MR TURNBULL 11 January 1985

PETROLEUM BILL

Energy are proposing a Petroleum Bill for the 1985/86 Session. The primary aim of the Bill is to improve the framework of legislation surrounding UK offshore oil and gas exploration and development. For example, with some fields nearing the end of their productive lives, it is recognised that the Government needs suitable powers to ensure that when the facilities are no longer operational they are properly dismantled and abandoned. Also, the Government needs to be sure that the licensees have made adequate financial provision to cover this obligation, the cost of which can run into hundreds of millions of pounds per field in the deeper waters of the northern North Sea.

Peter Walker contends that the Bill largely comprises a straightforward package of administrative improvements which do not raise significant policy issues and can therefore be cleared by correspondence between E(A) members. We believe that he is wrong. There are important policy issues associated with some of the proposed legislation. We are in danger of getting the cart before the horse - the administration before the policy.

Successive UK Governments have adopted the policy of developing our oil and gas resources by creating a commercial climate which stimulates the initiative and enterprise of the international oil industry, and other investors to commit their resources, skill and risk capital. The taxation system ensures that, if successful, the risk investors are well rewarded and that the balance of economic rent accrues to the Government. Understandably, the Government's efforts so far have been directed towards getting the "chemistry" right as regards exploration, appraisal, and the development of new fields. Now, we urgently need to turn our attention to the first generation of mature North Sea fields approaching the point of economic abandonment. It is after all fields of this generation which are the largest and most productive. Even so, conventional oil field practice and technology would not recover more than 30-50% of the total volume of oil reserves in the ground.

Take a field producing exportable oil worth, say, $28 per barrel. As the field depletes, production declines and unit operating costs rise to the point where, coupled with royalty and tax, they account for all the $28 realisation and leave no reward for the resources and management effort committed. For the oil company accountants, the point of economic abandonment has been reached.

We don't need to shed tears for the oil companies; they will usually have made a good return on their previous risk investment. In any case, most of the oil companies have enticing new field development projects to be getting on with. But unless we devise a commercial framework which induces the oil companies to go on applying their ingenuity and resources until they have located and recovered the last barrel of oil or cubic foot of gas on which there is economic rent to be had, considerable benefits to the UK economy will be irrecoverably lost.

Unfortunately, things won't come right on the night. If we are to realise the maximum economic benefit from mature producing fields, the oil companies need to be aware now of what is in it for them. The lead times for extending field life and undertaking incremental development projects are long - entailing for example, detailed three-dimensional seismic surveys, more appraisal drilling, development planning, perhaps an experimental pilot test, construction, and meanwhile more rigorous maintenance of the existing facilities.

(Conclusion: Government should set itself the task of devising a commercial framework for maximising the economic benefit from mature producing fields in time for the 1986 Budget.)

The proposed Petroleum Bill would introduce a number of changes aimed at simplifying the calculation of royalty and removing anomalies and inconsistencies. As far as we can see, the Bill would not amend those provisions which make it financially advantageous for the Government to take royalty in kind rather than cash. The Government's need to dispose of the royalty oil is one of the factors used to defend BNOC against abolition.

(Conclusion: include provision in the Petroleum Bill to remove the handicap on royalty being taken in cash. Moreover, in view of the possibility that the Government may wish to abolish BNOC within the next year or two, we ought to prepare the requisite legislation and, at least initially, include it within the scope of the Bill.)

We do not feel that Peter Walker should duck the wider policy issues raised by his proposed Petroleum Bill. They should be considered in E(A).

JMW.

JOHN WYBREW

10 DOWNING STREET

Mr Turnbull.

Andrew. PETROLEUM BILL

This note is prompted by Peter Walker's recent letter to the Chancellor on the subject.

John Redwood and I felt that it may be useful for you to have our thoughts on the subject now so that you can use them if and when the need arises.

JMW.

11/1.

File

Spoke to Steve Robson. He agrees that issues raised in the minute need to be tackled but not need to raise to E(A). The Crawley Group at Inland Revenue will

PTO

Consider most of them

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