UNC Mods 498/502 Workgroup on Gas Quality at Teesside Entry Point

Submission of Oil & Gas UK on Current Government Objectives and Reforms

At the most recent meeting of the workgroup on UNC Mods 498 and 502 on 10 November, Oil & Gas UK was asked to provide some background information on the UK government's current regulatory and fiscal reforms to promote the development of the remaining hydrocarbon resources of the UK Continental Shelf (UKCS). We are pleased to respond since we believe that the decisions of the UNC Mod Panel and Ofgem on these and other UNC modification proposals should be consistent with government policies towards the development of our indigenous resources.

UK government policy towards UKCS. The development of UKCS offshore hydrocarbon resources has been a key element of government energy policy since the first discoveries were made in the North Sea in the 1960s. The government remains committed to maximising the benefits of hydrocarbon extraction for the UK economy. These benefits comprise both a fair return to the nation through direct taxation and wider economic benefits through the contribution to investment, jobs, indirect taxes, energy supply security and exports by the UK-based supply chain. An important part of the government's objective is the concept of 'maximising economic recovery' set out in the Wood Review and now being incorporated in primary legislation. As the UKCS has matured and the underlying investment economics of the basin have deteriorated, the government has since 2009 introduced a number of field allowances which offer support to technically and commercially challenging projects which would otherwise be marginal at existing tax rates. These field allowances, introduced since 2009, provide relief from the Supplementary Charge (SC) currently levied at 32% of profits, on top of the Ring Fence Corporation Tax (RFCT) levied at 30%.

Wood Review and Maximising Economic Recovery. In June 2013, the Secretary of State for Energy invited Sir Ian Wood to conduct a thorough review of the regulatory regime governing the UK offshore industry. His final report ('UKCS Maximising Economic Recovery'), published in February 2014, made a number of important recommendations including the creation of a new regulator, the Oil and Gas Authority (OGA). The report was accepted in its entirety by the government which is now in the process of passing legislation to establish the principles of 'MER UK' in law and to fund the new OGA. Further legislation in the next Parliament will introduce new powers and functions for the OGA. The new body is expected to be fully operational in 2016.

Based on an estimate that 12-14 billion boe of oil and gas remains to be recovered from the UKCS, the Wood Review estimated that successful implementation of its recommendation would add 3-4 billion boe to the quantity recovered in the 20 years from 2016. The government has since estimated the NPV of this incremental recovery at £21-56 billion in 2014 prices.

The Wood Review recommended the development of 'regional plans' for specific parts of the UKCS and for HPHT fields. It also identified for further consideration the issue of tax incentives to develop 'gas discoveries high in impurities such as CO_2 and nitrogen which are inherently more costly and less rewarding to develop'. The emphasis on regional plans has been taken up HMT in the proposed ultra-HPHT allowance.

Ultra High Pressure High Temperature (u-HPHT) Cluster Area Allowance. In March 2014, the Chancellor announced the introduction of a new allowance to support investment in ultra high-pressure, high temperature oil and gas projects. In July 2014, HM Treasury (HMT) launched a consultation on the design of the new allowance which will be based on the onshore allowance introduced in December 2013. The consultation closed in late-September and an announcement on the new allowance is expected at the same time as the Autumn Statement on 3 December.

As the consultation document notes, 'ultra HPHT projects are concentrated in the Central North Sea (CNS), which is the part of the UKCS with the greatest future potential for oil and gas'. Building on the recommendations of the Wood Review, the new cost-based allowance will be designed not only to support large field development projects but also to encourage exploration and appraisal in the surrounding area or 'cluster'.

As the data presented by DECC illustrates, there is no necessary link between the HPHT status of gas fields and the CO2 content of the gas. Existing HPHT field developments on the UKCS such as Elgin-Franklin and Shearwater are not associated with higher CO_2. Among the known HPHT prospects in the CNS, Jackdaw is the only field with an expected CO_2 content in excess of the current Teesside entry limit of 2.9 mol%.

Fiscal Review. In March 2014, HMT announced that it would conduct a comprehensive review of the offshore tax regime to complement the regulatory changes recommended by the Wood Review. The aim of this Fiscal Review, which ran at the same as the more specific u-HPHT consultation, is to ensure that the UKCS remains sufficiently competitive to attract new investment, that any tax allowances are effective, that the current impediments to exploration are addressed and that existing infrastructure remains available for future offshore developments. The consultation period began in July and closed in October. The government has already accepted in principle the need to alleviate the fiscal burden offshore but not the pace or nature of any future changes. The Chancellor is expected to announce the government's response in the 2015 Budget.

Conclusion. The major reforms introduced by the Wood Review and the two fiscal consultations undertaken in 2014 reflect a new sense of urgency to address the deficiencies of the existing regulatory and fiscal arrangements and to promote and incentivise new offshore oil and gas developments. Once the new ultra-HPHT allowance is announced, possibly in December 2014, we expect that at least one of the existing HPHT projects in the Central North Sea will proceed to Final Investment Decision, provided of course that the onshore receiving terminals are capable of accepting the gas quality from the fields without additional gas processing costs to remove impurities such as CO_2.

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