vehicle. This would remove a significant constraint on policy options in this area. I would for my part be prepared to propose legislation in a Finance Bill to ensure that the PRT rules did not operate to negate the cash flow advantage thus preserved.

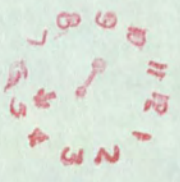
I am copying this to the Prime Minister and to Sir Robert Armstrong.

Peter Rees

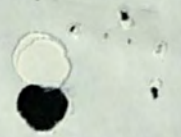
PETER REES

CONFIDENTIAL

Parliament: Legislation Pt 13



-8 FEB 1965



CONFIDENTIAL

CC 110

01 211 6402

NBPM
N.

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London
SW1P 3AG

21 December 1984

Dear Chancellor,

I attach a paper outlining the provisions I have in mind for a Petroleum Bill which I have proposed for the 1985/1986 session. As you will see, its provisions are somewhat specialised and of major interest only to your department and mine. I would like to be able to tell the Prime Minister that what is proposed in the paper is agreed between us, and to suggest that given its limited interest to other members of E(A) I should circulate the paper to them for clearance by correspondence. I should be grateful to know if you are content.

I should draw your attention to items f, g and h in paragraph 4 of the paper. These are essentially technical provisions which have not previously been put specifically to Ministers, but have been cleared by correspondence at official level with both the Revenue and Treasury.

I am copying this to the Prime Minister and to Sir Robert Armstrong.

Yours sincerely
John Neilson

P.P. PETER WALKER
(approved by the
Secretary of State
and signed in his absence)

CONFIDENTIAL



PETROLEUM BILL

Memorandum by the Secretary of State for Energy

1. I seek the agreement of colleagues to the policy content of a Petroleum Bill, which I have proposed as a candidate for the 1985/6 Session. The broad theme of the Bill is the proper management of oil and gas on the UK Continental Shelf; but it would also amend present controls over land pipelines; and authorise sale or lease of the Government oil pipeline and storage system if a decision to privatise were the outcome of an interdepartmental study now in progress.

2. The offshore management provisions fall into four groups:-

- (i) changes in the regime for controlling offshore developments especially in relation to platform removal;
- (ii) clauses to clarify and simplify the law on petroleum royalties;
- (iii) clauses to place licensing of offshore gas storage on the same basis as licensing of other offshore oil and gas developments. This affects the interests of the Crown Estate;
- (iv) clauses establishing safety zones around offshore installations automatically rather than by order.

These and the other provisions are summarised in the following paragraphs.



Regulation of oil and gas developments

3. (a) Abandonment of disused offshore installations

- (i) to impose a duty on operators to dismantle and remove disused oil and gas installations at the end of their productive life unless the Secretary of State for Energy (SOS) agrees otherwise;
- (ii) to give the SoS power to approve plans for platform removal;
- (iii) to give the SoS power to set appropriate removal standards; and
- (iv) to impose a duty on operators to satisfy the SoS that finance will be available at the end of field life to meet abandonment costs.

Some of these provisions would also apply to pipelines. They are needed now because some fields will quite soon be nearing the end of their productive life and plans will need to be made in good time to ensure that the process takes place in an orderly way. Although most operators already assume that they will be responsible for platform removal, and some are already making financial provisions in their accounts, there are no satisfactory provisions for removal in existing legislation. It is important to note that clarifying the obligation to remove will encourage efforts to extend the economic use of installations by further marginally profitable exploitation of oil and gas fields: with advantages to the economy and the Exchequer.

(b) Extension of licensing regime to N Ireland territorial waters

At present neither the Great Britain nor the Northern Ireland petroleum licensing (and thus taxation) legislation applies in these waters.



Royalties

4. The changes proposed in relation to new situations are:

(c) To put royalty payments on a cumulative basis

The effect would be to put the treatment of platform abandonment costs and of post production tariff receipts (eg for use of pipelines) on broadly the same basis for royalty purposes as for Petroleum Revenue Tax (PRT) and corporation tax (CT) purposes.

(d) To apply to royalty payments amendments to the PRT valuation rules

This change would also facilitate the collection of royalty, as well as PRT and CT, on "capacity charges". "Capacity charges" may be an important part of the receipts of a developer who contracts to supply gas on demand at peak periods only.

(e) To provide for royalty rights on injected gas

This would provide that rights to take royalty are not lost when gas produced from one field is injected into another to assist production.

The changes proposed to simplify procedures and correct anomalies are:

(f) To simplify calculations of residual cash royalties due where royalty in kind is taken

This would bring within the formal procedures a simple method, already in use by mutual agreement, of calculating residual cash royalties due where most of the royalty is taken in the form of oil.

(g) To simplify the provision of royalty-related returns by licensees

Under this change the existing Modified Payments Procedure, under which some licensees will have to submit a full Statement of Value only once a year, would be brought more fully within the scope of the licence model clauses.



(h) To correct anomalies on dispute procedures

At present different licence model clauses provide for different notice periods and procedures for resolving different types of dispute between the SoS and a licensee; these would be brought into line with each other.

(i) To amend petroleum measurement requirements

The licence model clauses would be amended to enable the SoS to require separate measurement of petroleum won and saved from fields located in the same licensed area; licensees would also be required to measure the quality of petroleum as well as the quantity. These amendments would facilitate the verification of quantities of petroleum for tax and royalty purposes where there is more than one field in a licensed area or where petroleum is commingled.

(j) To change present arrangements for sharing licence revenues with the Isle of Man

This would compensate the Manx authorities for the loss of royalty from new fields, resulting from the 1983 fiscal changes, which they would otherwise have received.

Offshore Gas Storage

5. (k) To enable the SoS to licence the storage of gas (and other petroleum) offshore. At present this function falls - anomalously - to the Crown Estate Commissioners.

Safety Zones

6. (1) To amend existing legislation so that a protective 500 metre safety zone would automatically be created around new offshore installations, avoiding the need for hundreds of separate Orders.



Pipelines

7. (m) To exempt certain BGC pipelines from the present notification requirements

This would relieve BGC of the need to notify the SoS of proposals to construct new high-pressure pipelines of 1km or less. The aim is administrative saving. The private sector would be able to continue to make representation in respect of longer pipelines, but the notifications of small lengths have proved excessive and of no interest to the private sector.

(n) Public enquiries on pipeline route modification

These enquiries would be made discretionary rather than obligatory; the aim is administrative saving.

(o) Pipeline insurance

To take powers to require the owner of a pipeline to have adequate third party insurance.

Government Oil Pipeline and Storage System (GPSS)

8. (p) Legal advice is that the rights given by the wayleave orders under which the GPSS has been constructed, maintained and used are personal to the SoS, and cannot be sold, or even leased, to anyone else without new primary legislation. A report will shortly be made to Ministers about the scope for privatising the GPSS; if the decision were in favour of some form of privatisation, this Bill would be the appropriate vehicle for the necessary new provisions.

Controversy and timing

9. Most of these provisions are unlikely to be seriously controversial. Some of the royalties proposals may possibly give rise to some opposition from the industry though our consultations so far do not suggest that



serious opposition is likely. The provisions affecting the Crown Estate could be controversial: it would be advantageous if their objectives could be achieved without legislation, but our appreciation is that there may be real statutory difficulties for the Crown Estate Commissioners in agreeing to the kind of administrative solution we would favour. Privatisation of the GPSS, if added, could be expected to attract ritual opposition.

10. On timing, these provisions are directed at situations which are already of practical significance in offshore oil and gas administration, or affect Government finances. Deferment of legislation could put some royalty revenue at risk as well as creating delays damaging to development and to the reputation of the UKCS as a well managed oil province.

Financial Implications

11. It is impossible to put a figure of net cost or benefit to the Exchequer on the provisions proposed for this Bill, but broadly its impact must be to the advantage of the Exchequer. Some of the provisions remove risks of loss to the Exchequer from ambiguities or gaps in the existing law. Making "capacity charges" by gas developers liable to royalty will increase revenue in the period immediately ahead. Some of the provisions achieve or entrench administrative savings, with modest Exchequer benefits. There could be proceeds to the Exchequer from the privatisation of the Government pipeline system if Ministers decided to proceed with this, though it is difficult to quantify the yield at this stage. Potentially the largest financial implications flow from the provisions for controlling dismantling of disused rigs. The amounts of tax relief to which companies will be entitled over a long period for removal expenditure is bound to be substantial but it would be wrong to regard that as a "cost" of this Bill. It has in fact long

... been



been recognised that companies cannot reasonably be denied full relief on abandonment costs against tax and royalty; and this Bill brings the royalty position broadly into line with the existing tax position. In giving recognition to this for royalty however the Bill would at the same time reduce the risk that the Government might find itself obliged to finance the removal of a rig through default by the licensee. Unless developers are required by law to demonstrate the capacity to finance removal, there is a real risk that finance for removal may just not be available after the period of profitable exploitation. In that respect the Bill would protect the Exchequer. And if the costs of removal encourage extended exploitation, that should produce some benefit to the Exchequer.

Manpower Implications

12. Minimal

Community Implications

13. None

Recommendations

14. I ask colleagues to approve the principle of a Petroleum bill and the inclusion of provisions (a) to (p) above.

PEW

Secretary of State for Energy

18 December 1984

21 DEC 1984

