DEVELOPING SMALL OIL AND GAS FIELDS IN THE NORTH SEA: NEW LEGAL INSTRUMENTS AND LESSONS TO BE LEARNED

Five Years of Energy Law in Groningen: Academics Meet Practice

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Small fields on the UKCS: Context

- The UKCS is now described as mature
- Implies declining production, increased costs, reduced size of new discoveries
  - Production declining by around 6%/year over past decade
  - Unit operating costs have risen from c£3/boe to c£9/boe over past decade
  - 60% of new fields < 20m barrels
  - 75% of incremental developments

    < 10m barrels

Source Oil and Gas UK Activity Survey 2011

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Government v Industry views UK

- Government
  - Stated policy is maximisation of economic recovery
  - Wants industry to continue investing in exploration, development, enhanced recovery, extension of life of infrastructure
- Industry
  - Higher RRI available in younger provinces globally
  - Are the smaller fields and incremental developments on the UKCS now worth the effort?

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Challenges UK

- Encouraging industry to develop discoveries made under earlier licences which lack relinquishment provisions
- Ensuring those willing to develop small fields have access to infrastructure
- Ensuring that the state recovers a sufficient return without stifling investment

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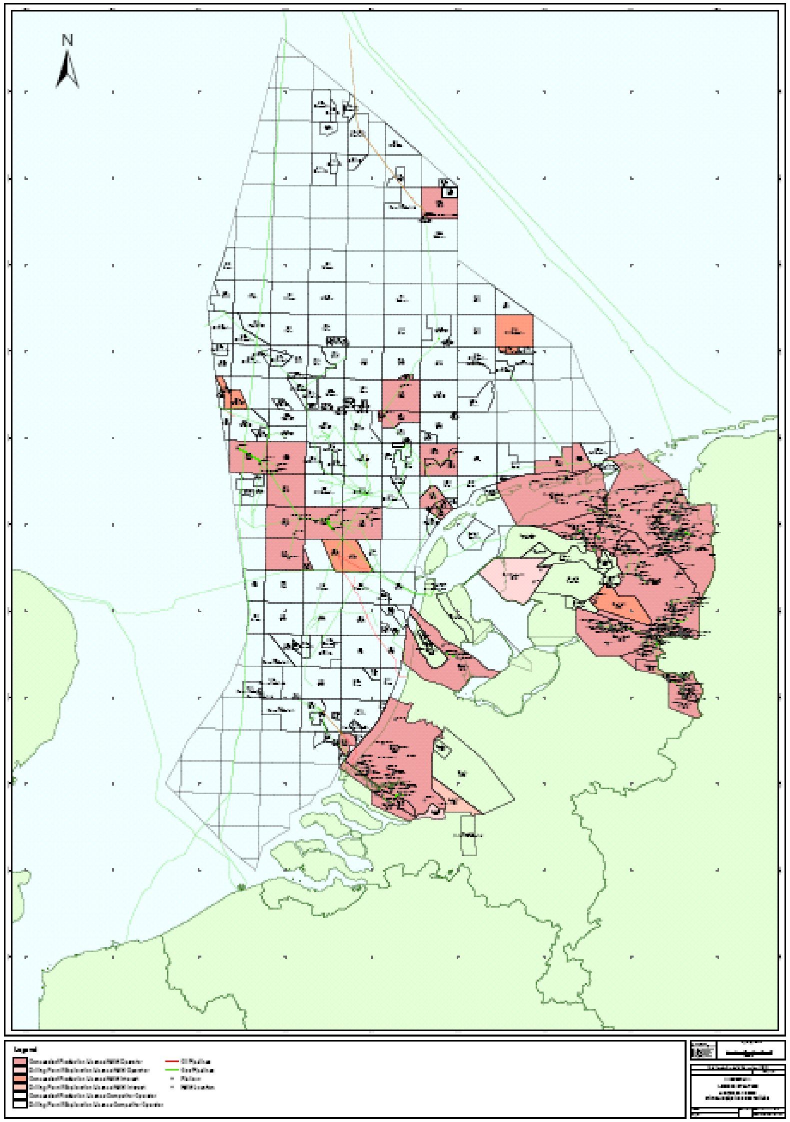
Oil and gas production in the Netherlands



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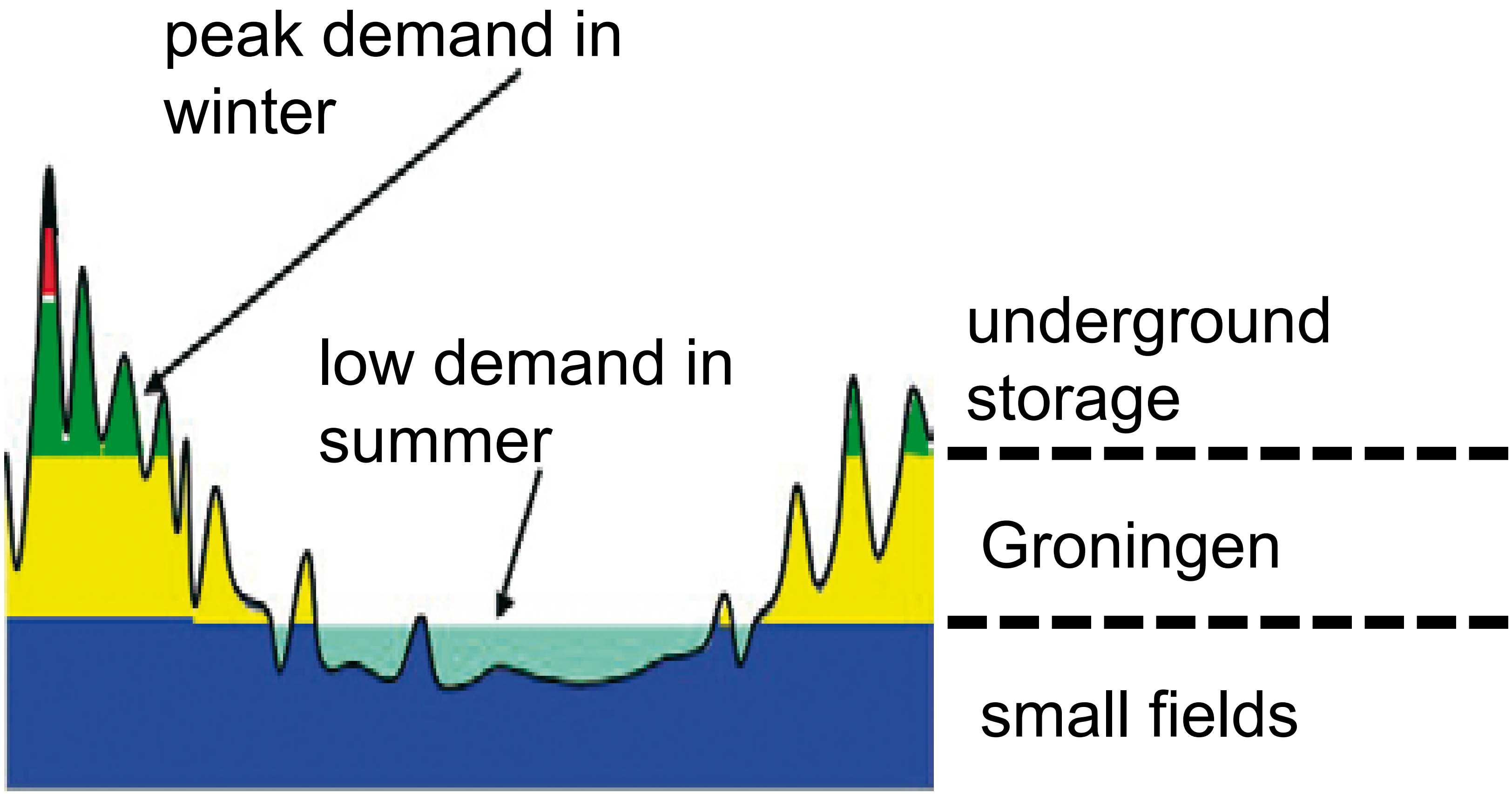
"Small fields policy": Groningen accommodates small fields



Need for increased activity NL

- Groningen field will at some point cease to be able to accommodate small field production
- Technical and economic lifetime of infrastructure is not unlimited

If undeveloped fields offshore are not developed soon, they may not be developed at all

Non-Fiscal Measures UK 1

- Fallow Initiative
  - Joint government-industry working group discovered in 2002 that some 250 discoveries were lying undeveloped
  - Prior to 2002, licences contained insufficient relinquishment provisions to force licensees to hand back undeveloped acreage
  - Working group considered options

Non-Fiscal Measures UK 2

- Fallow Initiative (cont.)
  - Retrospective legislation unilaterally altering licences rejected
  - Voluntary scheme rejected
  - Hybrid chosen – essentially voluntary, but underpinned by existing licence powers…it is unclear, however, whether the licence powers relied upon actually allow the ministerial action undertaken

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Non-Fiscal Measures UK 3

- Access to infrastructure
  - Small fields may only be economic if licensee has access to infrastructure belonging to someone else
  - How can access be ensured at a reasonable price without compromising the rights of the owner?
  - Statutory provision (dating from 1975, but now Petroleum Act 1998, s17F) allows 3rd party to refer access issue to the Minister for determination in event of dispute
  - But this provision was never used

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Non-Fiscal Measures UK 4

- Access to Infrastructure (cont.)
  - Joint committee proposed Industry Code of Practice
  - After some false starts, the system now relies upon the statute (as amended in 2008), the ICoP and Guidance Notes produced by the Minister
  - Industry reluctance to call in Minister overcome by Automatic Referral Notice
  - First case referred to Minister in 2010
  - Will recent spill cases make owners more wary?

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New legislation and covenant NL

- covenant between State and industry
- fiscal measure (investment deduction)
- amendment to Mining Act, enabling partial revocation of production licenses (area reduction)

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New legislation: partial revocation (area reduction) NL

- amendment Mining Act per 1.1.2010
- annual stock-taking of areas with no relevant activities in two preceding calendar years
- procedure area reduction:
  - notification by Ministry
  - response by license holder (within 6 months)
  - decision regarding area reduction (within 4 months)

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Covenant NL (1)

- signed 31 August 2010 between State and all E&P industry
- scope: offshore (onshore excluded)
- not legally binding

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Covenant NL (2)

- preliminary classification and final classification
- possibility to submit activity plans:
  - license holder: immediately
  - co-license holders: after 9 months
  - third parties: after 12 months
- if third party activity plan is approved, license holder will support divestment

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Application in practice NL

- **offshore:**
  - **procedures Mining Act and covenant combined (results stock-taking = classification)**
  - **publication 1 July 2011 (third party activity plans allowed as from 1 July 2012)**
- **onshore:**
  - **publication results stock-taking also 1 July 2012**
  - **covenant does not apply onshore**

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Fiscal Measures UK 1

- History of oil taxation on the UKCS is frequently one of bad-tempered exchanges between industry and government
- In more recent years, industry had begun to feel that government understood its position
- Supplementary Charge to Ring Fence Corporation Tax has therefore caused particular upset
  - 2002 – 10%
  - 2006 – 20%
  - 2010 – 32%
- Government points to industry “windfalls”, but industry points to damaging effect on investment

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Fiscal Measures UK 2

- Government has therefore had to introduce a number of allowances in 2009 and 2010 to ensure that investments can proceed
- Allowances reflect the sorts of fields currently in prospect on the UKCS
  - Small oil fields (reserves < 3.5m tonnes)
  - Ultra heavy oil fields (API gravity < 18º; viscosity > 50 centipoise)
  - Ultra high pressure/high temp. fields (> 1034 bar; > 176.67ºC)
  - Deep water gas fields (> 300m; > 60km transport distance)
- Although these are provisions of general law, they have been drafted with particular developments in mind…is this the shape of things to come?

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Stability tax regime NL

- State profit share
- rate: 50% (since 1967)
- changes to tax regime do not affect existing licenses ("stability clause")

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Fiscal measure NL (1)

- new fiscal measure (investment deduction) as of 16 September 2010
- additional deduction of 25% of investment amount in year of investment
- applies to “marginal fields”:
  - gas fields that would not be developed if no fiscal incentive
  - criteria: distance to infrastructure, volume and productivity
  - designed to exclude “free riders”

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Fiscal measure NL (2)

- procedure:
  - Minister determines in advance whether gas field meets criteria
  - investment to take place within 2 years after determination (may be extended by additional 2 years)
- application in practice

THANK YOU FOR YOUR ATTENTION

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