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Dear Allan,

Energy Policy Review

We have great pleasure in attaching UKOOA's response to the Energy Policy Review. This not only has the support of all 32 members of UKOOA, but we understand that it also has the support of the Industry Leadership Team of Pilot, comprising several of our members, leading contractors and unions – you should receive a separate communication regarding this.

We shall look forward to meeting you in due courses to discuss our response. To this end, we are already looking at possible dates.

Yours sincerely,

James May
Director-General

KEY MESSAGES FOR THE ENERGY POLICY REVIEW

1. Summary of Main Points

- **Over the next 20-30 years, oil and gas are likely to remain the most important fuels for the UK, with gas having a particular role for 50 or more years.**
- **Remaining, recoverable reserves of oil and gas from the UK Continental Shelf (UKCS) are estimated at between 28 and 36 billion barrels of oil equivalent (boe),**

more than has been produced to date. Global reserves are sufficient to meet demand beyond 2050.

- Maximising recovery of UKCS reserves and facilitating the entry of other supplies to the UK market requires fiscal and regulatory stability, including effective and timely arrangements for ensuring adequate investment in network capacity.
- Diversity of supply, at competitive prices, is fundamental to achieving security of supply. The role of open markets is central to achieving this. There should be no cause for concern among policy makers, provided markets are open and any barriers to entry for new sources of supply and new technologies are removed.
- Natural gas has, more than anything else, enabled the UK to achieve big improvements in its environmental performance and put the country well on its way to meeting its Kyoto commitments. Gas also provides the most efficient form of power generation.
- Expenditure on UKCS activity supports some 270,000 jobs in the UK (exports of oil and gas goods and services add to these), mostly highly skilled, with much of the work being at the leading edge of technology.
- Oil and gas production benefits the balance of payments considerably (£6 billion net in 2000) and has generated exchequer revenue of some £166 billion (2000 values) since the mid-60s.

2. Record of supply

- The upstream oil and gas industry has a long record of uninterrupted supply in meeting market requirements in the UK. It can continue to meet demand reliably for the foreseeable future provided market conditions are conducive. We recognise, however, that, as the UK begins to import oil and gas, international conditions will become of more importance for UK policy-makers. There need be no shortage of oil and gas world-wide, with the right investment climate and sufficient lead times, so as to ensure diverse and secure supplies at competitive prices.

3. Reserves

(i) UKCS

- Continued emphasis should be given to collaborative efforts to enhance the future life and production potential of the UKCS. Policies which have taken account of the UKCS's competitive position have made a significant contribution to engendering the current, record production of oil and gas, with large benefits to the Exchequer and the balance of payments.
- There is a tendency for forecasts of UKCS production to be pessimistic; indeed UKCS production has risen year on year since 1989, against the grain of most predictions. However, this record cannot be sustained because the rate of extraction exceeds reserve additions from extensions, discoveries and new developments. The issue for next decade and beyond will be to maximise recovery of economic reserves.
- Estimates of the remaining potential vary considerably depending upon the view taken of Yet to Find (YTF) reserves and the rate at which these are proved through exploration and appraisal drilling. Official estimates indicate a wide range from 5 billion to 30 billion boe; UKOOA advises that an estimate of 13 billion is realistic. The challenge for the industry is that the average size of new discoveries is only 30 million boe, low by

international standards; for these to remain attractive investment propositions requires innovative technical and commercial solutions, together with a stable fiscal and regulatory regime. Overall, remaining UKCS recoverable reserves are estimated by the industry at 28 to 36 billion boe, more than has been produced to date and representing a substantial opportunity for the country.

- The PILOT initiative and its predecessors have shown what can be done. The shared industry/Government strategy under PILOT is for the UKCS still to be producing 3 million boe per day by 2010 based on annual capital expenditure of some £3 billion. Technology will play a key role in achieving these aims.

(ii) Global

- Globally, the large volumes of
 - probable and possible reserves in existing discoveries,
 - potential reserves in unexplored prospects,
 - reserves in unconventional discoveries such as heavy oil and tar sandsmean that the estimated Reserve/Production ratio for world requirements is likely to be closer to 100 years than 40 years. More than 70% of global gas reserves lie within economic transport distance of the EU.

4. Fiscal Policy

- Current investment activity and increases in UKCS production in recent years would not have been possible without the Government's policy of fiscal stability coupled with appropriate regulation. The globalisation of the upstream industry and a run of major exploration successes in areas such as Gulf of Mexico, Angola and FSU have highlighted the critical importance of sustaining UKCS competitiveness. This balance needs to be maintained if the PILOT targets of production and investment are to be delivered. Recent studies have concluded that the upstream industry in the UK supports employment of some 270,000 people (exports of oil and gas goods and services add to this) and some 7% of employment in Scotland.
- Regarding other fuels and sources of power, free market solutions are to be preferred and policy should be aimed at removing any obstacles or barriers to ensure fair access to markets for all sources.

5. Investment & Other Challenges

- There are technological and other challenges to be overcome and significant investment will be required to meet the UK's future requirements for oil and gas. The industry forecasts that at least \$1 trillion of investment in new upstream facilities will be required world-wide in the next decade alone and that half of the oil and gas being produced at the end of that period will come from sources not yet in production.
- As well as the prime need to maximise recovery from the UKCS, such a scale of international expenditure offers large export opportunities for goods and services from the UK. Both in terms of securing supplies and in opening export markets, this is an important area in which the Government can continue to make a difference by helping producer countries create the right political, economic, business and legal climate to encourage long term investment in energy supplies, with financial and technical expertise provided by business and industry.

6. International Trade & Security of Supply

- Diversity of supply, at competitive prices, is fundamental to achieving security of supply, as the UK has experienced in the past 20 years. Open markets are central to achieving this, because they increase diversity and minimise dependency on any one source. Allied to this is the matter of free trade which is itself a two-way process, both parties benefiting from it. Many of the countries which supply oil and gas are significant importers of goods and services. The essential point is that free trade, as a result of open markets, binds countries together as never before and, in turn, this can only serve to enhance security of supply.
- Energy price stability, with its consequent economic and social benefits, can best be ensured through competitive UK and European energy markets on the one hand and the promotion of international energy trade on the other hand.
- Oil is freely traded on the international markets, with supplies coming from all over the world. The IEA has estimated that the share of world oil production dependent on export markets will grow from some 40% now to over 50% by 2020 and the dependence of Middle East and North African producers on export markets will remain at nearly 90%. The UK remains a large and attractive market for producers as, of course, does the rest of the EU.
- It is right that the Government should consider the implications of the projected increase in imports of oil and gas carefully, but we do not believe that the UK should be concerned about this trend or need to take special measures, so long as the right climate for international trade and investment has been established.
- New infrastructure links are already enhancing the range of supply options for gas and advances in technology are creating new international trade in LNG, along the lines of the oil market.
- Since long-term UK gas supply needs to be seen in the wider international context, current European initiatives to improve network interoperability and interconnection, including the proposed establishment of a European Gas Industry Standards Board, are important. Policy makers and regulators should continue to look at other stakeholder-based means of delivering effective and pragmatic solutions to future requirements.
- There should be no barriers created to the provision of additional gas storage facilities and active consideration should be given to whether measures, such as the easing of planning procedures, can be taken to facilitate such projects. The UK has a relatively small amount of gas storage compared with most other EU countries and the development of more facilities could help improve market flexibility of response and temper price volatility, as the UK moves into a position of import dependence. However, flexibility to manage short-term gas supply pressures can be provided by other commercial and operational tools than the provision of physical storage facilities. Open markets and consistency of approach between the UK and European regimes will help ensure supply flexibility for the future.

7. UK Energy Policy & Regulatory Issues

- Within the right international context, a properly liberalised UK energy market also remains the best means of ensuring secure and diverse energy supplies at competitive prices. It is important in this context that:
 - A general objective should remain to extend the scope of competition where feasible and reduce the field of detailed regulation to minimise the need to design and redesign complex substitutes for real markets.
 - The oil and gas markets should continue to be able to manage their investment and other risks in the way which best meets the needs of sellers and buyers within a competitive market. Efficient, flexible and diverse supplies will result from companies being able to draw on a full range of commercial arrangements, including long-term contracts, provided such arrangements are consistent with relevant requirements, such as competition law.
 - The UK's legal and regulatory framework for the energy market enables true and clear supply and demand signals in energy provision to be communicated in a timely manner and consistently with the regime in the EU.
 - Targets for the share of individual fuels in the total primary energy mix should be avoided – this would distort signals for the sufficient development of all new supplies and energy technologies and so compromise security and diversity of supply.
 - It is recognised that liberalised UK energy markets are already safeguarding security of supply for consumers by encouraging greatly increased flexibility in the gas market. We believe, therefore, that the energy industry is developing in a way which can maintain security of supply to end users, within an overall trend towards gas-fired power generation which has itself brought substantial environmental benefit to the UK
 - The regulatory regime for gas transportation should provide timely and efficient signals for new investment in Transco's NTS. Regulation needs to work in the broad national interest, which includes UKCS (and other) producers having reasonable certainty about both the availability and price of transportation capacity. The current regime is not working in this wider interest, as it provides neither the signals to Transco, nor the certainty for producers. It is important to note that the risks to the economy of under-investment in the NTS far outweigh the risks of over-investment. (UKOOA has been working with Ofgem and other participants on this and has some new proposals for helping to resolve this matter, too detailed for inclusion here.)

- Careful attention should also be given to the policy and regulatory framework for the offshore oil and gas infrastructure. This infrastructure represents a significant asset which can potentially contribute to meeting the UK's energy requirements for many years to come in a number of ways:
 - By maximising the recovery of UKCS reserves – it is estimated that some two thirds of yet-to-find exploration potential and the majority of undeveloped discoveries lie within 50 kms of existing infrastructure. The realisation of this potential is, however, dependent on a fiscal and regulatory regime which fairly recognises and balances the interests of infrastructure owners and users – for example, in the outcome of the current review of the Code of Offshore Infrastructure Practice – in a mature province. Once infrastructure is decommissioned, the potential within its catchment area disappears with it.
 - Facilitating the construction of more interconnectors where there is a market driver for such projects and other cross-boundary connections with existing UKCS infrastructure – for example, with Norway. Such links can both help promote secure and diverse supplies for the UK market and help underpin the economics of existing UKCS infrastructure, so maximising the prospects for recovering UK reserves.
 - Offering scope for alternatives to the onshore transmission system.

8. Environmental Issues

- The industry has made substantial advances in its environmental performance over the past 10 years with:
 - Reduction in gas flaring offshore.
 - Reduced spills into the sea.
 - Reduced discharge of oil in produced water.
 - Greater re-cycling of waste.
- The use of gas for power generation (and throughout the economy) has already contributed more than anything else to the UK's progress in reducing emissions of greenhouse gases, in order to meet its international commitments. Gas can make further contributions to economic and environmental objectives in future – for example through the potential for more CHP schemes of greater efficiency. The scope for reduced emissions from domestic CHP schemes is substantial. In order for such benefits to be realised fully, however, it is important that the rules for embedded generation are resolved as soon as possible. This will also enable other forms of local power generation to be developed effectively.
- Various oil and gas companies have been participating in and helping to develop emissions' trading schemes as an efficient means of meeting environmental objectives.
- The industry can contribute further by:
 - Continuing its work to assess the long-term potential for CO₂ capture and sequestration.
 - Continuing to invest in renewable and alternative energies.
 - Investing in improved technologies for the efficient extraction and use of oil and gas.

9. Conclusion

- We do not believe that policy makers should be concerned about the existence of adequate supplies of oil and gas in the foreseeable future, but we do believe that there is a significant role for Government both in achieving the maximum recovery of UKCS reserves and in ensuring reliable, market access to longer-term, international sources of supply.

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