E(80)98
10 September 1980

COPY NO 56

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

BNOC: TIMING OF CLYDE OILFIELD DEVELOPMENT

Memorandum by the Secretary of State for Energy

I was asked at the E Committee meeting on 9 July (E(80)24th meeting) to circulate my proposals on the timing of BNOC's Clyde field development.

Background

2. We agreed at E(80)9th meeting on 11 March the broad principles of oil depletion policy and I subsequently announced these to the House on 23 July. We decided on the policy for strategic and economic reasons, but agreed that it should be a flexible one. One of the elements was the possibility of delaying the development of fields not protected by the Varley assurances. I am advised that such delay beyond 5 years could be held to frustrate the purposes for which petroleum production licences are granted.

3. At present, Clyde is one of only two potential developments (the other is Phillips' "T" Block) which are not protected by the Varley Assurances. The licensees (BNOC, Shell and Esso) provisionally estimate the recoverable reserves to be some 20 million tonnes and envisage production starting in 1985 from a fixed steel platform (further details are in Annex A).

Arguments for 5 year delay

4. (a) A 5 year delay of production start-up from June 1985 (BNOC's forecast) to 1990 would probably reduce the estimated net surplus of 60 - 100 million tonnes

over the period by about 10m. tonnes. The expected maximum annual surplus in the mid-1980's of up to about 35m. tonnes would be reduced by around 2m. tonnes (ie about 2% of total expected production). Similarly delaying Phillips' "T" Block would also postpone about 10m. tonnes from the 1985 - 1990 period.

(b) The total net present value (NPV) gains (Government take plus company profits) from a 5 year delay are about £110 million in 1979 prices if real development costs do not increase with delay.

(c) On BNOC's current cost assumptions, a 5 year delay would result in the following short-term gains to the PSBR (rounded):

Year	1981	1982	1983	1984	1985	Total
£1979m.	20	40	40	25	15	140

The PSBR could benefit by up to a further £60m. of CT receipts from Shell/Esso, depending on their alternative investment opportunities. These short-term gains would be reversed when Clyde development resumed in the late 1980's.

(d) Unless Clyde were delayed substantially, our decision could be interpreted as a reluctance by the Government to implement its stated oil depletion policy.

Arguments for Early Approval

5. (a) There are five platform yards, all in Scotland. Four currently have work but this will be completed in late 1981/early 1982. We must ensure an essential core of two steel fabricating yards for the longer term and this will require two major orders per year. Orders are being placed for follow-on work in 1981 for the two most recently approved fields. Clyde represents a clear prospect for a major steel platform order to start in 1982. Beyond then, uncertainties surround other

developments which may go ahead over the next few years and this gives added importance to an early development of Clyde during this critical period for the offshore supplies industry.

(b) BNOC is one of the three significant British companies with a capability to undertake major developments on the UKCS as operator. It is presently engaged in handling the Beatrice field development and believes that, unless full Clyde development can start by mid-1981, it will lose the majority of its staff with oil-related experience in project engineering/management as the Beatrice work phases out. It also thinks that these losses could extend to other areas. BNOC considers that it would take at least 5 years to recover from such a setback which, if so, would be an unwelcome weakening of the British pressure on the UKCS.

(c) Shell/Esso fully support BNOC's plans. About £30m. has so far been spent on or committed to Clyde development (including appraisal work) by the three partners and, although Shell/Esso have not carried out any detailed economic re-appraisal of possible delay, the two companies regard it as in their best commercial interests to get the field into production as soon as possible. Shell/Esso also consider the amounts of oil at stake are insignificant.

(d) A five year delay would not provide the best background against which to launch BNOC revenue bonds on the market.

Conclusions

6. The depletion policy arguments for reducing the hump of excess production over 1985-1990 are strong and we could be severely criticised for doing nothing about the first substantial case to arise. Since this involves a field which is 51% owned by and operated by BNOC and we have made clear our policy not to give

favoured treatment to them, failure to act would make it more difficult to defer eg "T" Block, which is wholly in the private sector. On the other hand, a full 5 year delay to Clyde would have severe repercussions on employment in and the future viability of the offshore supplies industry in Scotland as well as in BNOC itself. It is not, therefore, a course I could recommend.

7. The licensees have reluctantly offered to stretch a development programme starting in May 1981 by about a year, which would defer first oil into 1986, albeit at some increase in overall development costs. But I do not think this goes far enough to meet our depletion policy objectives. (This possibility, and other points on the position of the licensees, are explained in Annex B).

8. I propose to ask BNOC and their partners to accept a two year delay. This would be in accord with depletion policy; give us a freer hand over other fields like "T" Block; postpone about 4m. tonnes of oil from the hump; increase total NPV by about £45m; and reduce the PSBR in 1981 and 1982 by about £60m. (1979 prices). (These economic benefits might, however, be reduced depending on how a two year delay could be achieved). A two year delay, with the prospect of a major platform order in 1984 rather than 1987, should help to presserve the jobs in the essential core of two platform yards and in the offshore supplies industry. Moreover, it should not significantly impair our privatisation plans.

Recommendation

9. I accordingly invite colleagues to agree that first oil from Clyde should be deferred by two years, ie to mid 1987.

Department of Energy
10 September 1980

D A R H

A N N E X A

BACKGROUND NOTE

Clyde was discovered in 1978, and is thus not protected by the Varley Assurances. At present, it is one of only two fields (the other is Phillips' "T" Block) open to development delay. BNOC (51%) are the operator; the other licensees are Shell (24.5%) and Esso (24.5%). BNOC provisionally estimate the recoverable reserves to be 20 million tonnes; they plan a rapid build-up of production to 36,000 barrels/day for the first four years starting in 1985, and thereafter a decline at about 20% per year. 10-20 million standard cubic feet of gas per day will be available which is expected to be recovered via the Gas Gathering Pipeline. Production will be from a fixed steel jacket; the total capital costs are estimated to be £350 million (1979 prices).

2. BNOC have envisaged submitting a full development plan in the spring of 1981, leading to a platform order in 1982 for installation in 1984 and first oil in 1985. BNOC's project team would build up from the present 20 to around 150 at peak mainly by internal transfers as the Beatrice project runs down.

A N N E X B

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SUMMARY BY OFFICIALS OF LICENSEES' VIEWS

Scope for Deferral

The licensees first envisaged production starting in 1984 but concluded that this was too optimistic for orderly field development. Their present preferred course is to start development proper in May 1981 leading to first oil in June 1985 following pre-drilling of 3 wells whilst the platform is being built.

2. A range of possible options to defer production from this field have been put forward by the licensees. The most attractive of these for depletion policy would be to defer start up of production by 9 - 12 months ie to March - June 1986. Retaining the May 1981 start date, this would increase capital costs by about 5% (plus inflation). But it should also postpone about 2 m. tonnes from the 1985 - 1990 period; reduce the PSBR in 1981 - 1982 by about £ 40 m. (1979 prices), and provide gains in total net present value of about £7m. (1979 prices), net of real capital cost increases.*

3. BNOC have regarded the May 1981 start for full development as important if they are to retain and build up their project team, while Shell/Esso have made it clear that they would not be prepared to see preliminary work continue if the Government were to jeopardise the May 1981 date.

4. The licensees claim not to have attempted any analysis of the cost of shutting down the project and re-starting it later. Nor have they made any detailed re-appraisal of overall field economics based on possible deferral. They have emphasised that the range of options is based on notional estimates of recoverable reserves within a wide possible range and on a notional production profile. Their position is that any further economic analysis must await closer definition of

*All figures in this sentence based on 12 month delay.

the reservoir characteristics (expected March 1981) following the results of further appraisal drilling.

5. The licensees have refused to consider a slower depletion rate on the grounds that:

(a) the optimum production profile should be determined by "good oilfield practice" and not arbitrarily;

(b) that profile cannot be determined with the necessary confidence pending closer definition of reservoir characteristics;

(c) any reduction from the optimum profile would (necessarily) be less commercially attractive; and

(d) it would be difficult to offer any reduction without knowing how this might be regarded in the context of any later Government-imposed production cut-backs and the level and timing of such cuts.

BNOC's Future

6. As mentioned in para.7 of the Paper, BNOC regard a timely go-ahead for Clyde as crucial for their ability to retain and build up their project team and other experienced management staff. The only other UKCS prospects they have are two small accumulations in the area of the Thistle field which would require far fewer staff. And they do not believe that, at the present stage of development of their upstream capability, they have any significant prospect of redeploying staff for overseas ventures. If Clyde were to be deferred - certainly for a matter of years - then BNOC believe that competition from the multi-nationals (who have much more flexibility to retain and redeploy staff given their geographically much wider activities and opportunities) would prevent BNOC from rebuilding

their expertise except possibly over several years. They are also concerned that they would not be able to keep abreast of offshore technological developments in the meantime. Finally, BNOC believe that they should supplement BP as a second fully integrated British exploration and production company who could be good partners for inexperienced British enterprises and investors.