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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

AN EIGHTH ROUND OF OFFSHORE LICENSING

Memorandum by the Secretary of State for Energy

INTRODUCTION

1. My predecessor tabled a paper (E(81)65) about an Eighth Round of offshore licensing, which was discussed at E(81)21st Meeting on 23 June 1981. He proposed a Round comprising 40 blocks selected by my Department in previously unexplored or 'frontier' areas. As the primary objective was to open up new, high risk areas no special front-end payments were proposed. The Committee decided that it would be preferable to defer the Round so that applications were not received until after the 1982 Finance Bill had been enacted.

2. It is nearly two years since arrangements for the Seventh Round were announced and an Eighth Round is now needed in order to maintain the momentum of exploration required to sustain oil and gas supplies in the 1990's. An early announcement will enable the companies to make use of the 1982 Summer season for the preliminary surveys on which they will base their applications.

3. This paper sets out proposals on the nature, size and timing of an Eighth Round. In brief, I propose extending the original proposal to cover about 85 blocks by including areas in the Southern Basin gas

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province and a few blocks selected in the mature oil province of the central North Sea. The blocks in the mature oil area would be offered for 'auction' by way of closed tender bidding.

OBJECTIVES OF THE ROUND

4. The objectives are:

- a. to open up exploration in frontier areas of the UKCS;
- b. to promote exploration for gas as a logical follow-up to the measures for the encouragement of the industry included in the Oil and Gas (Enterprise) Bill;
- c. where practicable and consistent with other objectives, to secure early money through front-end payments.

CONSTRAINTS

5. Blocks in the frontier areas would not attract early money. The prospects and risks are such as to deter many companies from applying even without a premium. An auction might be seen as being less of a deterrent since the companies could pitch their bids as low as they wished. But in these unevaluated areas many companies would see the only sensible bid as being zero. Even if the deterrent is primarily psychological, I believe that an auction would reduce interest and limit my choice of applicant. I shall be looking for those companies who can provide the most competent and imaginative approach to the exploration of these frontier areas. It is important to bring these talents to bear now; lead times are so long that today's exploration cannot be expected to contribute to our oil and gas supplies before the 1990's when they would otherwise be declining.

6. In recent years there has been little enthusiasm in the Industry for gas exploration and development. Production has been static over the past six years and no significant discoveries have been made in the southern gas province since 1976. I am convinced of the need to

restore the momentum of exploration for new supplies. One of the purposes of the Oil and Gas (Enterprise) Bill is to stimulate fresh interest. To foster this interest the companies need to be offered opportunities for exploration in the gas area in the southern North Sea.

7. I have considered carefully whether front-end money could be obtained from this territory, either from cash premia or auction. By licensing the territory while these legislative changes are in progress we shall be breaking new ground. We cannot know the right level at which to set any fixed premium, and if we made a mistake we could deter applications. It would be possible to auction the territory, but I should be opposed to doing this since our first objective must be to get a first class response to our policy of encouraging exploration by freeing the gas market. We can certainly consider auctioning gas blocks in subsequent Rounds.

8. The companies are beginning to show interest in possible deep prospects in the south of the Southern Basin, which may yield oil rather than gas. Their evaluation of the area, which is unlikely to be completed this year, might lead to its general upgrading and enable us to secure significant front-end money in future Rounds. I have therefore excluded the area from my present proposals.

9. The mature oil province in the northern and central areas of the North Sea was offered in the Seventh Round as a company nomination area at £5m per block. The companies' interest at that time was satisfied. Any further interest stimulated by recent discoveries is likely to be limited; some early money could be obtainable, but the amount is hard to judge and likely to vary significantly from block to block. A fixed premium could deter applications for some of the blocks. I propose that these blocks should be offered for auction by closed tender bidding. This will bring in some front-end money and will give us a

further opportunity, after an interval of some ten years, to test the advantages of this method of licensing in current fiscal and economic circumstances.

10. Other areas which might be especially attractive to the companies, eg the Inner Moray Firth and the English Channel, are subject to restrictions on defence, shipping and environmental grounds which rule them out for further licensing at present.

PROPOSALS

11. a. SCOPE

My aim is to licence about 85 blocks overall. To achieve this I propose offering:

15 blocks in the mature oil province (possibly 10 would be licensed)

45 (approximately) blocks in the mature gas province (possibly 30 would be licensed)

150 (approximately) blocks in frontier areas (possibly 40-50 would be licensed).

The areas are shown on the attached map.

It is necessary to give the companies a wide choice particularly in the frontier areas. Even in known areas they do not take up all the blocks on offer. The actual distribution of awards will be decided in the light of the response received.

b. TERMS

For blocks in the mature oil province in the central area of the North Sea, I propose inviting closed tender bids. In assessing bids the proposed work programmes would be considered alongside the cash sum bid, but subject to that I would normally accept the highest bid. I would however retain sufficient room for manoeuvre to enable me to exclude applicants whose technical and financial standing was inadequate. For all other blocks

decisions would be based on the normal licensing criteria. This would not only enable me to select the most suitable applicants for individual blocks; it would also enable me to extract the maximum drilling effort and all possible support for our other offshore policies.

c. TIMING

I have considered whether, in view of the present weakness of oil prices and possible continued opposition from the industry to the tax regime, the Round should be further postponed. I have concluded that it should not. As UKOOA have themselves stressed, companies take a longer-term view in deciding whether to take up licence opportunities; they will not be unduly influenced by the immediate prospects for oil prices. I do not believe that the industry will wish, or would be able, to mount a boycott of the Eighth Round as a gesture of protest against the tax regime.

I accordingly propose a preliminary announcement in April - indicating the broad areas to be included in the Round. This will open the way for consultations with environmental groups and others and will enable the companies to direct their preliminary surveys appropriately. The formal invitation to apply would follow in mid-Summer with a closing date in November/December and awards early 1983.

RECOMMENDATION

12. I invite the Committee to agree that I should proceed as proposed.

N.L

Department of Energy
18 March 1982

UK CONTINENTAL SHELF LOCATION OF BLOCKS

