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## A Comparison of American and British Offshore Oil Development during the Reagan and Thatcher Administrations--Part II

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**A COMPARISON OF AMERICAN AND BRITISH  
OFFSHORE OIL DEVELOPMENT DURING  
THE REAGAN AND THATCHER  
ADMINISTRATIONS\***

**PART II\*\***

Uisdean R. Vass\*\*\*

IV. THE DEVELOPMENT OF BRITISH OFFSHORE OIL LAW . . . .	227
A. <i>The Early Stages of North Sea Development</i> . . . . .	231
1. The Licensing System . . . . .	233
2. Model Clauses . . . . .	235
B. <i>The Changes of the Early 1970's</i> . . . . .	238
1. Scottish Nationalism . . . . .	240
C. <i>Labour Policy from 1974 to 1979</i> . . . . .	242
1. Changes in Operating Conditions . . . . .	242
2. BNOC: The National Oil Company . . . . .	245
3. The New System of Taxation . . . . .	251
V. BRITISH OFFSHORE OIL DEVELOPMENT UNDER THE THATCHER ADMINISTRATION . . . . .	252
A. <i>Conservative Oil and Gas Policy</i> . . . . .	254
B. <i>Oil Industry Concerns at the Outset of Stage One</i> . . . . .	256
1. BNOC . . . . .	256

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\* Winning essay of the Ninth Annual National Energy Law and Policy Institute Essay Competition.

\*\* Part I of this essay appears in 21 TULSA L.J. 23 (1985) and discusses the distinctions between private and governmental mineral owners, the development of American offshore oil law, and American offshore oil development under the Reagan administration. Part II continues with an examination of British offshore oil development and a comparison of the success enjoyed by the Reagan and Thatcher administrations in implementing their respective offshore oil development strategies.

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- 2. Depletion Policy ..... 258
- 3. Exploration Policy ..... 259
- 4. Taxation ..... 260
- C. *Stage One* ..... 260
  - 1. BNOC ..... 260
  - 2. Depletion Policy ..... 266
  - 3. Exploration Policy ..... 267
  - 4. Taxation ..... 269
  - 5. Conflicting Goals ..... 272
- D. *Stage Two* ..... 272
  - 1. BNOC ..... 273
  - 2. Depletion Policy ..... 279
  - 3. Exploration Policy ..... 280
  - 4. Taxation ..... 283
  - 5. Towards a Market-Oriented Regime ..... 287
- VI. THE COMPARATIVE SUCCESS OF RECENT AMERICAN AND BRITISH OFFSHORE OIL DEVELOPMENT ..... 288
  - A. *The Shaping of American and British Offshore Oil Strategies* ..... 288
    - 1. The Political Systems ..... 288
    - 2. Environmentalists ..... 291
    - 3. Legal Constraints ..... 292
  - B. *Implementation of the Reagan and Thatcher Offshore Agendas* ..... 293
    - 1. The Watt Program ..... 295
      - a. *Exploration and production* ..... 296
      - b. *The OCS inventory* ..... 298
      - c. *Socioeconomic impacts and environmental protection* ..... 298
    - 2. Conservative Goals ..... 301
      - a. *Exploration* ..... 301
      - b. *Market utilisation and other socioeconomic impacts* ..... 302
  - C. *Recommendations* ..... 304
    - 1. United States ..... 304
      - a. *Coastal revenue sharing* ..... 304
      - b. *Enlargement of OCS tracts* ..... 306
      - c. *Sequential bidding* ..... 308
      - d. *Enhanced oil recovery* ..... 309

2. United Kingdom .....	310
a. <i>An auction experiment</i> .....	310
b. <i>BNOC's oil trading role</i> .....	312
VII. CONCLUSION.....	313

#### IV. THE DEVELOPMENT OF BRITISH OFFSHORE OIL LAW

In many ways the development of the United Kingdom oil industry has followed different lines from its United States counterpart. During the first half of this century the United Kingdom produced virtually no indigenous hydrocarbons. However, this does not mean to say that there had not been a British oil industry during that time. The Middle East was a sphere of British influence from roughly the beginning of the century to the 1950's, and the British were the prime movers in the exploration and development of that region's tremendous reserves.<sup>498</sup> Indeed, the history of the British Petroleum Company Limited (BP) can be traced to the granting of the 1901 D'Arcy concession agreement,<sup>499</sup> which heralded the beginning of the Iranian oil industry.

As the First World War ominously approached, and as the oil-based fuel needs of the Royal Navy became more readily apparent, the British government began to take steps to ensure that the United Kingdom would have some national control over its oil supply. In 1911, the government obtained a large shareholding in BP and, consequently, acquired the power to elect directors who could veto any corporate decision.<sup>500</sup> While this veto power has never been implemented,<sup>501</sup> the idea of government acquiring an operational stake in the exploration of oil and gas would eventually prove to be an important precedent for the United Kingdom and many other oil-producing countries. The coming of the First World War also provided the first real impetus for exploration in the British Isles themselves.<sup>502</sup> Beginning with the passage of the Petroleum (Production) Act<sup>503</sup> in 1918, no one could explore for or produce petroleum in the United Kingdom without a government licence.<sup>504</sup> The Act was designed to avoid the wasteful drilling which had occurred in

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498. See T. DAINTITH & G. WILLOUGHBY, *A MANUAL OF UNITED KINGDOM OIL AND GAS LAW* 10 (1977).

499. Ely & Pietrowski, *Changing Concepts in the World's Mineral and Petroleum Development Laws*, 1976 B.Y.U. L. REV. 9, 22.

500. T. DAINTITH & G. WILLOUGHBY, *supra* note 498, at 10-11.

501. *Id.* at 10.

502. *Id.* at 11.

503. Petroleum (Production) Act, 1918, 8 & 9 Geo. 5, ch. 52.

504. *Id.* §§ 1, 2.

contemporary American onshore fields.<sup>505</sup> Under the authority of this legislation, the government hired an oil company, S. Pearson and Sons Limited, to do exploratory work in various parts of the country. But results were unencouraging, and aspirations for a domestic oil supply were put to rest for about fifteen years.<sup>506</sup>

In 1934, the government reviewed the possibility of onshore exploration and found that one of the reasons why progress had been so slow was that operators were not sure whether the rule of capture was the law in the three British legal systems.<sup>507</sup> The Petroleum (Production) Act 1934<sup>508</sup> (PPA) resolved this perceived difficulty by providing that all petroleum deposits in Britain were to be henceforth owned by the Crown.<sup>509</sup> The PPA also provided for oil and gas licensing<sup>510</sup> and is currently the legislative basis for the granting of all United Kingdom oil and gas licences.<sup>511</sup> In 1964, the PPA was extended to apply to the UKCS.<sup>512</sup>

Like the Secretary of the Interior in the United States,<sup>513</sup> the British Secretary of Energy has discretion to award licences to the applicant whom he feels is most suitable. Unlike the OCSLA or the OCSLAA, the PPA does not provide for specific bidding systems which must be used when licensing. The only direction given to the Secretary with respect to the issuance of licences appears in section 6 of the PPA.<sup>514</sup> Given this skeletal statutory framework for oil and gas development, the PPA obvi-

505. See T. DAINIITH & G. WILLOUGHBY, *supra* note 498, at 11.

506. *Id.*

507. *Id.* at 11-12. The United Kingdom is composed of four nations: Scotland, Northern Ireland, England, and Wales. But there are three legal systems: Scotland, Northern Ireland, and England and Wales.

508. Petroleum (Production) Act, 1934, 24 & 25 Geo. 5, ch. 36.

509. *Id.* § 1(1).

510. The PPA provides:

(1) The Board of Trade [currently, the Secretary of State], on behalf of His Majesty, shall have power to grant to such persons as they [he] think[s] fit licences to search and bore for and get petroleum.

(2) Any such licence shall be granted for such consideration (whether by way of royalty or otherwise) as the Board of Trade with the consent of the Treasury may determine, and upon such other terms and conditions as the Board of Trade think[s] fit.

*Id.* § 2(1), (2).

511. The PPA does not cover Northern Ireland. *Id.* § 11(3).

512. Continental Shelf Act, 1964, ch. 29, § 1(3).

513. See 43 U.S.C. § 1337(a)(1) (1982).

514. Petroleum (Production) Act, 1934, 24 & 25 Geo. 5, ch. 36, § 6(1). Section 6(1) provides: The Board of Trade [Secretary of State] shall, before granting any licence under this Act, make regulations prescribing—

(a) the manner in which and the persons by whom applications for licences under this Act may be made;

(b) the fees to be paid on any such application;

(c) the conditions as to the size and shape of areas in respect of which licences may be granted;

ously envisaged that United Kingdom oil and gas law would be almost wholly the product of regulations. There is nothing in the British oil regime comparable to the exhaustively intricate, pyramidal structure of American OCS legislation. Not only is the OCSLA much more complex than the PPA, the whole body of the latter is smaller than many sections of the OCSLAA. In addition, the PPA, which confiscated private mineral rights without compensation, exemplifies the notion that there is no constitutional constraint on the actions of the British Parliament.<sup>515</sup> The fact that Parliament is unfettered by a written constitution means that its capacity as a regulator is much less inhibited than is the case in the United States. In sum, the PPA grants maximum discretion to the British government.

The PPA was confined in effect to "Great Britain,"<sup>516</sup> an area usually taken to refer to the Island of Great Britain and offshore Scottish, English, and Welsh islands. This area does not normally include Northern Ireland or the three-mile territorial sea.<sup>517</sup> While Northern Ireland was made subject to similar provisions pursuant to the Petroleum (Production) Act (Northern Ireland),<sup>518</sup> the position of the territorial sea was unclear till very recently. Despite the doubts of some commentators,<sup>519</sup> the government believed that the PPA vested the Crown with the oil and gas rights in the territorial sea. This issue gave rise to virtually the only instance of United Kingdom oil and gas litigation, the case of *Earl of Lonsdale v. Attorney General*.<sup>520</sup> The dispute in *Earl of Lonsdale* centered around the construction and effect of a Crown grant of "mineral substances" made in 1880 and its relation to the seabed and subsoil of a part of the territorial sea off the Cumberland coast in northern England.<sup>521</sup> In 1973, the Earl of Lonsdale, a descendant of the original grantee, sued the Crown for a declaration that he owned the oil and gas covered by the 1880 grant. Counsel for the Crown advanced a twofold defense: (1) references to minerals in the 1880 grant did not include oil

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(d) model clauses which shall, unless the Board of Trade think[s] fit to modify or exclude them in any particular case, be incorporated in any such licence.

*Id.*

515. Daintith, *The Petroleum Production License in the United Kingdom*, in *THE LEGAL CHARACTER OF PETROLEUM LICENSES: A COMPARATIVE STUDY* 206-07 (T. Daintith ed. 1981).

516. See Petroleum (Production) Act, 1934, 24 & 25 Geo. 5, ch. 36, § 1(1).

517. See Daintith, *supra* note 515, at 202-03.

518. Petroleum (Production) Act (Northern Ireland), 1964.

519. See Daintith, *supra* note 515, at 202-03.

520. [1982] 3 All E.R. 579 (Ch.).

521. In Scotland it seems as if the Crown owns the minerals of the territorial sea at common law. See *Crown Estate Commissioners v. Fairlie Yacht Club*, [1977] S.L.T. 19.

and gas and (2) even if the 1880 grant did include oil and gas, the PPA and the Continental Shelf Act 1964 effectively extinguished all such private rights.<sup>522</sup>

The Crown won its case on the first argument as Judge Slade held that the grant had never anticipated oil and gas workings.<sup>523</sup> In discussing the Crown's second ground of defense, however, Judge Slade noted that the words "Great Britain" as used in the PPA were ambiguous.<sup>524</sup> If the Crown was right, Judge Slade observed, the PPA would allow for a taking without compensation of private oil and gas rights in the territorial sea.<sup>525</sup> While this type of taking was within Parliament's power, statutes providing for such power had to be written expressly and unambiguously to be effective.<sup>526</sup> Accordingly, Judge Slade concluded that the appropriation provisions of the PPA did not apply to the territorial sea.<sup>527</sup>

Because a ruling on the applicability of the PPA to the territorial sea was not necessary to decide *Earl of Lonsdale*, the British government could have dismissed Judge Slade's opinion as mere *obiter dicta*. However, at about the time that judgment was rendered, a new offshore oil provision, the Oil and Gas (Enterprise) Bill, was being debated in the House of Lords. Seizing upon the opportunity to eliminate the possibility of any future litigation over the issue, the Scottish Lord Advocate successfully proposed an amendment to the PPA which retroactively vested the Crown with the ownership of petroleum underlying the territorial sea.<sup>528</sup>

The United Kingdom ratified the Geneva Convention on the Continental Shelf in 1964.<sup>529</sup> The Continental Shelf Act 1964<sup>530</sup> vested Her Majesty with the United Kingdom's rights in the minerals of the

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522. [1982] 3 All E.R. at 582.

523. *Id.* at 613-16.

524. *Id.* at 625.

525. *Id.* at 619.

526. *Id.*

527. *Id.* at 626.

528. Oil and Gas (Enterprise) Act, 1982, ch. 23, § 18(1).

529. The exact date of ratification was May 11, 1964. See Young, *Offshore Claims and Problems in the North Sea*, 59 AM. J. INT'L L. 505, 509 (1965). For several discussions on the apportionment of the North Sea Continental Shelf amongst the various European states which it borders, see Dam, *Oil and Gas Licensing and the North Sea*, 8 J.L. & ECON. 51 (1965); Morris, *Oil and Gas Legal Problems on the North Sea Continental Shelf*, 7 WASHBURN L.J. 245 (1968); Utton, *Institutional Arrangements for Developing North Sea Oil and Gas*, 9 VA. J. INT'L L. 66, 68-76 (1968); Young, *supra*, at 509.

530. Continental Shelf Act, 1964, ch. 29.

UKCS<sup>531</sup> and provided that the extent of the UKCS was to be determined by Order in Council.<sup>532</sup> The parts of the ocean floor claimed as the UKCS are referred to as "designated areas."<sup>533</sup> There have been a number of Orders of Council defining and expanding the UKCS. The present extent of the latter is about 651,650 square kilometers,<sup>534</sup> roughly one-eighth of the size of the American OCS. Most importantly, section 1(3) of the Continental Shelf Act extends the effect of sections 2 and 6 of the PPA to the UKCS, thereby allowing for the discretionary onshore licensing system to be repeated in the vastly more lucrative offshore areas.<sup>535</sup>

Finally, it should be noted that there are three legal systems in the United Kingdom.<sup>536</sup> The criminal law of all three systems concurrently governs acts or omissions on, above, or below, or in waters within 500 meters of, installations in the UKCS.<sup>537</sup> So, if an act taking place on an oil rig in the UKCS off southern England is an offense according to the law of Scotland, Scottish courts can try the offense as if it had occurred in Scotland. For purposes of civil acts or omissions relating to mineral activity, the UKCS is apportioned by Order in Council between the three legal systems.<sup>538</sup> Most of the UKCS falls under the Scottish sector.

#### A. *The Early Stages of North Sea Development*

Despite the changes made by the PPA, very little exploration was undertaken in the British Isles during the thirty years between 1934 and 1964. Indigenous British production in that period amounted to about 0.1% of annual consumption.<sup>539</sup> But in 1959, a huge gas reservoir was found in Groningen in the Netherlands. Because Holland is part of a sedimentary basin which extends to Denmark, West Germany, and a large section of the North Sea, it became plain to geologists that hydrocarbons might also be found under the North Sea.<sup>540</sup> When faced with

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531. *Id.* § 1(1). The Act did not include coal. *Id.*

532. *Id.* § 1(7).

533. *Id.*

534. U. K. DEP'T OF ENERGY, DEVELOPMENT OF THE OIL AND GAS RESOURCES OF THE UNITED KINGDOM 1983, at 9 (1983).

535. *See* Continental Shelf Act, 1964, ch. 29, § 1(3).

536. *See supra* note 507.

537. Continental Shelf Act, 1964, ch. 29, § 3(1), amended by Oil and Gas (Enterprise) Act, 1982, ch. 23, § 22(1).

538. Continental Shelf Act, 1964, ch. 29, § 3(2), amended by Oil and Gas (Enterprise) Act, 1982, ch. 23, § 23(1).

539. Milner, *Petroleum Legislation and Licensing Procedures in the North Sea and Some Associated International Problems*, 18 NAT. RESOURCES J. 545, 545 (1978).

540. *See id.* at 545-46.



this possibility, British governments of the 1960's, Conservative and Labour, pursued three main goals with respect to the North Sea's unfolding potential: (1) thoroughly explore the UKCS as fast as possible; (2) secure maximum British involvement in that exploration; and (3) obtain a useful additional flow of revenues.<sup>541</sup> Realising that the state had neither the necessary funds or expertise for the task, the British government found itself forced to rely on private oil companies. While it was hoped that British corporations would become heavily involved in the exploration and development of the North Sea, it was also clear that the participation of the American multinational oil corporations would also be required.<sup>542</sup>

The first important step that the government took towards the realisation of its goals was to set up a legal basis for offshore mineral exploitation with the passage of the Continental Shelf Act 1964. Thereafter, the Ministry of Power embarked on the creation of a substantive offshore oil and gas regime by drafting pertinent regulations and by administrative fiat. The final product reflected the government's goals and very closely resembled the previous provisions applying to onshore exploration and production.<sup>543</sup> Many of the salient features of this initial system, particularly the allocation of the UKCS into licensing blocks, the exploration and production licences, and the method of licensing itself, have remained substantially unchanged up until the present.

Offshore areas were divided into blocks averaging about 250 square kilometers or approximately 100 square miles.<sup>544</sup> The government's intention was to offer many of these blocks simultaneously in licensing rounds. According to some commentators, the blocks were made small to encourage more offers and hence to involve more British companies in the licensing process.<sup>545</sup> While some have argued that the British blocks are too small, it should be noted that they are normally about ten times

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541. P. CAMERON, *PROPERTY RIGHTS AND SOVEREIGN RIGHTS: THE CASE OF NORTH SEA OIL* 76 (1983).

542. See K. DAM, *OIL RESOURCES: WHO GETS WHAT HOW?* 24-25 (1976).

543. See *Petroleum (Production) Regulations, 1966 STAT. INST. NO. 898*; *Petroleum (Production) (Continental Shelf and Territorial Sea) Regulations, 1964 STAT. INST. NO. 708*. For a discussion of the similarity between these largely identical regulations and earlier regulations governing onshore exploration and development of oil and gas, see P. CAMERON, *supra* note 541, at 74.

544. See Dam, *supra* note 529, at 55.

545. See Millard, *The Legal Environment of the British Oil Industry*, 18 TULSA L.J. 394, 414-15 (1983). Apparently, the major American oil companies wanted larger blocks. See P. CAMERON, *supra* note 541, at 77.

larger than American OCS tracts.<sup>546</sup> It is for this reason that proponents of expedited OCS leasing in the United States hold the UKCS system up as an example of areawide leasing.<sup>547</sup> Indeed, the block method has opened up large areas of the UKCS to exploration. For example, in just the fourth round of licensing, held in 1971-72, 282 blocks comprising an area of roughly eighteen million acres were licenced.<sup>548</sup> As late as August 1983, by comparison, only about thirty million acres had ever been leased in the American OCS.<sup>549</sup> But despite the size of the British blocks, much of the UKCS, especially the deepwater Northwestern, Atlantic, and Southwestern Regions, is still unexplored frontier territory. Almost all of the initial licensing and all of the initial development took place in the North Sea.

### 1. The Licensing System

A company may apply for two types of offshore licences: the exploration licence and the production licence. The exploration licence allows the licensee, upon payment of a fixed fee, to conduct geological and geophysical exploration anywhere in territorial waters or on the UKCS, except in an area which is allocated to a production licence.<sup>550</sup> Because it provides only for the right to explore, the exploration licence is directly equivalent to the American preliminary exploration permit.<sup>551</sup> The exploration licence allows exploratory drilling to a depth of 350 meters.<sup>552</sup> Oil wells drilled pursuant to an exploration licence must be approved by the Minister of Energy.<sup>553</sup> The term for an exploration licence is three years, but it is possible to request an extension for a further three years.<sup>554</sup> Anyone can apply for an exploration licence at any time as they are not offered on the basis of "rounds."

The production licence is the only legal means for any person other

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546. One hundred square miles equals 64,000 acres. American OCS tracts are normally 5760 acres or larger if the Secretary of the Interior so determines. See 43 U.S.C. § 1337(b)(1) (1982).

547. See AM. PET. INST., *THE SEARCH FOR OFFSHORE OIL AND GAS: SETTING THE RECORD STRAIGHT* (1984).

548. U. K. DEP'T OF ENERGY, *supra* note 534, at 32.

549. See MINERALS MGMT. SERVICE, U.S. DEP'T OF THE INTERIOR, *FEDERAL OFFSHORE STATISTICS* 16 (1984).

550. See Petroleum (Production) Regulations, 1982 STAT. INST. NO. 1000, Reg. 8 & sched. 7. The law relating to exploration licences, production licences, and the licensing process in general has remained essentially the same since the inception of the British offshore legal regime. Accordingly, references will be made to regulations presently in force.

551. See 43 U.S.C. § 1340(a)(1) (1982).

552. Petroleum (Production) Regulations, 1982 STAT. INST. NO. 1000, sched. 7, cl. 3.

553. *Id.* at cl. 7.

554. *Id.* at cl. 4.

than the Crown to produce petroleum in United Kingdom territorial waters or on the UKCS. As noted previously, production licences are granted with respect to 250 square kilometer blocks and pursuant to licensing rounds. Production licences constitute a grant of proprietary concession by the Crown and are, for most purposes, similar to an American OCS lease. One major difference, however, lies in the fact that the British government may unilaterally vary the terms of a production licence, whereas the United States government is constrained in this respect by the Constitution.<sup>555</sup>

The British selected at the outset and have, with some exceptions, continued to utilise what has been termed by Dam as the "discretionary allocation system" of licensing.<sup>556</sup> The principal feature of this system is that it allows the government to select applicants for licences on the basis of the applicant's ability to meet national goals. The government begins the process by announcing its intention to hold a licensing round in the London, Edinburgh, and Belfast *Gazettes* and including in this notice a list of blocks for which applications are invited and a closing date for their receipt.<sup>557</sup> Also included in the *Gazette* notice is a list of criteria which the government will use in the selection of applicants. In the first round, held in 1964, there were five criteria:

[F]irst, the need to encourage the most rapid and thorough exploration and economical exploitation of petroleum resources in the Continental Shelf. Second, the requirement that the applicant for a licence shall be incorporated in the United Kingdom and the profits of the operations shall be taxable here. Thirdly, in cases where the applicant is a foreign-owned concern, how far British oil companies receive equitable treatment in that country. Fourthly . . . the programme of work of the applicant and also . . . the ability and resources to implement it. Fifthly . . . the contribution the applicant has already made and is making towards the development of resources for our Continental Shelf and the development of [the British] fuel economy generally.<sup>558</sup>

The licensing criteria have varied from round to round because of the changing political colors of the governments and because of economic circumstances. Nevertheless, every government has used its discretion to attempt to obtain the maximum benefit for the British economy and Exchequer.

Part of the consideration given for a licence, which may be issued

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555. See Daintith, *supra* note 515, at 206-07.

556. See generally K. DAM, *supra* note 542, at 3-11 (discussing the reasons for a licensing system).

557. Petroleum (Production) Regulations, 1982 STAT. INST. NO. 1000, Reg. 7.

558. 692 PARL. DEB., H.C. (5th ser.) 897 (1964).

with respect to more than one block, has always involved a royalty of about 12.5%, as well as a small fixed fee.<sup>559</sup> Given this relatively small source of income, the British government has consistently relied on taxation as the main guarantor of the United Kingdom's economic rent accruing from oil and gas activity. In this respect it is different from the United States, which relies mainly on bonus payments and royalties.

The main competitive aspect of the licensing system has been the required submission of a work programme,<sup>560</sup> which is the closest thing to a British bid variable. The work programme, although a significant aspect of the licensing system, is not directly equivalent to an American bid variable because it is only one of several wide ranging factors used in determining the issuance of a licence. In the United Kingdom, the other factors encompass a much wider scope than the mere technical and financial competence of the applicant, as they take into account the whole range of national desiderata defined in the *Gazette* notice.

The applications procedure is also somewhat different from the American model. In the United States, bids are submitted for, and are opened on, a certain date. It is then up to the DOI to announce awards after tract evaluation has been completed. While applications are also returned pursuant to a closing date in the United Kingdom, the process continues with a period of further negotiation with the Department of Energy on the subject of exploration programmes and other issues.<sup>561</sup> Only then will licences be awarded. Tract evaluation is undertaken informally at the discretion of the Department of Energy.

## 2. Model Clauses

At first glance, the Reagan administration's objectives for OCS development—encouraging exploration and stimulating the economy—appear to be similar to the goals adopted by the British government for the UKCS in 1964. But the Reagan administration has adopted a very competitive and market-oriented mode of offshore leasing and has rejected the work commitment method of bidding which, in a modified version, forms the basis of the British system. A number of factors have accounted for this difference in approach. On the American side, the initial premise of the Reagan administration's offshore policy is that the oil cor-

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559. Petroleum (Production) Regulations, 1982 STAT. INST. NO. 1000, Reg. 11 & sched. 5, cls. 7-10.

560. See generally Dam, *supra* note 529, at 59-60 (discussing the merits of the work programme system).

561. See P. CAMERON, *supra* note 541, at 78.

porations are ready and willing to explore and develop the OCS. The Department of the Interior has had extensive experience in dealing with oil companies for at least a century. Moreover, the United States is the home base for a large majority of the world's major oil companies and consumes more oil than any other nation on earth.<sup>562</sup> The United States is also the world leader in offshore hydrocarbon technology. In this context, it is quite plausible to conclude that it will be the American oil industry, American energy security, and the wider American economy which will benefit most from a competitive and aggressive OCS leasing policy.

In contrast, in the early and mid-1960's the British government faced a quite different situation. The extent of interest that oil companies would show for North Sea exploration was uncertain. In addition, no one had any real idea of the region's potential. The only certain thing was that it would be one of the most difficult areas in the world to exploit, a point which the oil companies were quick to emphasise.<sup>563</sup> It was feared that if the bonus system of bidding was used, the bids would be small and concentrated only in the most lucrative areas.<sup>564</sup> It was also felt that American-style competitive leasing would enable the multinational oil corporations to use their vast capital to outbid the smaller British corporations.<sup>565</sup> On the other hand, it was recognized that the imposition of harsh leasing conditions biased in favor of British corporations might result in prejudice towards British companies located overseas. In light of these adverse possibilities, the discretionary system became an increasingly popular alternative. The Conservatives in particular saw the discretionary system as a means of attracting necessary foreign capital and expertise with easy terms. Moreover, the discretionary system allowed the government to insist on exploration and to induce foreign oil companies to collaborate with their British counterparts and buy British goods.<sup>566</sup>

The British eventually chose to regulate the offshore oil industry solely through model clauses in licences.<sup>567</sup> At successive times these

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562. For a statistical comparison of United States oil consumption with other major Western nations, see J. GRAY, H. FOWLER, & J. HARNED, *U.S. ENERGY POLICY AND U.S. FOREIGN POLICY IN THE 1980s*, at 275 (1981).

563. See Millard, *supra* note 545, at 411-12.

564. *Id.* at 412-13.

565. P. CAMERON, *supra* note 541, at 56.

566. Cameron goes so far as to remark that "the objective of securing [economic] rent at this stage took second place to the two other objectives: promoting the interests of specifically British companies, and securing an intensive programme of exploration." *Id.* at 79.

567. See T. DAINITH & G. WILLOUGHBY, *supra* note 498, at 12.

clauses have been laid down in both statutes and regulations. Although they are not technically effective until the Secretary of Energy includes them in any given licence, it has been consistently provided that model clauses are to be made a part of each licence unless the Secretary determines otherwise,<sup>568</sup> thus giving them a form of presumptive validity. Perhaps the closest American parallel is the lease stipulation, which varies from lease sale to lease sale and from tract to tract and which is created purely by administrative fiat.<sup>569</sup>

The model clauses remained very similar throughout the first four rounds of licensing.<sup>570</sup> The only significant change that a period of Labour government (1964-1970) brought was that *Gazette* notices for the second (1965) and third (1969) rounds allowed for the participation of nationalised industries in the licensing process. The result was that the British Gas Corporation (BGC) and the National Coal Board (NCB) obtained an entry into the new offshore business.<sup>571</sup>

The model clauses remained the only regulatory system of control that the British government had over the UKCS till 1971 and the passing of the Mineral Workings (Offshore Installations) Act.<sup>572</sup> In a basically underregulated industry, the model clauses, which under their own terms allowed for no renegotiation, were undoubtedly favorable to the oil companies. For example, the initial term for a licence was six years,<sup>573</sup> upon the elapse of such time the licensee could choose to retain up to half its acreage for a further forty years.<sup>574</sup> This right was not dependent on the licensee performing its work programme.<sup>575</sup> A single model clause governed the drilling of wells and the development of reservoirs.<sup>576</sup> Royalty was fixed at 12.5% and North Sea revenues were taxed until 1974 on the basis of ordinary corporate earnings.<sup>577</sup> Coupled with the easy availabil-

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568. See Petroleum (Production) Regulations, 1982 STAT. INST. NO. 1000, Reg. 3(1).

569. See 43 U.S.C. § 1337(b)(1982); 30 C.F.R. § 256.29 (1983).

570. See Millard, *supra* note 545, at 421.

571. For a further analysis of early state involvement in UKCS oil operations, see P. CAMERON, *supra* note 541, at 80-85.

572. Mineral Workings (Offshore Installations) Act, 1971, ch. 61. See generally Donelan, *Offshore Exploration and Exploitation: The Legal Regimes of the United Kingdom and the Republic of Ireland*, 133 NEW L.J. 461 (1983) (describing the Act's main provisions, which largely relate to the management of oil rigs).

573. Petroleum (Production) Regulations, 1966 STAT. INST. NO. 898, sched. 4, cl. 3.

574. *Id.* at sched. 4, cl. 5.

575. *Id.* at sched. 4, cl. 4. It is interesting to note that in 1980 Professor Odell claimed that 38 exploration wells agreed to in work programmes from the fourth round had never been drilled. See P. CAMERON, *supra* note 541, at 161.

576. Petroleum (Production) Regulations, 1966 STAT. INST. NO. 898, sched. 4, cl. 13.

577. See P. CAMERON, *supra* note 541, at 79.

ity of acreage, the model clauses encouraged exploration and development as the oil-bearing potential of the northern sector of the UKCS was unveiled.

Some of the model clauses were used to effect the government's goal of securing a large part of the benefits derived from the oil for Britain. All oil and gas taken from the UKCS and territorial sea had (and still has) to be landed in the United Kingdom.<sup>578</sup> Up until 1975, permission was needed for the export of such petroleum.<sup>579</sup> And, until 1976, only British persons could apply for production licences, a provision which necessitated the formation of British subsidiaries by the major multinational oil corporations.<sup>580</sup> It was hoped that these clauses might help to spur the expansion of a domestic oil production and refining industry.

### B. *The Changes of the Early 1970's*

The eight years from 1964 to 1972 marked a transformation in the status of the North Sea as the area developed into a proven hydrocarbon province. The four licensing rounds held in those years involved the licensing of offshore acreage larger in total size than England and Wales combined.<sup>581</sup> Included in these rounds were many of the most prospective blocks in the UKCS.<sup>582</sup> Oil was discovered in large quantities in the UKCS as early as June 1970, and immense strikes followed soon after.<sup>583</sup> In fact, the average size of a find in 1970 was a massive 900 to 1000 million barrels.<sup>584</sup> Wells in the Forties field, discovered in that year, each produced an average of ten thousand barrels per day.<sup>585</sup> In contrast, a Gulf of Mexico well which produces in excess of one thousand barrels per day is considered good.<sup>586</sup> North Sea wildcatting has had a one in four success rate, which is much higher than in many other of the

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578. Petroleum (Production) Regulations, 1966 STAT. INST. NO. 898, sched. 4, cl. 21 (reenacted in Petroleum (Production) Regulations, 1982 STAT. INST. NO. 1000, sched. 5, cl. 27).

579. The necessity for permission to export domestically produced petroleum was lifted by the Export of Goods (Control) (Amendment) Order, 1975 STAT. INST. NO. 149.

580. Petroleum (Production) Regulations, 1966 STAT. INST. NO. 898, Reg. 4. This provision was later changed so that "any person may apply." Petroleum (Production) Regulations, 1982 STAT. INST. NO. 1000, Reg. 4.

581. Daintith & Gault, *Pacta Sunt Servanda and the Licensing and Taxation of North Sea Oil Production*, 8 CAMBRIAN L. REV. 27, 33 (1977).

582. See P. CAMERON, *supra* note 541, at 89.

583. The 1969 discovery of oil in the Ekofisk field in the Norwegian Continental Shelf erased the earlier belief that natural gas alone would constitute the valuable reserves in the North Sea. See *id.* at 87.

584. Shell U.K. Ltd., *Depletion Policy in the UK: A Discussion Paper (August 1980)* (chart 1).

585. Milner, *supra* note 539, at 546.

586. *Id.*

world's oil-producing areas.<sup>587</sup>

All told, the North Sea has been the fastest developed part of the world's hydrocarbon-bearing continental shelf.<sup>588</sup> It would be erroneous to assume, however, that the only reason for this development was the region's physical potential. A number of other factors played a significant role in the rapid exploitation of United Kingdom offshore oil. The British government's licensing policy, which provided for easy access to UKCS acreage and generous licence terms, proved to be a major stimulus to development. But possibly as important was the changing political nature of the Arab oil-producing states. After the formation of OPEC, the Middle East was increasingly regarded by the multinational oil corporations as a risky theatre of operations.<sup>589</sup> In comparison, the stormy North Sea provided a relatively stable political zone. The North Sea was also within very easy reach of some of the largest oil-consuming markets in the world.<sup>590</sup>

In the fourth round of licensing, held in 1971-72, licences were again awarded for large amounts of acreage pursuant to the pattern used in the 1960's.<sup>591</sup> After the size of the North Sea bonanza became apparent, however, legislators and public opinion began to doubt the wisdom of the contracts which had been struck during the early rounds. In 1972, the House of Commons Public Accounts Committee, composed of Members of Parliament (M.P.'s) of all shades of political opinion, strongly criticised the government's North Sea oil policy and the terms under which the oil companies were working. The First Report on North Sea Oil and Gas highlighted the fact that the United Kingdom was getting very little economic rent from offshore resources.<sup>592</sup> The report suggested that taxation, the means of obtaining "fair market value," was set at an inadequately low level. The contemporary tax law, it was claimed, would allow oil companies to set off North Sea profitability against tax

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587. SCOTTISH DEVELOPMENT AGENCY, SCOTLAND: *THE OIL AND GAS FUTURE* 5 (1983).

588. *Id.* at 8.

589. See generally Jaidah, *The United States' Energy Situation: An OPEC View*, 11 NAT. RESOURCES LAW. 617 (1978); Mirvahabi, *Claims to the Oil Resources in the Persian Gulf: Will the World Economy Be Controlled by the Gulf in the Future?* 11 TEX. INT'L L.J. 75 (1976).

590. See generally D. KETO, *LAW AND OFFSHORE OIL DEVELOPMENT: THE NORTH SEA EXPERIENCE* 1-15 (1978) (discussing the European oil market).

591. See Millard, *supra* note 545, at 423-25. The Conservative government did, however, use an auction system for 15 of the 435 blocks offered. All 15 blocks were bid on, bringing the Exchequer £37 million. See generally K. DAM, *supra* note 542, at 36-43 (discussing the auction experiment in detail).

592. HOUSE OF COMMONS COMM. OF PUBLIC ACCOUNTS, *FIRST REPORT ON NORTH SEA OIL AND GAS*, H.C. REP. NO. 122, 1972-73 Sess. xxxii-xxxiii, reprinted in 19 PARLIAMENTARY PAPERS (HOUSE OF COMMONS AND COMMAND) (REPORTS, ACCOUNTS AND PAPERS) 1, 32-33 (1973).



losses made by their trading activities abroad.<sup>593</sup> Awarding such a massive amount of highly prospective acreage on such favorable terms also met with criticism. Much of the best of the UKCS, the Committee found, was now held by multinational oil companies for up to forty-six years.<sup>594</sup> The Committee's recommendations were largely confined to the realm of taxation, but the main effect of the findings was to initiate a political debate over the future of UKCS oil and gas regulation.<sup>595</sup>

No sooner had the First Report on North Sea Oil and Gas been published, than the Yom Kippur conflagration ensued with the consequent Arab oil embargo and the quadrupling of OPEC oil prices. The crisis ended the era of cheap oil and greatly heightened public awareness of the valuable nature of energy resources. It also caused the multinational oil companies to be seen in an unfavorable light. It was felt that these companies had taken advantage of events in the Middle East; increases in the profits of Exxon by 59%, Texaco by 48%, and Mobil by 47% did little to dispel this notion.<sup>596</sup> The Conservative government of Mr. Edward Heath embarked on an early general election campaign in the spring of 1974 amid scenes of unprecedented industrial unrest and the imposition of a three-day working week. An important issue in the election was the future course of British oil policy. The Conservatives proposed an increase in taxation, but the Labour party went further, advocating much tougher governmental control over North Sea operations and a substantial, direct state role in exploitation.<sup>597</sup>

When Labour won the elections of March and October of 1974, it became clear that changes in the offshore oil and gas regime would be inevitable. Before going on to evaluate the oil policy adopted by Labour, note should be taken of a very significant development which was occurring in Scotland.

### 1. Scottish Nationalism

To date, most of the oil found in the UKCS has been discovered in the large Scottish sector. Scotland has for centuries been a political enigma. In 1707, she joined with England and Wales to form the United Kingdom. The Treaty of Union, which effectuated a merger of the Scot-

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593. See Dam, *The Evolution of North Sea Licensing Policy in Britain and Norway*, 17 J.L. & ECON. 213, 214 (1974).

594. See HOUSE OF COMMONS COMM. OF PUBLIC ACCOUNTS, *supra* note 592, at xxix-xxx.

595. See P. CAMERON, *supra* note 541, at 89-90.

596. *Id.* at 91.

597. See K. DAM, *supra* note 542, at 103-07.

tish and English Parliaments, allowed the Scots to retain their Presbyterian religion and their distinctive legal system, which is partly based on Roman law. The Scottish educational system has also, up until the present, been run on different lines from the English system. Perhaps most importantly, the Scots have never lost their sense of national identity and tend to think of themselves as a member of the world's community of nations in their own right.<sup>598</sup>

Since 1707, Scotland has never had any form of legislative control over her own affairs. She has none of the legislative power possessed, for example, by a state in the United States. She currently returns seventy-two M.P.'s to a House of Commons which has over 600 members, the overwhelming majority of whom are English. There is a Scottish Office in Edinburgh which has responsibility for administrative aspects of Scottish matters—for example, education, fishing, and agriculture.<sup>599</sup> But the members of this Scottish Executive are chosen by a British Prime Minister who is frequently the leader of a party that is different from that which attracts the support of the majority of Scottish voters. At various times since the inception of the Union, Scotland has manifested discontent with the British constitutional arrangement. In the post-war period, the vehicle for this dissent has been the Scottish National Party (SNP). The object of the SNP has been to achieve Scottish independence within the British Commonwealth. The party has always sought to advance this objective through the election of an SNP majority of Scottish M.P.'s. Although SNP membership peaked at 200,000 in 1968 before the major North Sea oil discoveries, the slogan "It's Scotland's Oil" undoubtedly assisted the party in later gaining about a third of the Scottish vote and obtaining the election of eleven M.P.'s in October 1974.<sup>600</sup> By 1976, nationalist support had increased to the point where, had there been a general election at any time before 1977, Scotland would probably have returned an SNP majority.<sup>601</sup> Whether this would have resulted in Scottish independence is a matter of conjecture. In any event, the effect of this Scottish political atmosphere pressured both the Labour and Con-

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598. See generally C. HARVIE, *SCOTLAND AND NATIONALISM: SCOTTISH SOCIETY AND POLITICS* (1977).

599. A good description of the history and workings of this Scottish Executive is given in D. WALKER, *THE SCOTTISH LEGAL SYSTEM* 155-58 (5th ed. 1981).

600. Forster & Zillman, *The British National Oil Corporation: The State Enterprise as Instrument of Energy Policy*, 3 J. ENERGY L. & POL'Y 57, 102-04 (1982).

601. See Northrup, *Nationalists Who Seek Independent Scotland Are Gaining Strength*, Wall St. J., Oct. 23, 1975, at 1, col. 1; see also Grant, *Oil and Gas*, in *INDEPENDENCE AND DEVOLUTION: THE LEGAL IMPLICATIONS FOR SCOTLAND* 86 (J. Grant ed. 1976) (projecting an independent Scotland's position towards North Sea oil).

servative parties into advancing schemes for Scottish legislative devolution.<sup>602</sup> Scottish nationalism proved particularly discomfiting to the Labour party, which traditionally relied on Scotland to overcome the English dominance of the Conservative party. In fact, the Labour government of the 1970's had frequently depended on SNP collaboration to allow it to continue its wafer-thin hold on power. Scottish political resurgence, therefore, cast a shadow over Labour's proposals for varying the *modus operandi* of the North Sea.

### C. *Labour Policy from 1974 to 1979*

The main goals of the new Socialist administration of 1974 were to increase government control over British oil reserves and offshore activity and to obtain a more equitable economic rent from the development of Britain's resources.<sup>603</sup> These goals were implemented by legal changes which can be broken down into three classifications: (1) changes in operating conditions; (2) the creation of a national oil company; and (3) the creation of a new oil taxation system.

#### 1. Changes in Operating Conditions

Before looking at the most important substantive variations which were introduced by the Labour government into UKCS regulation, it is useful to consider the procedure with which the changes were accomplished. Labour realised that if the government was going to significantly tighten its control over oil operations, then changes in offshore terms would have to be made applicable to existing production licences.<sup>604</sup> This was because it was generally (and correctly) assumed that the largest fields, and those fields most susceptible to easy exploitation, had already been discovered as of 1974. However, the production licences granted pursuant to the first four rounds did not contain any model clause stipulating a procedure for renegotiation. Under these circumstances, the government had three options open: (1) try to come to a separate agreement with each licensee; (2) attempt to pass regulations which might effect the changes without varying the licences; or (3) unilaterally vary the model clauses.<sup>605</sup> The first possible course of action would have taken far too long, if indeed it could have achieved success at

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602. D. WALKER, *supra* note 599, at 158-59.

603. See P. CAMERON, *supra* note 541, at 93.

604. See *id.* at 95.

605. Daintith, *supra* note 515, at 213-14.

all. The oil companies had no desire to cooperate with Labour's initiative and would undoubtedly have preferred to continue with the pre-1974 status quo. It was felt that the second solution would necessarily involve some extremely complex drafting and almost inevitably result in confusion and litigation. Thus, with some misgivings, the government opted for the third approach. Although the proposed changes would certainly be seen as a diminution of the value of the production licences, no compensation was envisaged. The Conservative opposition protested that this disregard of the principle of *pacta sunt servanda*<sup>606</sup> might well rebound on British interests abroad.<sup>607</sup> But, given the government's goals, there did not seem to be any other viable alternative.

Accordingly, Parliament unilaterally varied the terms of pre-existing licences by virtue of section 18 of the Petroleum and Submarine Pipe-lines Act 1975<sup>608</sup> (PSPA). Model clauses which were in many respects similar were made applicable to future licensing rounds by the Petroleum (Production) Regulations 1976,<sup>609</sup> passed pursuant to the PPA. Possibly the most important of the new licence conditions was the provision which gave the government power to impose production controls.<sup>610</sup>

The size of the UKCS discoveries indicated that when the North Sea oil fields were brought on stream, the United Kingdom would attain self-sufficiency. In this respect, Britain's offshore oil resources allow for a greater measure of economic independence when compared to those of the United States, which can reduce, but can probably never eliminate, foreign imports. Legislating in the wake of the Arab oil crisis, Westminster's politicians wished to acquire controls which would allow a British government to continue self-sufficiency for as long as possible. It must be borne in mind, however, that at about that time oil companies were investing the huge capital sums necessary to begin production from their offshore fields. Fearing that the production clauses might pre-empt such a crucial investment, the government gave the corporations certain guar-

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606. "Agreements (and stipulations) of the parties to a contract must be observed." BLACK'S LAW DICTIONARY 999 (5th ed. 1979).

607. Daintith & Gault, *supra* note 581, at 36-37.

608. Petroleum and Submarine Pipe-lines Act, 1975, ch. 74, § 18.

609. Petroleum (Production) Regulations, 1976 STAT. INST. NO. 1129.

610. This power was appropriated with respect to previous and future licences. For previous licences, see Petroleum and Submarine Pipe-lines Act, 1975, ch. 74, § 17. For future licences, see Petroleum (Production) Regulations, 1976 STAT. INST. NO. 1129, sched. 5, cl. 16 (reenacted in Petroleum (Production) Regulations, 1982 STAT. INST. NO. 1000, sched. 5, cl. 15). For a discussion of the political events surrounding the British government's appropriation of this control, see P. CAMERON, *supra* note 541, at 117-23.

antees concerning the use of the new powers under the so-called "Varley Assurances," which were announced in Parliament on December 6, 1974 by Mr. Eric Varley, the then Secretary of Energy.<sup>611</sup> The Varley Assurances provided that no production cuts would be required from discoveries made before the end of 1975 until 1982 or four years after the start of production from such a field, whichever was later.<sup>612</sup> In addition, production cuts were not to be made from a field discovered after 1975 pursuant to an existing licence (i.e., a licence granted in the first, second, third, or fourth rounds) until the licence had recouped at least 150% of capital costs.<sup>613</sup> Any future use of the powers would generally be limited to a maximum reduction of twenty percent.<sup>614</sup>

The Department of Energy was also able to tighten its control over exploration and development. Although the PSPA did not interfere with the duration of rights under existing licences, new rounds were to be conducted on a differing basis. The initial term was henceforth to be four years.<sup>615</sup> If by that time the work programme had not been implemented, the licence would terminate. If the licensee fulfilled his obligations, he then had the option to continue the licence for an additional three years, referred to as the "second term."<sup>616</sup> At the end of the second term, the licensee was to have the further option of retaining up to one-third of his acreage for a "third term" of thirty years.<sup>617</sup> The Department of Energy was given additional power to require the submission of a further exploration plan in the third term.<sup>618</sup> But of greater significance was the provision which allowed the government to require the submission of development and production programmes.<sup>619</sup> If the licensee's proposed programmes proved unsatisfactory, the government could substitute its own approved versions, and if the licensee remained uncooperative, the licence could be revoked.<sup>620</sup>

611. T. DAINIITH & G. WILLOUGHBY, *supra* note 498, at 453.

612. *Id.*

613. *Id.*

614. *Id.*

615. Petroleum (Production) Regulations, 1976 STAT. INST. NO. 1129, sched. 5, cl. 3. The law relating to the terms of production licences has been subsequently changed. See *infra* notes 736-39 and accompanying text.

616. Petroleum (Production) Regulations, 1976 STAT. INST. NO. 1129, sched. 5, cl. 4.

617. *Id.* at sched. 5, cl. 5.

618. *Id.* at cl. 5(4); see also Petroleum (Production) Regulations, 1982 STAT. INST. NO. 1000, sched. 5, cl. 13 (under current provisions, the Dep't of Energy retains the right to require the submission of an extra exploration programme).

619. Petroleum (Production) Regulations, 1976 STAT. INST. NO. 1129, sched. 5, cl. 15 (re-enacted in Petroleum (Production) Regulations, 1982 STAT. INST. NO. 1000, sched. 5, cl. 14).

620. Petroleum (Production) Regulations, 1976 STAT. INST. NO. 1129, sched. 5, cl. 40(2)(b)

Labour also enacted a procedure which allowed the government to take royalty in kind.<sup>621</sup> As in the United States, this procedure was designed to give the government proprietary access to national oil production. Another major reform was the tightening of government control over the assignment of licence interests.<sup>622</sup> With the exception of model clauses governing the duration of licence terms, the preceding changes were reenacted in substantially similar form by the Petroleum (Production) Regulations 1982.<sup>623</sup>

## 2. BNOC: The National Oil Company

A major difference between the oil and gas systems of America and Britain is that the latter has a national oil company. America has always relied solely upon private enterprise to exploit its mineral resources. But in the British National Oil Corporation (BNOC), a legislative creation of the PSPA, the British government signaled its intent to use both a private and public approach in the development of British offshore oil. Despite the fact that major changes in the operation of BNOC were effectuated by the later Conservative government of Mrs. Thatcher, the BNOC retains a major role in the British oil industry.

The bitter experience of Mr. Edward Heath in 1973 had been that British government at that time had little or no control over the country's supply of oil. The government's long-standing equity powers over BP had never really been exercised, and when BP was requested to favor the United Kingdom in its allocation of supply in 1973-74, BP replied that its primary responsibility was to its international customers.<sup>624</sup> Labour hoped that a national oil company with appropriate powers would do much to remedy this situation. It was felt that, vis-à-vis the oil industry, Britain in some respects was in a very weak bargaining position. After the fourth licensing round of 1971-72, a total of 192,400 square

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(reenacted in Petroleum (Production) Regulations, 1982 STAT. INST. NO. 1000, sched. 5, cl. 39(2)(b)).

621. "In kind" royalty takes the form of oil, rather than cash, payments. The power to take royalty in kind was appropriated with respect to previous and future licences. For previous licences, see Petroleum and Submarine Pipe-lines Act, 1975, sched. 2, part II, cl. 11. For future licences, see Petroleum (Production) Regulations, 1976 STAT. INST. NO. 1129, sched. 5, cl. 11 (reenacted in Petroleum (Production) Regulations, 1982 STAT. INST. NO. 1000, sched. 5, cl. 10).

622. This power was appropriated with respect to previous and future licences. For previous licences, see Petroleum and Submarine Pipe-lines Act, 1975, sched. 2, part II, cl. 38. For future licences, see Petroleum (Production) Regulations, 1976 STAT. INST. NO. 1129, sched. 5, cl. 39 (reenacted in Petroleum (Production) Regulations, 1982 STAT. INST. NO. 1000, sched. 5, cl. 38).

623. Petroleum (Production) Regulations, 1982 STAT. INST. NO. 1000; see *supra* notes 619-22.

624. See P. CAMERON, *supra* note 541, at 66.

kilometers of the UKCS—an area larger than the total amount of OCS acreage ever leased—had been licenced.<sup>625</sup> Yet in 1971, the Department of Trade and Industry (which at that time was responsible for the regulation of UKCS operations) had only seven technical staff competent in the handling of offshore matters.<sup>626</sup> The BNOC was envisaged as a means for obtaining the technical and commercial expertise necessary for dealing with the multinational oil corporations. Additionally, the profits of a state oil company would not become a source for a private investor's dividends, but would rather be channeled into the national coffers, thereby enabling Britain to obtain more economic rent.<sup>627</sup>

Initial speculation suggested that BP might be transformed into the government's chosen instrument of national control. BP, an essentially private oil company, was decidedly unenthusiastic. Many doubted the corporation's reliability in such a role, and the government feared that if BP became the state oil company, its developing interests in America, particularly in Alaska's North Slope, might be prejudiced. Thus it was decided that an entirely new corporation would be required to achieve national aspirations.<sup>628</sup>

It should be emphasised that Labour at no time proposed the nationalisation of the North Sea industry. Such a course would have been far too expensive if it had been undertaken with compensation. If it had been attempted without compensation, very serious rifts in foreign relations with the United States would have taken place. BNOC was instead destined to be a major state participator working in tandem with the British and multinational private sector in UKCS development. On January 1, 1976, the BNOC was enacted into existence as a state corporation through section 1(1) of the PSPA.<sup>629</sup> Part one of the PSPA defined, in a manner not dissimilar to the articles of association of a private company, the powers, rights, and duties of BNOC.<sup>630</sup> The PSPA provided that BNOC was to be managed by a board consisting of not less than eight and not more than twenty suitably qualified people chosen by the Secre-

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625. Daintith & Gault, *supra* note 581, at 33.

626. P. CAMERON, *supra* note 541, at 88.

627. See WHITE PAPER ON UNITED KINGDOM OFFSHORE OIL AND GAS POLICY, CMD. 5696 (1974), reprinted in 14 INT'L LEGAL MATERIALS 460 (1975) [hereinafter cited as WHITE PAPER].

628. Forster & Zillman, *supra* note 600, at 63-64.

629. Petroleum and Submarine Pipe-lines Act, 1975, ch. 74, § 1(1). For further discussion of the Act's provisions relating to BNOC, see P. CAMERON, *supra* note 541, at 139-44; Brenscheidt, *Petroleum Legislation in the North Sea Countries*, 11 TEX. INT'L L.J. 281, 296-97 (1976); Forster & Zillman, *supra* note 600, at 65-67.

630. Petroleum and Submarine Pipe-lines Act, 1975, ch. 74, §§ 1-16.

tary of Energy.<sup>631</sup> At least two members of the Board had to be civil servants.<sup>632</sup> Section 2(1) gave the BNOc fairly wide general powers to operate as a normal oil company. It could engage, for example, in exploration, production, transportation, marketing, and refining.<sup>633</sup> But section 2(4) qualified these concessions by requiring the consent of the Secretary of State and the approval of the Treasury for activities such as refining or foreign exploration.<sup>634</sup> Section 2(1) provided that the BNOc could perform any task related to petroleum requested by a Minister of the Crown, and could undertake any obligation arising from offshore participation agreements.<sup>635</sup> These provisions set forth the practical means by which BNOc was to play a role in the operation of pre-1975 licences.

Section 3 of the PSPA further elaborated upon the duties of the BNOc. The BNOc was required to give notice whenever it began new projects or enterprises and was required to furnish advice on all relevant matters to the Secretary of Energy.<sup>636</sup> The BNOc was also charged with undertaking any action which was required by the Energy Department and related to Crown-controlled pipelines or storage facilities, or petroleum which was the property of, or held on behalf of, the Crown.<sup>637</sup> Section 4 gave the Secretary of Energy the right to give BNOc mandatory general or specific directions.<sup>638</sup> As British ministers of state are not usually given the power to issue specific directions to state corporations, the latter provision illustrates the importance which was attached by the Labour government in acquiring a tight rein over BNOc operations.<sup>639</sup> BNOc's profits were to be paid into a National Oil Account.<sup>640</sup> Although BNOc was not allowed to retain its profits, neither was it required to pay Labour's new Petroleum Revenue Tax (PRT).<sup>641</sup> By virtue of section 6, the corporation was given power to borrow funds from the Secretary or other institutions subject to Secretarial and Treasury ap-

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631. *Id.* § 1(2).

632. *Id.* § 1(3)(c).

633. *Id.* § 2(1).

634. *Id.* § 2(4).

635. *Id.* § 2(1)(d), (e).

636. *Id.* § 3(2), (3).

637. *Id.* § 3(5).

638. *Id.* § 4(1).

639. See Forster & Zillman, *supra* note 600, at 66.

640. Petroleum and Submarine Pipe-lines Act, 1975, ch. 74, § 40(2). This provision has subsequently been changed. See *infra* notes 845-46 and accompanying text.

641. Petroleum and Submarine Pipe-lines Act, 1975, ch. 74, § 9. This provision has subsequently been altered. See *infra* note 734 and accompanying text.



proval.<sup>642</sup> BNOC was also afforded the power to borrow £600 million to finance initial operations.<sup>643</sup> The Secretary of Energy could increase this amount to £900 million at his discretion.<sup>644</sup>

It will be recalled that during the first four licensing rounds, especially the second and third, the National Coal Board (NCB) and the British Gas Corporation (BGC) managed to obtain a share in some of the licence awards.<sup>645</sup> But these shares were not large and only BGC had acquired actual operating experience.<sup>646</sup> The NCB's interests in six oil fields were transferred for £100 million to BNOC.<sup>647</sup> The BGC, however, was permitted to retain its offshore oil interests.<sup>648</sup> In addition, BNOC in 1976 acquired the North Sea licence properties of the failing Burmah Oil Company, which included shares in the Ninian and Thistle fields.<sup>649</sup>

Having created a national oil company, Labour had to ensure that the company would be able to play a leading role in present and future UKCS exploitation. Britain's discretionary system of licensing could easily be used to facilitate this result with respect to future licence offerings. As with the changing of the model clauses, however, the real difficulty lay in the alteration of previously agreed upon contracts. Although the government at first threatened to unilaterally grant BNOC participation rights in pre-existing licences, this solution was not ultimately adopted.<sup>650</sup> Instead, the government announced that it would negotiate majority state participation and promised that the oil companies would neither gain nor lose as a result. However, the government also made it known that companies which were uncooperative in beginning discus-

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642. Petroleum and Submarine Pipe-lines Act, 1975, ch. 74, § 6(1).

643. *Id.* § 6(3).

644. *Id.*

645. See *supra* note 571 and accompanying text.

646. This experience had been gained in two blocks in the Irish Sea for which BGC was the sole licensee. See Woodcliffe, *State Participation in the Development of United Kingdom Offshore Petroleum Resources*, 1977 PUB. L. 249, 252.

647. See Millard, *supra* note 545, at 437; see also Petroleum and Submarine Pipe-lines Act, 1975, ch. 74, § 13 (providing for transference of shares at a sum equal to face value).

648. Forster & Zillman, *supra* note 600, at 66.

649. *Id.* at 70.

650. Woodcliffe, *supra* note 646, at 257. It might also be noted that Labour did take other action apart from the creation of BNOC to guarantee security of supply. In particular, sections 1, 2, 3, 4, and 6 of the Energy Act, 1976, ch. 76, give the government very wide power over the national oil supply. Section 6, for example, allows the Secretary of State to force oil producers to keep their U.K. stocks at a given level. See Energy Act, 1976, ch. 76, § 6(2)(a),(b). Only in an extreme situation would such powers be used, however.

sions would be prejudiced in the new licensing round of 1976.<sup>651</sup> Conversely, the government promised that cooperation would be a favorable factor that would be taken into account in later rounds.<sup>652</sup> By 1977, agreements had been made with respect to all pre-existing licences.<sup>653</sup> These agreements differed on details, but the main features were twofold: BNOC was to be given the right to buy up to fifty-one percent of production and allowed to sit on all operating committees.<sup>654</sup> It was hoped that these new contracts would provide the type of national control over supply and access to corporate information sought by the Labour government.

The government held a fifth round of licensing in 1976. One of the relevant licence criteria was that all applications had to provide for fifty-one percent participation by BNOC or BGC.<sup>655</sup> The form that this arrangement took was as follows. BNOC was given the right to become a fifty-one percent equity owner in every licence<sup>656</sup> and, like other licence share owners, the corporation was thereafter required to contribute to exploration and development costs.<sup>657</sup> The only exception to BNOC's equity right occurred when BGC was offered a share in a licence. In that case, the combined share of BNOC and BGC had to be equal to, or greater than, fifty-one percent.<sup>658</sup>

The sixth round of 1978 was conducted on similar, but somewhat more state-oriented lines. It was expected that a larger than fifty-one percent interest for BNOC would be offered, and that favor would be given to applicants who were prepared to waive BNOC's obligation to pay exploration and development costs, and who would give BNOC the option of purchasing part of their equity share in production.<sup>659</sup> In the same year, the government decided that two further important privileges would be granted to BNOC and BGC. First, the government decided that state companies would be given the opportunity to obtain produc-

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651. Amoco, the last oil company to accept licence revisions, had all of its applications for fifth round awards denied. See Daintith & Gault, *supra* note 581, at 37.

652. See Millard, *supra* note 545, at 442-43.

653. See P. CAMERON, *supra* note 541, at 155-56.

654. See generally P. CAMERON, *supra* note 541, at 147-56 (setting forth the details of some of the most important agreements).

655. See Baker & Daniel, *BNOC and Privatisation—The Past and the Future*, 1 J. ENERGY & NAT. RESOURCES L. 149, 150 (1983).

656. *Id.*

657. *Id.*

658. *Id.*

659. See Millard, *supra* note 545, at 427-28.

tion licences at times other than during licensing rounds.<sup>660</sup> Second, the government decided that BNOC would be given the chance to accept any offer of offshore acreage before any part of a licence interest could be transferred.<sup>661</sup>

The four years from 1976 to 1979 saw BNOC develop from a paper organisation to a substantial and potent influence in the British oil industry. The corporation was involved in development work from the outset due to its inherited stake in the Thistle field.<sup>662</sup> In the second year of its existence, BNOC participated in a considerable amount of exploratory work, and in 1978 it encountered its first potentially economic discovery on fifth round acreage.<sup>663</sup> The same year marked the beginning of BNOC's oil trading role and the start of production from the Thistle field. The BNOC's North Sea equity holdings and the BNOC's rights to purchase a large share of the oil from fields where it had no such holdings made the corporation the effective arbiter of the price of North Sea crude oil.

Lord Frank Kearton was appointed as the first Chairman of BNOC's Board and the first Chief Executive. Previously, Lord Kearton had held the directorship of Cortaulds, but had no background in the oil industry. His relations with the contemporary Secretary of Energy, Mr. Anthony Benn, were close, and this relationship enhanced BNOC's role as advisor to the government on oil-related matters.<sup>664</sup> Indeed, BNOC's function as industry counsel to the Department of Energy was highlighted by such practices as reviewing development plans submitted by private oil companies.<sup>665</sup> It was, of course, easy for the government to suggest that BNOC should give preference to British goods and services. This was evidenced in 1977 and 1978 when the state oil company bought "jack-up" rigs, for which it had no immediate use, from the threatened Marathon shipyard in Clydebank.<sup>666</sup> As British voters again ventured to the polls in May of 1979, BNOC could justifiably claim to have achieved many of the goals set for it by Labour in 1974.

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660. See 947 PARL. DEB., H.C. (5th ser.) 439 (1978).

661. *Id.*; see Forster & Zillman, *supra* note 600, at 75.

662. Forster & Zillman, *supra* note 600, at 76.

663. *Id.*

664. *Id.* at 69, 77.

665. *Id.* at 77.

666. *Id.*

### 3. The New System of Taxation

As discussed before, the Public Accounts Committee Report of 1972 was sharply critical of the then Conservative government's North Sea taxation policy.<sup>667</sup> The dramatic rise in the cost of petroleum following the Arab oil embargo stimulated the new Labour administration to completely reassess the offshore tax regime. One of the government's main objectives was to recoup what it regarded as the oil companies' "enormous and uncovenanted profits."<sup>668</sup> On the other hand, the government had to balance this desire with the consideration that the new system should not prejudice the development of the discoveries of the early 1970's. The Conservative opposition accorded much more weight to the latter factor. As future Conservative Minister of State for Energy, Hamish Gray, put it, "[t]he object at the time was to get the oil out of the ground at the earliest possible moment following the ghastly price rises of 1973."<sup>669</sup>

The result of these deliberations was the Oil Taxation Act 1975.<sup>670</sup> This legislation introduced for the first time in the United Kingdom a separate tax on oil revenues, the Petroleum Revenue Tax (PRT). The PRT is a supplement to the previously applicable revenue devices, the corporation tax and the royalty payment. Initially levied at forty-five percent,<sup>671</sup> the PRT is calculated before corporation tax. Unlike the latter, the PRT is not charged against single companies with respect to all of their relevant United Kingdom operations. Instead, it is charged against participating licence shares in oilfields.<sup>672</sup> The reason for this so-called "ring fence" provision was that Labour wanted to be able to levy the tax against commercial discoveries without having to consider the licensee's costs and losses from other activities.

A number of tax reliefs were instituted to minimise this new disincentive to exploit earlier finds. For instance, corporations were not to be subjected to the PRT until commercial production had paid for at least 175% of the corporation's capital costs.<sup>673</sup> The corporations were also given an "oil allowance" of ten million tonnes per field on which the

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667. See *supra* notes 592-95 and accompanying text.

668. WHITE PAPER, *supra* note 627, at 461.

669. Letter from the Rt. Hon. the Lord Gray of Contin, P.C., Minister of State for Energy in the first Thatcher administration (1979-83), to the Author (July 3, 1984).

670. Oil Taxation Act, 1975, ch. 22.

671. *Id.* § 1(2).

672. *Id.* § 1(1)(1).

673. *Id.* § 2(9)(b).

PRT would not be charged.<sup>674</sup> In addition, the PRT was not to be levied on fields earning less than a thirty percent return on invested capital.<sup>675</sup>

Labour decided to change the rate and allowances of PRT in 1979 when it found that the reliefs had worked too successfully and that no PRT at all had been paid until 1978.<sup>676</sup> Indeed, the sum of all revenues from North Sea oil only totaled £562 million in 1978-79.<sup>677</sup> By comparison, the OCS, a much less intensively developed offshore area, contributed a total of \$2941 million by way of bonuses, royalties, and rentals to the United States Treasury in 1978.<sup>678</sup> Accordingly, Labour planned to increase the rate of the PRT to sixty percent and to cut back on capital allowances.<sup>679</sup> Before these changes could be implemented, however, a new Conservative administration was elected to power.

#### V. BRITISH OFFSHORE OIL DEVELOPMENT UNDER THE THATCHER ADMINISTRATION

Mr. Callaghan's Labour government was not returned by the British electorate in 1979. Instead, the Conservative party, led by Mrs. Thatcher, was elected with a handsome parliamentary majority. In order to properly explain the new government's energy policy, it will be necessary to review the contemporary economic situation, the ongoing evolution of UKCS development, and the dominant strands in Conservative philosophy.

The 1970's was, on the whole, an extremely bad decade for the British economy. It was marked by labor discontent, inflation, and low productivity. The real difficulties began to manifest themselves after the 1973-74 oil crisis, which quadrupled the price of oil. But the deficiencies in British industry which caused the results of that crisis to be so malignant were of a deeper nature. Large sections of the United Kingdom economy were based on the traditional heavy industries. The steel, shipbuilding, and coal industries had all been nationalised after the war and suffered from overmanning and inefficiency. These and other such industries found it increasingly difficult to compete in a much more interdependent and competitive world. As a result, the 1970's witnessed the beginning of a new restructuring of British industry, a process which

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674. *Id.* § 8(6).

675. *Id.* § 9(1).

676. See P. CAMERON, *supra* note 541, at 191.

677. U. K. DEP'T OF ENERGY, *supra* note 534, at 20.

678. MINERALS MGMT. SERVICE, *supra* note 549, at 51.

679. THE ECONOMIST, July 29, 1978, at 86, 86.

continues to the present. Unfortunately, the transition into the new electronic and less labor-intensive age has proved to be painful for the British economy.<sup>680</sup>

The Arab oil embargo threw Britain, along with the rest of the Western World, into a recession. The resulting inflationary spiral was especially vicious in the United Kingdom, where annual price increases averaged 16.3% in the years 1974-78<sup>681</sup> and rose by 200% in the decade from 1967 to 1977.<sup>682</sup> Productivity, on the other hand, rose by only twenty-seven percent during the same period.<sup>683</sup> There was a great deal of union unrest throughout the post-embargo era, particularly in the heavily unionised public sector. Indeed, two out of the four British general elections of the 1970's, those held in 1974 and 1979, were in large measure precipitated by the action of labor unions. The Labour government's interventionist policies mitigated the effect of the recession on the unemployment figures. But this approach necessitated high levels of public expenditure and accordingly pushed up the level of government borrowing.<sup>684</sup>

North Sea oil began to flow in significant quantities in 1977, and by 1978, the 52.8<sup>685</sup> million tonnes landed accounted for 80.5% of British oil consumption.<sup>686</sup> The main economic benefits which accrued from North Sea oil were twofold. First, Britain's balance of payments position was transformed. In late 1979, *The Economist* stated that "[w]ithout oil and gas, Britain would be heading for an international crisis with a 10 billion [pounds] current account deficit . . . ."<sup>687</sup> Second, the economy, having received vast amounts of oil-related investment, received a major boost. By 1979, it was possible to predict that the United Kingdom would soon be energy self-sufficient, and that for the first half of the 1980's Britain would probably produce in excess of her needs.<sup>688</sup> One of the reasons why Labour felt confident about increasing the PRT in early

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680. For several interesting discussions concerned with Britain's industrial problems, see *British Industry in Miniature at Merthyr Tydfil*, THE ECONOMIST, Sept. 1, 1979, at 79; Brittan, *How British is the British Sickness?*, 21 J.L. & ECON. 245 (1978); Cranston & Puri, *Government as Entrepreneur and Planner: Aspects of Recent Industrial Strategy in Britain*, 9 CAL. W. INT'L L.J. 78 (1979).

681. *How the War was Lost*, THE ECONOMIST, Sept. 1, 1979, at 80.

682. *Id.*

683. Kreidmann, *Inflation: A Global Enigma*, 9 CAL. W. INT'L L.J. 349, 356 (1979).

684. Mr. Callaghan, the last Labour Prime Minister of the United Kingdom, claimed that his government's interventionist policies had saved a million jobs in declining industries. See *Taxcutter's Election*, THE ECONOMIST, Apr. 21, 1979, at 13, 13.

685. U. K. DEP'T OF ENERGY, *supra* note 534, at 52.

686. *Putting Steam Behind an EEC Energy Policy*, THE ECONOMIST, Sept. 1, 1979, at 38.

687. *Worse and Worse*, THE ECONOMIST, Sept. 22, 1979, at 100.

688. Letter from the Rt. Hon. the Lord Gray of Contin, P.C., *supra* note 669.

1979 was that, for the most part, the expenditure necessary to fully develop the finds of the early and mid-1970's had already been committed.<sup>689</sup>

When the Shah of Iran's regime was overthrown in 1979, a second oil crisis followed. This time the price of oil doubled over a period of about a year.<sup>690</sup> The crisis again sent the Western World into a recession. For Britain it was to be the worst downturn since the 1930's.

The new Conservative government believed in a society based on free enterprise and, consequently, hoped that as much of Labour's public sector legacy as possible could be "privatised." More fundamentally, the Conservatives saw inflation and inefficiency as the main reasons for Britain's economic troubles. Inflation was seen as directly connected to the Treasury's public borrowing, or, as it was termed, the "public sector borrowing requirement" (PSBR). Accordingly, the linchpin of the Conservative's new monetary strategy was to control and cut PSBR. The fight to defeat inflation was seen as the most important governmental goal. While it was known that the projected cuts in public expenditure would result in a major increase in unemployment, it was felt that this was an unavoidable consequence of the interventionism of the past. It was envisaged that British industry could never be competitive and profitable till restrictive trade practices and overmanning were eliminated.<sup>691</sup>

These policies were dissimilar to those of the government's Socialist predecessor and, for that matter, to previous Conservative administrations. Since the last war, the latter had endorsed a considerable degree of state intervention and had never attempted to denationalise significant parts of the public sector. By no means did all of the Conservative party fully support the new approach, and these elements tempered, particularly in the first three years from 1979 to 1981, the new market-based economic strategy.

#### A. *Conservative Oil and Gas Policy*

A clear and concise initial summation of UKCS policy was never given by Mr. David Howell, the newly appointed Secretary of Energy. Nevertheless, an idea of the Conservative government's UKCS objectives

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689. *North Sea oil companies over a barrel*, THE ECONOMIST, July 29, 1978, at 86.

690. *Stop Oil doubling again*, THE ECONOMIST, Nov. 29, 1980, at 13.

691. For a further discussion of general Conservative policy, see *Sir Geoffrey Sees the Books*, THE ECONOMIST, May 26, 1979, at 15; *The Fall and Rise of Margaret Thatcher*, THE ECONOMIST, Apr. 21, 1979, at 39.

can be obtained from policy statements on individual issues and from subsequent government actions.

The Conservatives believed that Labour interventionism had caused, in the words of the strongly pro-market *Daily Telegraph*, “[a] massive lack of investment in the North Sea over the past two or three years.”<sup>692</sup> By way of contrast, the Conservatives hoped to recreate conditions which would again induce private enterprise into further exploring and developing the UKCS. As Mr. Nigel Lawson, who succeeded Mr. Howell at the Department of Energy, said in 1981, “[i]t is private enterprise which made the North Sea the outstanding success that it is, and it is the private sector which is the key to its continued success.”<sup>693</sup> Since future discoveries were likely to be made in smaller, technically complex, and more remote areas, it was felt that government had to do more in the way of encouraging exploration by the oil companies. More exploration, it was thought, would certainly be needed to fully appraise the extent of the UKCS’s resources and to prolong Britain’s self-sufficiency. It was anticipated that a further burst of North Sea activity would be of great assistance to the British economy, especially in the beleaguered northern portion of the country, where many of the rig building yards were located.

Thus far it has been shown that the goals of Mrs. Thatcher’s government were similar to those espoused by Secretary Watt at the outset of the Reagan administration. But other aspects of Conservative policy gave the new British offshore oil regime a somewhat different flavor. The second oil crisis of 1979 reiterated to the British government the value of an indigenous supply of oil. Mr. Howell and his cabinet colleagues realised that Britain, as a member of the European Economic Community (EEC), was part of the largest oil-consuming market in the world. The multinational oil corporations, it was feared, would sell to the highest bidder in this extremely competitive marketplace. The Conservatives, no less than Labour, responded to this situation by following a policy of state control over oil supply.<sup>694</sup>

Another issue which created a considerable difference, at least initially, between the Thatcher and Reagan oil strategies, related to the maximisation of economic rent or revenue. It was clear in 1979 that the impending recession and the Tory policy of making industry “leaner and

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692. *The Daily Telegraph* (London), July 10, 1979, at 8, col. 6.

693. *The Times* (London), Oct. 20, 1981, at 1, col. 2.

694. *See, e.g., id.*, at 6, col. 1. (statement of Secretary of Energy Nigel Lawson in the House of Commons, Oct. 19, 1981).



fitter" would result in a short-term deflation of the economy, more unemployment, less revenues, and more need for social expenditure.<sup>695</sup> If the government planned to reduce public borrowing, then it would certainly be necessary to raise extra Treasury funds by increasing taxation in some, if not all, sectors of the economy. The oil companies, whose profits had risen again due to the 100% increase in the price of oil, became an obvious target.<sup>696</sup>

To recapitulate, the goals of the Conservative government were: (1) to encourage exploration; (2) to create a market-oriented operating climate; (3) to use UKCS oil to boost the British economy; (4) to maximise oil revenues; (5) to attempt to prolong British self-sufficiency; and (6) to continue national controls over oil supply. Not surprisingly, the difficulty with this set of goals is that they logically conflict. For example, the maximisation of revenues tends to lead to the minimisation of exploration, development, and production, while the retention of controls over supply produces a less market-oriented operating system. The implementation of the Conservative government's interrelated, and sometimes contradictory policies, will now be considered in two stages: "Stage One," which lasted from May 1979 to September 1981, and "Stage Two," which covers the period of time from September 1981 to the present.

#### B. *Oil Industry Concerns at the Outset of Stage One*

Since the British Conservatives, like the American Republicans, depend on free enterprise to develop offshore oil, it seems pertinent to begin this part of the essay by examining the views held by the British oil industry at the outset of the Thatcher administration. There were four major areas of concern to industry: (1) the future role of BNOC; (2) depletion policy; (3) exploration policy; and (4) taxation.

##### 1. BNOC

A number of the large American oil corporations, especially Gulf and Conoco, were quite enthusiastic about forming bidding consortia with the NCB and BGC in the early days of North Sea exploration.<sup>697</sup> According to Cameron, early state involvement "did not in practice dif-

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695. The Daily Telegraph (London), Aug. 10, 1979, at 15, col. 2.

696. BP's after tax profits in the first quarter of 1979 amounted to £281.9 million. This compares with £85.6 million in the first quarter of 1978. The Daily Telegraph (London), June 8, 1979, at 21, col. 2.

697. P. CAMERON, *supra* note 541, at 84-85.

fer from that of a private oil company participating in a joint venture."<sup>698</sup> But the oil companies refrained from similar treatment of the BNOC, which, after all, had been charged by Labour with a far more ambitious role. The BNOC had been created to swell economic rent, to increase government bargaining power vis-à-vis the oil industry, and to ensure a measure of control over oil supply.

There were possibly three main reasons why the private sector was so opposed to this form of state intervention. First, in broad terms, industry regarded BNOC as an unwarranted and duplicative public enterprise, attempting to perform a task that the private oil industry was always better equipped to handle.<sup>699</sup> Second, BNOC's special operating privileges were seen as a means by which the corporation's creators had endeavored to compensate for the national oil company's shortcomings. The individual privileges were all sources of rancour, as it was charged that BNOC's access to Treasury funding constituted an unfair advantage not afforded to the oil companies who, by comparison, often found it difficult to obtain loan stock. The BNOC's exemption from the PRT was regarded by private industry as a considerable cash flow benefit. Furthermore, the first refusal right and the opportunity given to BNOC and BGC to acquire licence acreage outside normal rounds were regarded as gratuitous favors. Put simply, industry was deeply unhappy with BNOC's close advisory relations with the government and believed that this arrangement fostered the undermining of confidential business planning.<sup>700</sup> Finally, BNOC's distributive role was also the subject of attack. The participation agreements and criteria for the fifth and sixth rounds enabled BNOC to become the major trader in North Sea oil, giving it the effective power to set the price of that oil. Although many of the participation agreements provided for the resale of oil from BNOC back to the original producers if they needed such oil for their British demand, it was felt that the UKCS marketing system, at the very least, severely limited corporate discretion. At worst, the UKCS marketing system probably lost some lucrative trading opportunities abroad.<sup>701</sup>

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698. *Id.* at 85.

699. The animosity of private industry towards BNOC was exemplified by the comments of Mr. James Longcroft, the Chairman of Tricentrol Oil Company, who regarded BNOC as "a socialist concept." *The Times* (London), Mar. 25, 1983, at 21, col. 3.

700. Industry's position towards BNOC's operating privileges is discussed in Forster & Zillman, *supra* note 600, at 80-81.

701. P. CAMERON, *supra* note 541, at 151.

## 2. Depletion Policy

In the 1970's, it was possible to predict that oil from the UKCS would, for a number of years in the early 1980's, be more than sufficient to meet United Kingdom oil consumption.<sup>702</sup> Actually, self-sufficiency occurred faster than some earlier forecasts suggested because the two oil crises resulted in an impressive degree of conservation.<sup>703</sup> Additionally, cheaper alternatives, like UKCS natural gas, became increasingly available during the 1970's.<sup>704</sup> So, while energy independence continued to be a goal of both British and American governments after the 1973-74 embargo, the faster rate of development in the UKCS, allied with its relatively greater riches, presented the British with the additional problem of how to deal with overproduction. Early in 1980, the United Kingdom Offshore Operators Association (UKOOA) estimated that continental shelf oil production would peak at about 2.3 million barrels per day in 1982-83.<sup>705</sup> Assuming that British consumption would continue at about 1.8 million barrels per day, the study postulated that the United Kingdom would produce more than her net requirements for as long as from 1981 to 1987.<sup>706</sup> Further assuming that British consumption did not fall very far from the 1.8 million barrels per day figure, there were a number of methods the government could employ in extending the period of self-sufficiency.

In particular, the government could utilise the production controls unilaterally created by the previous Labour government. The oil companies were opposed to this option. If implemented, production controls would restrict oil trading when the price was rising and when demand was very strong.<sup>707</sup> Because the oil industry had sunk large amounts of resources into the development of fields that might not be allowed to produce properly, there was a possibility that further inequity might result. Wider economic and, indeed, international arguments, could also be deployed against the use of production controls. Oil exports, of course, improve balance of payments. But in the international context, a

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702. See *supra* note 688 and accompanying text.

703. United Kingdom oil consumption dropped 35% between 1973 and 1983. The Energy Dilemma, an address by J.M. Raisman, Chairman and Chief Executive of Shell U.K. Ltd., to the Coal Industry Society, Hyde Park Hotel, London 2 (Feb. 7, 1983).

704. *Id.*

705. Shell U.K. Ltd., *supra* note 584, at chart 2.

706. *Id.*

707. During the summer of 1979, exceptionally strong demand created a "Western panic to get oil from all sources almost regardless of cost . . ." The Daily Telegraph (London), July 3, 1979, at 21, col. 2.

reduction in oil flow would cause rifts between Britain and her European partners. The EEC could potentially be damaged by the prospect of West Germany and France suffering from a shortage of oil, while the Community's only large producer simultaneously restricted supply. It was also argued that production control would limit corporate cash flow and therefore deny the oil industry the internal financing it required to undertake new exploration and development.<sup>708</sup> It should be observed at this point that production restraint is not the only method of depletion policy, but it is the most effective. Delaying the approval of development plans, for instance, is yet another method. But because of lead times, however, such deferrals do not affect production immediately.

### 3. Exploration Policy

The years 1979-80 were dismal years for exploratory activity on the UKCS. In 1979, only thirty-three exploration wells—less than half of the seventy-nine exploratory wells sunk in 1975—were drilled.<sup>709</sup> In 1978, the UKOOA estimated that exploratory rates would have to double in order to produce the smaller, more complex discoveries likely to extend British self-sufficiency into the 1990's.<sup>710</sup> Here, a strong comparison can be drawn between offshore exploration in the United Kingdom and the United States. In both countries, it is believed that future oil supplies will be primarily drawn from deepwater fields in frontier continental shelf areas. The profitability of the British oil industry, like its American counterpart, depends on access to adequate hydrocarbon reserves. The UKCS and the Norwegian Continental Shelf are the only major oil-producing regions in Western Europe. If oil corporations are to continue to support their British refining capacity, then a geographically proximate and politically stable supply is vital.

Unfortunately, neither the UKCS nor the American OCS were being adequately explored at the close of the 1970's. United Kingdom operators tended to blame BNOC, the tax regime, and the disappointing availability of licence acreage as the dominant reasons for the British slowdown. The Labour government's policy in the fifth and sixth rounds had focused on reducing the number of blocks to be offered; 117 blocks had been offered in those two rounds, while 435 had been offered in the

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708. Shell U.K. Ltd., *supra* note 584, at 5.

709. U. K. DEP'T OF ENERGY, *supra* note 534, at 34.

710. Hirst, *How fast should we deplete our reserves?*, The Times (London), Apr. 25, 1980 (special feature), at II, col. 4.

fourth round.<sup>711</sup> As the price of oil began to rise steeply in 1979-80, oil companies understandably wished to gain access to new offshore areas. The UKOOA reckoned that at the start of the 1970's, thirty-three percent of the UKCS had been licenced. By 1980, the organisation claimed, this area had dropped to ten percent.<sup>712</sup>

#### 4. Taxation

When a rise in PRT was first considered in 1978, there were mutterings from the multinational oil corporations about an imminent departure from the North Sea.<sup>713</sup> When the Conservatives came to office in 1979, the oil industry asserted that the tax regime was too rigorous. High taxation, they argued, could just as easily rob the industry of the necessary funds for continuing exploration and development as could production controls.<sup>714</sup> The UKOOA view was well summed up in the words of J. M. Raisman, the Chairman of Shell U.K. Limited:

If North Sea oil is seen primarily as a floating fund for servicing the Public Sector Borrowing Requirement, or as a mechanism for a quick fix whenever a new economic ailment manifests itself on the body politic, it can only disrupt the steady progress that is essential if its development is to provide a sound basis for the future prosperity of this country.<sup>715</sup>

### C. Stage One

An analysis will now be undertaken of the Conservative government's handling of the preceding four areas from May 1979 to September 1981. The forthcoming discussion will suggest that initial Tory energy policy never reached the same degree of harmony as that demonstrated by the programs of Secretaries Watt, Clark, and Hodel.

#### 1. BNOC

It is the opinion of Forster and Zillman that if Mrs. Thatcher had been elected in 1976 or 1977, it is probable that BNOC would have been an early casualty of the new economic policy.<sup>716</sup> But in 1979, while the

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711. U. K. DEP'T OF ENERGY, *supra* note 534, at 32.

712. Hirst, *supra* note 710, at II, col. 4.

713. See *North Sea oil companies over a barrel*, THE ECONOMIST, July 29, 1978, at 86.

714. See, e.g., The Daily Telegraph (London), May 5, 1979, at 23, col. 2 (noting Esso's view of British oil taxation).

715. North Sea Oil: The Economic Opportunities, an address by J.M. Raisman, Chairman and Chief Executive of Shell U.K. Ltd., to the Guild Club, St. Andrews University, St. Andrews, Scotland 5 (Jan. 21, 1981).

716. Forster & Zillman, *supra* note 600, at 78-79.

Conservatives remained sympathetic towards many of the oil industry's complaints, their election manifesto merely stated that "[w]e shall undertake a complete review of all the activities of the British National Oil Corporation as soon as we take office."<sup>717</sup> The reason for the party's caution was grounded in the second oil crisis. Despite the fact that the United Kingdom was nearly self-sufficient in 1979, the country still suffered shortages<sup>718</sup> because of the exportation of high quality North Sea crude oil. To compensate for this exportation, reliance was placed on cheaper imported oil,<sup>719</sup> which became increasingly scarce during the summer of 1979.

Far from slackening state controls over oil supply, the Conservatives found it necessary to tighten them. In June 1979, oil companies were given six months notice that royalties would be required in kind.<sup>720</sup> Secretary Howell also used his discretion to limit flaring of natural gas in an attempt to encourage corporations to channel supplies of oil to the United Kingdom.<sup>721</sup> For some time the supply situation looked very grave, and many companies found that their available stocks were becoming insufficient to meet more than two months of normal demand. As a result, many corporations introduced a voluntary system of rationing.<sup>722</sup>

BNOC played a vital role during the crisis. Its option to purchase a majority of British North Sea oil stocks<sup>723</sup> placed Mrs. Thatcher in a much stronger position than Mr. Heath had been in during the first oil crisis. Though BNOC did not completely refrain from exporting its supplies, it did direct much more oil into the home market "to ease supply difficulties."<sup>724</sup> In June 1979, plans to scrap BNOC completely were dropped.<sup>725</sup> As *The Economist* remarked in the same month, "[o]il supply and price chaos could not have come at a better time for the British National Oil Corporation (BNOC), as it fights to survive under the Tories."<sup>726</sup>

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717. *Financial Times* (London), Apr. 12, 1979, at 11, col. 6.

718. *Why the North Sea gushes, but the pumps run dry*, *THE ECONOMIST*, June 16, 1979, at 77.

719. *See UK Refinery Closures and North Sea Exports*, *SHELL U.K. REPORTS*, Nov. 12, 1981.

720. *The Tories are learning to love BNOC*, *THE ECONOMIST*, June 9, 1979, at 111, 111.

721. Gribben, *Study into gas pipeline network*, *The Daily Telegraph* (London), June 26, 1979, at 21, col. 2.

722. Texaco, for instance, introduced rationing of its sales at the beginning of May 1979. *The Daily Telegraph* (London), May 2, 1979, at 19, col. 2.

723. *See North Sea oil companies over a barrel*, *supra* note 713, at 86.

724. *See The Daily Telegraph* (London), July 26, 1979, at 21, col. 6.

725. *Id.*, June 2, 1979, at 19, col. 3.

726. *See The Tories are learning to love BNOC*, *supra* note 720, at 111.

Notwithstanding the fact that BNOC had impressed the government with its usefulness as a state oil trader, the Conservative party still objected to its operating role and associated privileges. These considerations surfaced when Secretary Howell made an important announcement concerning BNOC's immediate future in the House of Commons on July 26, 1979.<sup>727</sup> Mr. Howell's statement expressed disappointment with a "serious decline in offshore activity" and blamed BNOC for being "a drag on North Sea development."<sup>728</sup> He went on to outline major restrictions on BNOC's operating privileges.<sup>729</sup> Specifically, the corporation's access to state financing via the National Oil Account was to be terminated, as was the PRT exemption.<sup>730</sup> BNOC was to lose its opportunity to obtain licences outside licensing rounds and its first refusal rights.<sup>731</sup> Moreover, in the future it would have no right to sit on the operating committees of licences in which it held no equity share.<sup>732</sup> Its advisory relationship with the government was also to be terminated, and there would be no requirement in future licensing rounds that applications offer BNOC a fifty-one percent equity holding.<sup>733</sup> Most of these changes were effectuated by ministerial directives, but BNOC's new PRT liability was statutorily created by section 22 of the Finance Act (No. 2) 1979,<sup>734</sup> and BNOC's right to apply for licences at any time was removed by the Petroleum (Production) (Amendment) Regulations 1980.<sup>735</sup> The latter regulations also instituted a return to two-term licences<sup>736</sup> and have subsequently been reenacted in the Petroleum (Production) Regulations 1982.<sup>737</sup> The initial term for UKCS production licences is now six years, and the continuing term is thirty years.<sup>738</sup> In connection with the latter term, there has also been a reduction in the surrender requirements.<sup>739</sup> Secretary Howell hoped that BNOC's more limited role would provide "the new impetus to restore exploration in the North Sea."<sup>740</sup>

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727. The Daily Telegraph (London), July 27, 1979, at 1, col. 6 (the government announced that BNOC could serve its purpose through "a much more limited role").

728. 971 PARL. DEB., H.C. (5th ser.) 894 (1979).

729. See *Howell slaps one of BNOC's faces*, THE ECONOMIST, July 28, 1979, at 87, 87-88.

730. *Id.*

731. *Id.*

732. *Id.*

733. *Id.*

734. Finance Act (No. 2), 1979, ch. 47, § 22.

735. Petroleum (Production) (Amendment) Regulations, 1980 STAT. INST. NO. 721, sched. 1.

736. See *id.* at sched. 2, (b).

737. Petroleum (Production) Regulations, 1982 STAT. INST. NO. 1000, Reg. 6(6) & sched. 5, cl.

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738. *Id.* at sched. 5, cl. 3.

739. *Id.* at sched. 5, cls. 4-6.

740. The Daily Telegraph (London), July 27, 1979, at 10, col. 1.

Despite the preceding changes, it was also announced that BNOC's marketing operations would remain in state hands.<sup>741</sup> No definite pledge was set forth for BNOC's exploratory and development division. The only light cast on this subject was Secretary Howell's remark that the corporation's offshore assets, conservatively estimated to be worth £1000 million in 1979,<sup>742</sup> "should be more widely owned."<sup>743</sup> The privatisation of such assets proved a tempting proposition for the government's Treasury Department, whose new monetarist policy continually sought ways to cut PSBR.<sup>744</sup> In the short-term, PSBR was reduced by requiring BNOC in October 1979 to negotiate a £500 million forward sale of oil.<sup>745</sup> The BNOC could confidently embark on the negotiation of such a contract because of its quasi-monopoly hold over oil supplies. The same tactic was used again in 1981.<sup>746</sup> In the late autumn of 1979, the government began making plans to privatise BNOC's upstream activities.<sup>747</sup> This proved to be a much more difficult task than originally envisaged for a number of reasons.

To begin with, the government was afraid that if it sold BNOC's operating division in a period of escalating oil prices (and an impending Gulf war), it would be open to the charge that it had disposed of a valuable, appreciating corporation. Accordingly, the government would be vulnerable to Labour's charge that selling BNOC was nothing other than a favor to City of London financiers.

BNOC's position was also very different from many of Britain's other state industries. Instead of being structurally unsound, labor-intensive, and ailing, BNOC was new, capital-intensive, and moderately profitable. In April 1980, Mr. Ronald Utiger, BNOC's new chairman, vigorously defended his corporation's record. He claimed that BNOC had met government profitability targets set in 1978, drilled more UKCS exploration wells than any other operator, and provided excellent service to the country during the 1979 oil crisis.<sup>748</sup> BNOC's profits, which were all paid into the National Oil Account, were a matter of particular pride to the state oil company. When allied with estimated profits of £1000 million per year during the coming period of peak North Sea produc-

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741. Forster & Zillman, *supra* note 600, at 80.

742. The Daily Telegraph (London), July 28, 1979, at 1, col. 2.

743. Forster & Zillman, *supra* note 600, at 80 n. 111.

744. P. CAMERON, *supra* note 541, at 166.

745. *Any advance on £500m?*, THE ECONOMIST, Oct. 13, 1979, at 90, 90.

746. Forster & Zillman, *supra* note 600, at 80.

747. See The Daily Telegraph (London), Nov. 12, 1979, at 36, col. 5.

748. *Id.*, Apr. 22, 1980, at 17, col. 2.



tion,<sup>749</sup> the government realised that it might be financially more lucrative for the Treasury if BNOC's operating arm was retained.

A third difficulty lay in the mechanics of privatisation. No British government had ever attempted large-scale denationalisation before. A particularly perplexing issue concerned the best means of transferring BNOC's upstream division into the private sector. If the assets were simply auctioned off, the probable beneficiaries of the former state holdings would be the oil companies, possibly at a bargain price. If a subsidiary was created and shares sold on the stock markets, questions would arise as to the attractiveness of the equity, how to offer it, and whether the markets could quickly cope with what would certainly be a very large influx of buying. Since the government wished to retain BNOC's role in oil trading, it was thought that any privatisation scheme would require highly complex renegotiation of previous participation agreements.<sup>750</sup>

Notwithstanding these problems, the Conservative government, a few months after it was elected, began considering how best to introduce private equity into BNOC. But by the end of March 1980, it was announced that the privatisation measures would be delayed till autumn of that year.<sup>751</sup> The practical working out of the proposed denationalisation scheme proved so arduous a task that the Energy Department temporarily channeled its efforts into creating an opportunity for the public to contribute loan capital to BNOC.<sup>752</sup> It was envisaged that the loan stock scheme (often referred to as the "LASMO" scheme because the London and Scottish Marine Oil Company had utilised a similar idea for raising debentures) would involve members of the public lending money to the state corporation for particular fields in which BNOC held licence equity.<sup>753</sup> The profitability of the bonds would be linked to development of the appropriate individual fields.<sup>754</sup> Secretary Howell introduced the loan stock plan to the Conservative party conference in October 1980. He propounded it as a chance to spread the spoils of the North Sea over a wide section of the British public.<sup>755</sup> The bonds would be available at post offices in denominations as small as ten to twenty-five pounds.<sup>756</sup>

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749. *Id.*, June 30, 1980, at 17, col. 4.

750. *Id.*

751. *Id.*, Mar. 26, 1980, at 21, col. 2.

752. See Baker & Daniel, *supra* note 655, at 151-52; *The Times* (London), Aug. 6, 1980, at 19, col. 3.

753. *The Times* (London), Oct. 10, 1980, at 4, col. 2.

754. *Id.*

755. *Id.*

756. *Id.*

He also proposed that legislation be brought before the House of Commons to facilitate the long awaited privatisation of BNOC's operating division.<sup>757</sup> It was carefully emphasised that neither measure would endanger the security of Britain's supply.<sup>758</sup>

Many members of the Conservative party saw the loan stock scheme as merely a way of covering up the government's failure to go ahead with denationalisation. The Selsden group of Conservative M.P.'s, for instance, thought it was "just one more example of the Government's words being braver than their actions."<sup>759</sup> They argued that the public loans to BNOC could never reduce PSBR or the state's role in the oil industry.

The Petroleum and Continental Shelf Bill, introduced into Parliament in February 1981, gave BNOC the right to create subsidiaries to take over its exploration and production activities.<sup>760</sup> Shares in the subsidiary or subsidiaries could then be sold to the public on approval of the Department of Energy and the Treasury.<sup>761</sup> Mr. Hamish Gray, Minister of State for Energy, confirmed shortly after the bill's introduction that no particular plan for the sale of BNOC equity had been singled out for special consideration.<sup>762</sup> The loan stock proposal did not require legislation.<sup>763</sup>

On March 26, 1981, the Leader of the House of Commons, Mr. Francis Pym, announced that the Petroleum and Continental Shelf Bill was being dropped from the legislative timetable for that session of Parliament because the bill had run out of time.<sup>764</sup> In the same month, *The Times* reported that "[g]overnment ministers, except for Mr. David Howell, Secretary of State for Energy, are lukewarm at best over bringing private capital into BNOC."<sup>765</sup> Nevertheless, the commitment continued.<sup>766</sup>

Mr. Geoffrey Howe, the Chancellor of the Exchequer, elaborated on the loan stock plan in his budget speech of March 1981. He proposed the issuance of about £500 million worth of the small bonds described

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757. *Id.*

758. *Id.*

759. *Id.* at 19, col. 5.

760. *Id.*, Feb. 14, 1981, at 19, col. 2.

761. *Id.*

762. *Id.*

763. *Id.*

764. See Baker & Daniel, *supra* note 655, at 151.

765. *The Times* (London), Mar. 20, 1981, at 17, col. 2.

766. See Baker & Daniel, *supra* note 655, at 151.

above.<sup>767</sup> But as spring turned into summer, no further concrete developments occurred, except continuing behind the scenes negotiation. At least one commentator was therefore forced to conclude that "in two and a half years as Energy Secretary David Howell had carried out virtually none of the privatization pledges which the Government had made before coming into power."<sup>768</sup>

## 2. Depletion Policy

It was not until the beginning of 1980 that the Conservative government announced its intention to use some form of depletion control to iron out the "hump" of overproduction expected in the first half of the 1980's.<sup>769</sup> Mr. Howell did not specify what form this action would take. Previously, the approach had been to encourage maximum production, a policy which was seen as creating the most beneficial effects on balance of payments and Treasury receipts.

A potential set of obstacles to the government's depletion policy were the Varley Assurances given during the previous Labour government.<sup>770</sup> The Varley Assurances precluded any use of production controls on most North Sea fields until 1982 at the earliest. They also limited the scope of production restrictions with respect to following years. The Conservatives had no wish to alter the status of a set of guarantees which they had previously ratified.<sup>771</sup>

Mr. Howell wished to furnish the oil industry with a concise exposition of the new depletion system before applications for licence acreage to be awarded in the seventh round of licensing became due in August 1980. The government's plans for curtailing output were explained in the House of Commons on July 26, 1980,<sup>772</sup> when the Secretary for Energy stated that "on strategic and security of supply grounds it is in the national interest to prolong high levels of United Kingdom Continental Shelf production to the end of this century."<sup>773</sup> This could be achieved partly by increased exploration and partly by the deferral of some pro-

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767. Phillips, *BNO share sale runs out of time*, *The Times* (London), Mar. 26, 1981, at 19, col. 4.

768. Stothard, *How high-speed Lawson stirred up Energy*, *The Times* (London), Oct. 21, 1981, at 12, col. 1.

769. *The Times* (London), Jan. 3, 1980, at 13, col. 2.

770. *See supra* notes 611-14 and accompanying text.

771. *See, e.g.*, *The Times* (London), May 20, 1980, at 6, col. 3 (statement of David Howell in the House of Commons, May 19, 1980).

772. *Shell U.K. Ltd.*, *supra* note 584, at 8.

773. *Id.*

duction. No cutbacks on output would be considered until the Varley Assurances ran out. Mr. Howell preferred to ensure that each reservoir was developed to its fullest potential. He also intended to consider delaying the approval of development plans for fields discovered after 1975.<sup>774</sup>

The fact that the government had initially overestimated North Sea output considerably eased its overproduction problems. For instance, it had been estimated that production in 1980 would be around 80 to 85 million tonnes, and that 85 to 105 million tonnes would be produced in 1981.<sup>775</sup> But in actuality, only 80.5 million tonnes were produced in 1980, and 89.4 million tonnes were produced in 1981.<sup>776</sup> This shortfall was largely caused by technical development problems.

In the wake of Mr. Howell's announcement, the Department of Energy began evaluating development plans to ascertain whether any plan could be suitably delayed. In December 1980, BNOC, the operator of the Clyde field, was directed to postpone its development programme for two years.<sup>777</sup> However, no further development plans were delayed during Secretary Howell's incumbency because no other such plans were submitted.<sup>778</sup>

### 3. Exploration Policy

The government's removal of BNOC's operating privileges and its intention to privatise the state oil company's upstream division were significant elements in the government's initial attempts to encourage UKCS exploration. But possibly the most important strand in the Department of Energy's strategy was the seventh round of licensing held in 1980 in response to the UKOOA's repeated pleas for more offshore acreage.

The discretionary allocation system used in former rounds was continued with an interesting innovation in the method of application for some of the blocks. In keeping with government policy, the requirement that BNOC be offered a fifty-one percent or more equity stake in each license was dropped and substituted with a requirement that BNOC be given the right to buy more than half of the petroleum produced for a

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774. *Id.*

775. Hirst, *How fast should the oil flow?*, *The Times* (London), July 18, 1980, at 21, col. 3.

776. U. K. DEP'T OF ENERGY, *supra* note 534, at 22.

777. See Forster & Zillman, *supra* note 600, at 85.

778. Stewart-Gordon, *Hamish Gray's Elegy*, *WORLD OIL*, June 1982, at 45, 45.

given licence.<sup>779</sup> The exploration programme was retained as the British equivalent to the American bid variable. But, as in the past, other criteria continued to play an important role in the selection process.<sup>780</sup>

Pursuant to the old block-specific fashion, eighty blocks were originally offered, primarily in frontier areas such as the West Shetlands, the English Channel, and the Southwestern Approaches.<sup>781</sup> At slightly more than five million acres, this round of licensing constituted nearly twice the area offered for OCS leasing in 1980.<sup>782</sup> At the UKOOA's prompting, however, a further huge region of well explored, but highly lucrative acreage in the northern North Sea was opened to corporate nomination upon payment of a five million pound fee per block.<sup>783</sup> The object of this offering was to elicit industry input into the licensing process,<sup>784</sup> a goal which strongly resembled the purpose behind the MMS's Call for Information. An auction of the blocks, for which there was precedent in the fourth round, was ruled out because, like earlier administrations, the government was afraid that competitive bidding might serve to exclude the smaller British independent oil companies.<sup>785</sup>

The experimentation employed in the seventh round proved to be a noteworthy success. One hundred and twenty-five applications, more than that received for any other round, were submitted<sup>786</sup> for ninety-five blocks, forty of which were in the nominations area.<sup>787</sup> Nomination payments totalled £210 million.<sup>788</sup>

The major reason for the success of the seventh round was indus-

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779. See Hirst, *Oil companies given more scope in licensing of 90 North Sea blocks*, *The Times* (London), May 2, 1980, at 19, col. 3.

780. The other criteria may be summarised as follows: (A) technical competence, (B) access to adequate financing, (C) the applicants' previous performance in meeting licence obligations, (D) exploration already undertaken by the applicant in the area presently being applied for, (E) the contribution the applicant has, or plans to make, to the British economy, with special emphasis on balance of payments and industrial growth, (F) whether a foreign applicant's government treats British companies equitably, (G) whether the applicant has provided, or intends to provide, British industry full and fair opportunity to compete for orders of goods and services, (H) whether the applicant is prepared to work with independent trade unions, and (I) the applicant's record in training employees for offshore work. *Gazette Notice of 4th July 1980, reprinted in OIL AND GAS LAW: THE NORTH SEA EXPLOITATION 3.1915-1916* (H. Henderson ed. 1982).

781. U. K. DEP'T OF ENERGY, *supra* note 534, at 32.

782. See MINERALS MGMT. SERVICE, *supra* note 549, at 16.

783. Millard, *supra* note 545, at 428.

784. Later reports indicated that "[t]he seventh round was popular because, for the first time, companies were able to nominate which blocks they wanted." *THE ECONOMIST*, Aug. 16, 1980, at 71, 71.

785. *The Times* (London), May 2, 1980, at 19, col. 3.

786. Hirst & Gunn, *Gambling on a Gusher*, *The Times* (London), Dec. 8, 1980, at 17, col. 1.

787. *Id.*

788. *Id.*, Dec. 17, 1980, at 15, col. 4.

try's eagerness to explore new areas. Other influential factors included the still rising price of oil (the official price for North Sea crude eventually rose to a high in 1981 of \$39.25 a barrel<sup>789</sup>) and a government supported plan to build a gas-gathering pipeline which would provide a 572 mile long grid for the Scottish oilfields.<sup>790</sup> This plan would have allowed for the speedier and more profitable development of discoveries in the northern North Sea, because the wasteful flaring of gas and its associated tight government supervision would no longer be necessary. However, the plan, which would have been one of the single most costly British investments of the century, was scrapped in September 1981.<sup>791</sup>

#### 4. Taxation

The government's oil taxation policy had been consistently geared to the reduction of PSBR. The burgeoning North Sea fiscal payments occurred simultaneously with the Conservatives' election to power. In 1978-79, the total tax collected from offshore operations stood at a modest £562 million.<sup>792</sup> By 1979-80, PRT payments alone swelled to £1436 million and rose to £2410 million in 1980-81.<sup>793</sup> Mr. Leon Brittan, Chief Secretary to the Treasury, acknowledged the fiscal importance of North Sea oil in May 1981: "Without these revenues, government borrowing would be higher and so interest rates would be higher, within a given rate of monetary growth."<sup>794</sup>

In 1979, when the United Kingdom embarked upon its worst recession in forty years and when oil company profits, as well as the price of oil, continued to rise, it again became inevitable that the British government would attempt to maximise its economic rent. Before the enactment of the Finance Act (No. 2) 1979,<sup>795</sup> Geoffrey Howe, the Chancellor of the Exchequer, said, "I have judged [the rises] now against a background of recent rises in the price of oil. On that basis . . . proposals for giving the Government more revenue from the North Sea are now fully justified."<sup>796</sup> To the disappointment of the oil industry, the Conserva-

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789. *See id.*, June 6, 1981, at 1, col. 6.

790. *Ready for the match*, THE ECONOMIST, June 21, 1980, at 71, 71.

791. Williams & Morris, *New Treasury doubts threaten gas pipeline*, The Times (London), Sept. 5, 1981, at 17, col. 2.

792. U. K. DEP'T OF ENERGY, *supra* note 534, at 20.

793. *Id.*

794. *See Williams, Frittering Away the North Sea's Riches*, The Times (London), Dec. 14, 1981, at 15, col. 3.

795. Finance Act (No. 2), 1979, ch. 47.

796. Salomons, *A Promise Fulfilled*, 19 EUR. TAX'N 231, 232 (1979).

tives opted for a rise in PRT to sixty percent<sup>797</sup> and a reduction in the PRT allowances planned by the previous Labour government.<sup>798</sup> Capital allowances were reduced from 175 to 135%,<sup>799</sup> and the oil allowance was reduced from ten million to five million tonnes per field.<sup>800</sup>

The 1980 budget raised PRT from sixty to seventy percent<sup>801</sup> and required that in addition to regular PRT payments, further sums of fifteen percent of estimated PRT liability for the next year would be payable with respect to any chargeable year.<sup>802</sup> The advance payments were a device designed to improve Treasury cash flow. Labour regarded these changes as inadequate,<sup>803</sup> while some Conservatives saw them as too radical.<sup>804</sup>

In any event, the oil industry suffered a much more severe jolt with the unveiling of Secretary Howe's "mini-budget" of November 1980. Specifically, it was announced that the budget of 1981 would provide for a Supplementary Petroleum Duty (SPD) to be introduced for a trial period of eighteen months.<sup>805</sup> The Finance Act 1981<sup>806</sup> stipulated that SPD was to be levied at twenty percent against oil company revenues derived from UKCS oilfields.<sup>807</sup> This levy was to be used in conjunction with the PRT, the corporation tax, and royalties. Unlike the PRT and the corporation tax, which were chargeable against net profits, the SPD was charged against gross revenues and hence functioned as a type of royalty.<sup>808</sup> It was estimated that the new duty would raise £1000 million in its first year and result in some fields being taxed at a marginal rate of ninety percent.<sup>809</sup> A further important change in PRT was also made. The Oil Taxation Act 1975 was amended to the effect that for any chargeable period, profits in excess of fifteen percent of capital expendi-

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797. Finance Act (No. 2), 1979, ch. 47, § 18(1).

798. Salomons, *supra* note 796, at 232.

799. Finance Act (No. 2), 1979, ch. 47, § 19.

800. *Id.* § 21.

801. Finance Act, 1980, ch. 48, § 104.

802. *Id.* § 105.

803. The Times (London), May 22, 1980, at 6, col. 1.

804. One Conservative, Mr. Trevor Skeet, remarked that government fiscal policy was "about extracting as much as they could from the oil companies." The Times (London), June 5, 1980, at 6, col. 4.

805. *United Kingdom: Public Spending Cuts and Tax Increases in the Forecast for 1981-82*, 20 EUR. TAX'N 373, 373 (1980).

806. Finance Act, 1981, ch. 35.

807. *Id.* § 122(2).

808. *Id.* § 122(1).

809. During the passage of the Finance Bill, Mr. Philip Shelbourne, the new chairman of BNO, indicated that a 90% tax on profits was unreasonable and that a 50% rate would be more appropriate. The Times (London), Mar. 15, 1981, at 20.

ture would be chargeable to PRT.<sup>810</sup>

Prior to the passage of the Finance Act 1981, the UKOOA lobbied intensively against the new changes in oil taxation. They offered to put up £1000 million for the Treasury if the Chancellor would consider other methods to increase tax collection. Mr. Howe refused the offer, but in March 1981 he did invite the oil companies to discuss with Treasury officials how, given the objectives of government and industry, the UKCS fiscal regime could be profitably altered.<sup>811</sup> Meanwhile, the oil tax provisions of the Finance Act 1981 made the UKCS one of the most highly taxed oil provinces in the world. As a result, the fiscal regime began to reflect the same unfortunate consequences anticipated by the United States Department of the Interior with regard to royalty and net profits bidding.<sup>812</sup> Thus it was the taxation system, in conjunction with the falling price of oil, which caused the complete dearth of development applications between December 1980 and March 1982.<sup>813</sup>

In the context of the United Kingdom, the SPD had a particularly adverse impact. Unlike the PRT, the SPD allowed for no capital expenditure relief.<sup>814</sup> This meant that the smaller, more technically complex fields, which were likely to be the mainstay of future UKCS production, would become subject to SPD once they attained profitability. Consequently, the SPD effectively discouraged the development of such fields. Shell and Esso, for instance, in April 1982, decided to defer development of the Tern and Eider fields, estimated to contain 140 and 120 million barrels respectively.<sup>815</sup> Given that very few new discoveries were likely to be larger than 150 million barrels,<sup>816</sup> the actions of Shell and Esso highlighted a potentially deleterious new trend.

A further problem caused by the government's tax policy in this initial period was that constant fiscal alterations made offshore investment planning very difficult. Speaking before the House of Commons Select Committee on Energy, Mr. Bexon of BP stated: "How can we make investment decisions when we don't know what Government fiscal

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810. Finance Act, 1981, ch. 35, § 114(1).

811. The Times (London), Mar. 24, 1981, at 7.

812. See *Pumping the Oilmen*, THE ECONOMIST, Mar. 14, 1981, at 62, 63 ("Oil companies will curb production to limit tax payments, and explore for more elsewhere.").

813. See Hirst, *Has Sir Geoffrey gone too far?*, The Times (London), Mar. 23, 1981, at 17, col. 3.

814. See Finance Act, 1981, ch. 35, § 124. There was, however, an oil allowance of 500,000 metric tonnes of oil per field. *Id.*

815. Davis, *£800m North Sea oil project abandoned*, The Times (London), Apr. 23, 1982, at 21, col. 3.

816. *Id.*



policy is going to be?"<sup>817</sup> The lack of stability in the oil taxation system introduced a type of uncertainty into the British oil regime which paralleled the confusion engendered by the dropping of OCS lease sales in the United States.

### 5. Conflicting Goals

As discussed previously, the goals of the Conservative government in relation to offshore oil tend to conflict.<sup>818</sup> Where there is such a conflict, one or more goals must eventually take priority over the rest. In the Conservative administration's first three years of office, the maximisation of revenue and the desire to maintain control over oil supply took precedence over other objectives. Nevertheless, significant steps, such as the abolition of BNOC's privileges and the holding of a market-oriented seventh round of licensing, did much to encourage private sector exploration. The high levels of taxation markedly slowed new developments, as the oil companies preferred to invest their funds in less expensive exploratory drilling.<sup>819</sup> The steadily worsening economic situation was the main reason for the alterations in the fiscal system. As predicted, unemployment increased, and British industry stagnated.<sup>820</sup> A side effect of large North Sea oil exports was the creation of a strong pound, which made it difficult for the rest of British industry to compete in overseas markets.<sup>821</sup> The British economy had seen no large-scale privatisations by the autumn of 1981, as the general caution on the part of the Conservatives contributed to delays in the denationalisation of BNOC's operating arm.<sup>822</sup>

### D. *Stage Two*

In September 1981, Mrs. Thatcher made several substantial changes in her cabinet. A number of ministers who had dissented against the government's monetarist stance were removed, and more sympathetic newcomers were introduced. Mr. David Howell was transferred to the Department of Transportation, and Mr. Nigel Lawson was made the new Secretary of Energy.<sup>823</sup> The latter's appointment eventually led to a rear-

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817. Morris, *BP joins in attack on North Sea policy*, *The Times* (London), July 23, 1981, at 19, col. 2.

818. See *supra* text accompanying notes 696-97.

819. See *The North Sea—how it helps Britain's economy*, SHELL U.K. REPORTS, July 9, 1981.

820. *Lady with any lamp?*, *THE ECONOMIST*, Oct. 10, 1981, at 11, 11.

821. Williams, *supra* note 794, at 15, col. 7.

822. See *The great Tory knock-down sale*, *THE ECONOMIST*, Oct. 24, 1981, at 54, 54.

823. *Mrs. Thatcher repairs the dykes for the rainy season*, *THE ECONOMIST*, Sept. 19, 1981, at 61.

rangement of priorities in Conservative energy policy. Despite the fact that Mr. Lawson has since been elevated to the Chancellorship of the Exchequer, the UKCS oil and gas regime remains in the mold that he fashioned. With Mr. Lawson's influence in mind, the consideration of the four leading issues outlined above will now be continued with reference to the period from autumn 1981 to the present.

## 1. BNOC

After occupying the post of Secretary of Energy for little more than a month, Mr. Lawson announced to the House of Commons on October 19, 1981, that the government intended to introduce legislation which would allow for the privatisation of BNOC's operating arm, the privatisation of BGC's offshore oil interests, the dismemberment of BGC's monopoly on gas supply, and other changes. The new Energy minister described his proposals as being "nothing less than the privatisation of the North Sea."<sup>824</sup> BNOC's oil trading role, however, was to continue unchanged.<sup>825</sup> At the time of these proposals, BNOC had the largest exploratory acreage of any corporation operating in the UKCS.<sup>826</sup> It also had interests in nine oil fields (six of which were then producing) which accounted for about seven percent of known North Sea reserves and which were estimated in 1981 as being worth between £1500 to £2000 million.<sup>827</sup> BGC owned interests in five producing offshore fields, worth an estimated £1000 million and accounting for about 0.5% of offshore reserves.<sup>828</sup>

The legislative embodiment of Mr. Lawson's proposals was introduced into Parliament on December 17, 1981.<sup>829</sup> The speed with which the denationalisation scheme was advanced was largely motivated by the government's funding needs, which became ever greater as the recession worsened.<sup>830</sup> An additional impetus was provided by the Secretary of Energy's "deep gut belief in the benefits of bringing private capital into the publicly owned industries."<sup>831</sup> The government rejected the asset

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824. Hill, *£1,500m sale of State's North Sea Oil*, *The Times* (London), Oct. 20, 1981, at 1, col. 2; see also Energy Act, 1976, ch. 76, § 8 (establishing BGC's monopoly rights over the supply of natural gas).

825. See *The Times* (London), Oct. 20, 1981, at 1, col. 2.

826. *Id.* at 6, col. 1.

827. *Id.*

828. *Id.* at 21, col. 3.

829. *The Times* (London), Dec. 18, 1981, at 1, col. 3.

830. *Id.*, Oct. 20, 1981, at 6, col. 1.

831. Stothard, *supra* note 768, at 12, col. 1.

auctioning approach to privatisation. On November 10, 1981, Mr. Lawson had stated in the House of Commons that BNOC's upstream assets would be used to create a new British oil company, to be called "Britoil," the shares of which would be floated on the stock markets.<sup>832</sup> Secretary Lawson had promised that the new corporation's articles of association would provide for a substantial measure of state control.<sup>833</sup> Though the government would own less than fifty percent of the shares, the state would have the option of appropriating majority powers, when, for example, it came to the election of directors.<sup>834</sup> This feature was intended to ensure that ownership of the company would not fall into unacceptable hands.<sup>835</sup> The projected plans also called for the creation of a "BP" type relationship between state and corporations.<sup>836</sup> It was additionally envisaged that Britoil would be formed and operational by autumn 1982, with shares being offered to the public by the end of 1982.<sup>837</sup> The loan stock scheme, never having been implemented, was quietly dropped.<sup>838</sup>

The Oil and Gas (Enterprise) Act 1982<sup>839</sup> received the Royal Assent on June 28, 1982. Sections 1 and 2 of the Act give BNOC the power to organise, register, and dispose of the shares of subsidiaries whose principal object is the exploration, development, and production of petroleum.<sup>840</sup> However, no such shares can be disposed of without the concurrence of the Energy Department and the Treasury.<sup>841</sup> Section 3 provides that the Secretary of Energy can direct BNOC to use the powers granted to it in sections 1 and 2.<sup>842</sup> Any proceeds of equity disposals are payable to the Secretary.<sup>843</sup> The Secretary may also, with the agreement of the Treasury, request that the shares of any such subsidiary be transferred to him or his nominee.<sup>844</sup> Although the National Oil Account was abolished,<sup>845</sup> it was provided that in the future, BNOC must, on the request of the Secretary of Energy and with the approval of the Treasury,

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832. The Times (London), Nov. 11, 1981, at 4, col. 6.

833. *Id.*

834. *Id.*

835. *Id.*

836. *Id.*; see *supra* notes 499-501 and accompanying text.

837. The Times (London), Dec. 18, 1981, at 1, col. 3.

838. Williams, *North Sea Oil public share plan scrapped*, The Times (London), Dec. 5, 1981, at 17, col. 2.

839. Oil and Gas (Enterprise) Act, 1982, ch. 23.

840. *Id.* §§ 1, 2.

841. *Id.* § 1(2).

842. *Id.* § 3.

843. *Id.* § 3(3).

844. *Id.* § 3(4), (7).

845. *Id.* § 8(1).

pay its annual profits into the fund in which all taxes are paid, the Consolidated Fund.<sup>846</sup> Sections 9, 10, and 11 create the same types of powers and duties for BGC as sections 1, 2, and 3 do for BNOC.<sup>847</sup> Section 12 of the Act ends BGC's monopoly over gas supply.<sup>848</sup> These statutory provisions were to be the machinery which would denationalise BGC's offshore oil fields.

As planned, the upstream assets of BNOC were transferred to Britoil, a company registered in Scotland, in August 1982.<sup>849</sup> At that point, only the timing of the sale was left to be resolved. The renegotiation of BNOC's participation agreements did not prove to be as difficult as had been previously thought. Nevertheless, major obstacles were encountered in the creation of Britoil and its subsequent flotation.

First, several problems arose over the issue of fair market value for Britoil shares. Beginning in the summer of 1981, oil prices tumbled from a high of \$39.25 to \$30.00 per barrel by March 1982.<sup>850</sup> North Sea oil lost fifteen percent of its value in February 1982 alone. Because of an oversupply of about three million barrels a day on the world market, the recession, and conservation, a glut of oil began to build up.<sup>851</sup> The resulting value of oil equities provoked Mr. Edward Rowlands, a Labour spokesman on energy, to comment, "nobody in his right mind would try to sell a large number of oil shares in the current situation."<sup>852</sup> Against this background, a related and similarly vexing "fair market" difficulty arose over the best method of selling the Britoil portfolio. The February 15, 1982 sale of Amersham International, a state-owned manufacturer of radioactive isotopes, provided a valuable lesson in the possible pitfalls of privatisation. Shares that were originally offered at 142p each were oversubscribed twenty-three times, and within two days shares were selling at 192p.<sup>853</sup> The Amersham sale was regarded as the type of debacle to be avoided if at all possible in the much larger Britoil flotation. In addition, Labour introduced further uncertainty into the flotation by pledging to renationalise Britoil upon regaining office and thereafter to grant compensation on the basis of "non-speculative" profits.<sup>854</sup>

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846. *Id.* § 5(1), (3).

847. *Id.* §§ 9-11.

848. *Id.* § 12.

849. *The Times* (London), Nov. 12, 1982 (Britoil prospectus supplement), at I, col. 1.

850. *Id.*, Mar. 2, 1982, at 15, col. 1.

851. *Id.*, Mar. 3, 1982, at 1, col. 2.

852. *Id.*, July 27, 1982, at 4, col. 1.

853. *The Times* (London), Feb. 27, 1982, at 13, col. 3.

854. *See, e.g., id.*, Nov. 11, 1981, at 4, col. 6 (statements of Labour M.P.'s Merlyn Rees and Anthony Benn in the House of Commons, Nov. 10, 1981).

It was also suggested by some economic analysts that Britoil would be a badly structured oil company.<sup>855</sup> Despite the fact that Britoil would probably make substantial profits from its producing fields, it was claimed that the company's cash flow would be paltry compared with that of its rivals.<sup>856</sup> Britoil's technical and management ability were doubted, and it was asserted that BNOC's massive exploratory commitments accruing from the fifth and sixth rounds would be an anchor around Britoil's neck.<sup>857</sup> It was further argued that Britoil, unlike the major oil companies, would be a purely North Sea corporation, exposed to the toughest operating conditions and highest fiscal regime in the world.<sup>858</sup>

These objections and hazards proved to be so serious that Secretary Lawson felt compelled to promise that the Britoil flotation would be deferred till 1983 in the event that market conditions indicated that an adequate price for the shares could not be obtained.<sup>859</sup> In the meantime and by virtue of the Britoil Limited (Transfer of Shares) Order 1982,<sup>860</sup> the Secretary of Energy exercised his right, pursuant to section 3(3) of the Oil and Gas (Enterprise) Act,<sup>861</sup> to have Britoil's shares transferred and vested in him.<sup>862</sup> The Order became effective on November 1, 1982.<sup>863</sup> One share, known as "the special preference share," was transferred to, and vested in, the Solicitor to the Treasury.<sup>864</sup> This special share, which may not be owned by anyone but a Minister of the Crown or the Solicitor to the Treasury, was the means by which the government chose to institute future state controls over the ownership of Britoil.<sup>865</sup> In certain circumstances described in Britoil's articles of association, the special shareholder is given the power to veto the director's appointments or dismissals and to outvote other shares at general meetings.<sup>866</sup>

It was announced that the sale, which would constitute fifty-one percent of Britoil's ordinary shares (the state planned to retain ownership of

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855. *Id.*, Mar. 3, 1982, at 1, col. 2.

856. *Id.*

857. *Id.*

858. *Id.*

859. *Id.*, Aug. 26, 1982, at 8, col. 2.

860. Britoil Limited (Transfer of Shares) Order, 1982 STAT. INST. NO. 1415.

861. Oil and Gas (Enterprise) Act, 1982, ch. 23, § 3(3).

862. Britoil Limited (Transfer of Shares) Order, 1982 STAT. INST. NO. 1415, Reg. 2.

863. *Id.* at Reg. 1.

864. *Id.* at Reg. 2.

865. The Times (London), Nov. 12, 1982 (Britoil prospectus supplement), at X, col. 1.

866. *Id.*

the other forty-nine percent), would be held on November 19, 1982.<sup>867</sup> Because of the fear that the fixed price system would lead to a repeat of the Amersham flotation and its attendant speculative gains, applications for shares were invited on a cash tender basis. A minimum tender offer or "striking price" was fixed at 215p, and the flotation was underwritten to the extent of £548 million.<sup>868</sup> The Secretary of Energy hoped that the sale would attract as many small investors as possible, thereby spreading ownership of Britoil widely among the British population. An incentive for such investors was provided by the proviso that shareholders with 2000 shares or less of Britoil equity would receive a one for ten scrip issue on the elapse of three years.<sup>869</sup> Despite this incentive only twenty to thirty percent of the ultimate subscribers proved to be small investors.<sup>870</sup> The underwriting of the shares proved to be a wise decision, as only seventy million of the 255 million shares on offer were subscribed.<sup>871</sup> Naturally, these results proved to be a political, if not a financial, embarrassment for the government.<sup>872</sup>

Secretary Lawson had stated in the House of Commons on November 10, 1982 that "[t]he method of disposal of British Gas Corporation shares for its oil interests has not yet been decided."<sup>873</sup> Nevertheless, the BGC denationalisation process had been well underway before these remarks. Mr. Lawson had previously directed BGC in August 1982, by virtue of the British Gas Corporation (Disposal of Offshore Oilfield Interests) Directions 1982,<sup>874</sup> to begin preparatory work for the disposal of its offshore fields.<sup>875</sup> Further directions were given in 1983.<sup>876</sup> In November 1983, a corporation known as "Enterprise Oil" was formed to take over BGC's equity shares in the five producing UKCS fields and some of BGC's offshore exploration interests.<sup>877</sup> The new Secretary of

867. *The Times* (London), Nov. 11, 1982, at 1, col. 3.

868. *Id.*, Nov. 13, 1982, at 13, col. 1.

869. *The Times* (London), Nov. 12, 1982 (Britoil prospectus supplement), at X, col. 1; *see id.*, Nov. 11, 1982, at 1, col. 3.

870. P. CAMERON, *supra* note 541, at 170.

871. House of Commons Library Research Div., *Privatisation, Background Paper No. 140*, at 9.

872. *The Times* (London), Nov. 20, 1982, at 1, col. 2.

873. *Id.*, Nov. 11, 1982, at 4, col. 4.

874. British Gas Corporation (Disposal of Offshore Oilfield Interests) Directions, 1982 STAT. INST. NO. 1131.

875. U. K. DEP'T OF ENERGY, *supra* note 534, at 12.

876. *See* British Gas Corporation (Further Disposal of Offshore Interests) Directions, 1983 STAT. INST. NO. 1096; British Gas Corporation (Transfer of Shares of Subsidiaries) (No. 2) Order, 1983 STAT. INST. NO. 1667.

877. *See* Dafter, *Company to make a Texan envious*, *The Financial Times* (London), Oct. 26, 1983, at 8, col. 4.; Lawson, *Enterprise Oil—Built from the top down*, *The Financial Times* (London), June 18, 1984, at 10, col. 1.

Energy, Patrick Walker, appointed immediately after the Thatcher government's reelection in June 1983, decided that the public should be offered 100% of Enterprise Oil's shareholding.<sup>878</sup> The special share concept, however, was once again used to prevent the new oil company from being taken over. As in the Britoil sale, the offering was underwritten, and minimum tenders were fixed at 185p a share.<sup>879</sup>

The sale of Enterprise Oil's shares was held on June 27, 1984. Applications were received for 66.4% of the portfolio.<sup>880</sup> But very shortly after the sale closed, the Rio Tinto Zinc Corporation announced that it had, through nominees, applied for about forty-nine percent of the offered stock.<sup>881</sup> In view of the fact that the government intended to ensure that Enterprise Oil would function as an independent British oil company, Secretary Walker exercised his discretion to reject the applications of Rio Tinto Zinc's nominees.<sup>882</sup> Accordingly, the final result of the flotation was that only about a quarter of the shares were subscribed.<sup>883</sup> The wisdom of underwriting the offering had once again been made apparent.

BNOC's marketing role remained unchanged. The state corporation went through a difficult period in the spring of 1983 when it seemed for a time that the price of oil might collapse on the world markets. The government exerted its influence on BNOC to ensure that falls in the price of North Sea crude followed, rather than led, OPEC decision-making. It was believed that this policy would contribute a measure of stability to the oil market.<sup>884</sup> BNOC, however, still had to buy its participation oil on long-term contracts and sell on a short-term basis. During the crisis of 1983, overwhelming pressure was brought to bear on BNOC by its customers—the largest of whom is the Gulf Oil Corporation—to cut the price of North Sea crude as a means of enabling refineries to be run more efficiently.<sup>885</sup> The experience of spring 1983 indicated that in times of conflicting perspectives over the appropriate price of oil, BNOC, with its dominant role in marketing, remained vulnerable to the varying demands of customers who could simply refuse to purchase supplies of oil regarded as being overpriced. In testimony

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878. *The Times* (London), June 22, 1984 (Enterprise Oil prospectus supplement), at 2, col. 1.

879. *Id.*, June 29, 1984, at 4, col. 1.

880. *Id.*

881. *Id.*

882. *Id.*

883. *Id.*

884. *The Times* (London), Apr. 15, 1983, at 17, col. 4.

885. *Id.*, Feb. 4, 1983, at 17, col. 2; *see id.*, Apr. 20, 1983, at 19, col. 4.

before the House of Commons Select Committee on Energy shortly after the oil markets had stabilised, many oil companies, including Esso, BP, and Shell, cited BNOC's awkward position in times of market fluctuation as a reason for changing the state oil corporation's trading function or even abolishing BNOC altogether.<sup>886</sup> But Mr. Lawson defended BNOC by noting that it had done much to avert a catastrophic fall in oil prices and that the supply controls which the corporation provided were as necessary as ever.<sup>887</sup> Mr. Patrick Walker, the new Secretary of Energy, also regards State oil trading as being essential to the national interest.<sup>888</sup>

## 2. Depletion Policy

The year 1982 saw a redefinition of the government's policy on depletion. Secretary Lawson regarded oil and gas forecasting as an inherently uncertain exercise:

I do not see the Government's task as being to try and plan the future shape of energy production and consumption. It is not even primarily to try and balance UK demand and supply for energy. Our task is rather to set a framework which will ensure that the market operates in the energy sector with a minimum of distortion. . . .<sup>889</sup>

The House of Commons Select Committee on Energy's report on depletion policy, which was published on May 18, 1982, closely conformed to the government's views.<sup>890</sup> Mr. Lawson let it be known in June that the government would not, barring an emergency, use production controls until the end of 1984 at the earliest.<sup>891</sup> After endorsing most of the Select Committee's report in July 1982, the Conservatives further promised that there would be no more delay in the approval of development plans, and that even in an emergency there would not be an excessive use of reserve powers that would otherwise seriously disrupt corporate economic expectations.<sup>892</sup>

These pledges have been fulfilled despite the fact that a rapidly falling rate of consumption (there was a fall of seventeen percent in 1980-81) has widened the margins of overproduction.<sup>893</sup> In 1983, Shell U.K. Lim-

886. *The Times* (London), Apr. 20, 1983, at 19, col. 4.

887. *Id.*, Apr. 15, 1983, at 17, col. 4.

888. *Id.*, Feb. 21, 1984, at 4, col. 7.

889. Address by Nigel Lawson, Secretary of State for Energy, at the Fourth Annual International Conference of the International Association of Energy Economists, Churchill College, Cambridge, England (June 28, 1982).

890. U. K. DEP'T OF ENERGY, *supra* note 534, at 13.

891. *Id.*

892. *Id.*

893. *See* Address by Nigel Lawson, *supra* note 889.



ited acknowledged that "during the recent uncertainty the Government could well have intervened to protect oil prices, and its own revenues, by imposing short-term production controls. Any less conservative government almost certainly would have done so."<sup>894</sup> OPEC, of course, has been continuously, but unsuccessfully, attempting to persuade the Conservatives to reduce UKCS production so as to ease the world glut.<sup>895</sup> Finally, it should also be noted that apart from its market-oriented policy, a major reason why the government rejected any form of depletion control was because of the short-term effect that such action might have had on Treasury receipts.<sup>896</sup>

### 3. Exploration Policy

Although offshore exploratory activity significantly increased in 1981 because of acreage licensed in the fifth and sixth rounds, the UKOOA claimed that in 1982 between two-thirds and one-half more oil was being produced than was being discovered.<sup>897</sup> In view of what the government saw as the continuing need for the opening up of the UKCS for exploration, an eighth round of licensing was announced in September 1982.<sup>898</sup> In Mr. Lawson's words, "[t]he main objectives for the Round are to open up areas where no exploration drilling has yet been undertaken and to provide further opportunities for exploration in the established [southeastern UKCS] gas province."<sup>899</sup> It was hoped that the abolition of BGC's monopoly powers over gas supply, which were associated with low UKCS gas prices, would provide an incentive for the oil industry to explore for gas again. There had been virtually no natural gas exploration since the early 1970's.<sup>900</sup> Thirty-eight blocks were to be offered in the gas-rich southern North Sea. One hundred and thirty-one blocks were to be drawn from virgin frontier territory such as the Forth Approaches, the Bristol Channel, the northwest Atlantic, and areas off northeastern England. All of the foregoing were to be licenced in the normal discretionary fashion. A further fifteen blocks in the northern North Sea were to be auctioned. As in the seventh round, it was expected that blocks in this region would draw the greatest industry inter-

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894. Shell U.K. Ltd., *The Future of BNOC 3* (1983) (internal policy paper).

895. See *The Times* (London), Nov. 1, 1983, at 21, col. 7.

896. *THE ECONOMIST*, Mar. 6, 1982, at 35, 36.

897. Stewart-Gordon, *supra* note 778, at 45.

898. See U. K. Dep't of Energy, Press Notice (Sept. 23, 1982).

899. *Id.*

900. *The Times* (London), Oct. 8, 1982 (special report), at 25, col. 7.

est.<sup>901</sup> At a total of 184 blocks offered, the eighth round was the largest licence offering since the fourth round in 1971-72<sup>902</sup> and invited applications for about twice as much offshore acreage as did all of the 1982 American OCS lease sales put together.<sup>903</sup> The licensing criteria, which included BNOC's fifty-one percent purchase right, were similar to those stipulated for the seventh round.<sup>904</sup>

From the perspective of natural gas, the eighth round was a definite success, but interest was low in the frontier and oil-prospective areas.<sup>905</sup> Only half of the auction blocks were bid on, and these blocks attracted high bids totalling a mere thirty million pounds.<sup>906</sup> The sixty applications which were received involved 100 corporations in consortia,<sup>907</sup> considerably less than the 125 applications received in the seventh round.<sup>908</sup> The two main reasons behind the round's relative failure were the fiscal regime, which was not significantly lowered in the 1982 budget, and the falling price of oil. But another reason may have been that many smaller companies simply had enough acreage left to explore from the seventh round.

Despite the lack of interest in the eighth round, exploratory drilling increased on the UKCS during 1982. Sixty-eight exploration wells were drilled in that year, as compared with forty-nine in 1981.<sup>909</sup> In light of the 1983 budget, there was a further substantial increase in exploration in 1983.<sup>910</sup> And, in 1984, the Conservatives decided to make more acreage available through a ninth round of licensing.<sup>911</sup> According to Mr. Alick Buchanan-Smith, Minister of State for Energy, the main objective of the ninth round was "to maintain and increase the momentum of exploration drilling which reached record levels in 1983."<sup>912</sup>

The 195 blocks offered in the ninth round encompassed a wide vari-

901. See U. K. Dep't of Energy, *supra* note 898.

902. U. K. DEP'T OF ENERGY, *supra* note 534, at 32.

903. About 11,000,000 UKCS acres were offered in the eighth round. The five OCS sales of 1982 offered a total of 7,637,122 acres. MINERALS MGMT. SERVICE, *supra* note 549, at 16.

904. Gazette Notice, Sept. 24, 1982 (inviting applications for the eighth round of licensing).

905. The Times (London), Jan. 20, 1983, at 13, col. 1.

906. *Id.* Eventually, 70 blocks were licenced as a result of the eighth round. U.K. DEP'T OF ENERGY, THE DEVELOPMENT OF THE OIL GAS RESOURCES OF THE UNITED KINGDOM 1985, at 40 (1985).

907. The Times (London), Jan. 20, 1983, at 13, col. 1.

908. U. K. DEP'T OF ENERGY, *supra* note 534, at 32.

909. *Id.* at 34.

910. Letter from Alick Buchanan-Smith, Minister of State for Energy, to the Author (Apr. 4, 1984).

911. Gazette Notice, July 1984 (inviting applications for the ninth round of licensing).

912. U. K. Dep't of Energy, Press Notice (Feb. 15, 1984).

ety of terrain. The 182 blocks licenced pursuant to the previously used discretionary basis drew 117 applications from 134 companies.<sup>913</sup> Licences were awarded in May 1985 for eighty of these discretionary blocks.<sup>914</sup> The fifteen northern North Sea blocks which were auctioned attracted thirty-two bids, with total high bids adding up to more than £120 million.<sup>915</sup> Thirteen auction blocks were eventually licenced. All applications, as in the seventh and eighth rounds, gave BNOC the right to purchase fifty-one percent of any production.<sup>916</sup>

Some of the ninth round frontier acreage, such as the Rockall and Faroes Troughs, was in hostile deepwater territory. Three incentives were introduced to encourage exploration of such areas. First, blocks classified as being "Deep Water Frontier Areas" were given an initial term of eight years, with a further term of forty years.<sup>917</sup> Interestingly, a parallel practice has developed in the United States, where the Secretary of the Interior has recently used his powers pursuant to section 8(b)(2)(B) of the OCSLAA<sup>918</sup> to grant ten-year lease terms for Gulf of Mexico tracts deeper than 400 meters.<sup>919</sup> Second, blocks in the Rockall and Faroes Troughs were offered in pairs, and up to two pairs of blocks were allowed to be incorporated in a single production licence.<sup>920</sup> Finally, applications for non-auction blocks in mature areas were considered in light of "the extent to which the applicant is prepared also to apply for, and explore, a block or blocks listed under frontier areas . . . particularly in depths of water exceeding 200 metres."<sup>921</sup>

Fewer companies were involved in consortia than might have been expected because the Department of Energy decided to allow no more than ten licence equity owners per licence granted.<sup>922</sup> This decision was designed to encourage the participation of the large companies, whose finance and expertise were seen as necessary for the exploration and development of hostile frontier acreage.<sup>923</sup> An unfortunate result, however, has been that small companies have found more difficulty in obtaining licence shares. Also, the wording of the criteria for granting licences in

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913. U. K. DEP'T OF ENERGY, *supra* note 906, at 40.

914. THE OILMAN WEEKLY NEWSLETTER, May 25, 1985, at 1, 1.

915. *Id.*

916. Gazette Notice, *supra* note 911, at para. 4.

917. *Id.*

918. 43 U.S.C. § 1337(b)(2)(B) (1982).

919. *See New lease terms should encourage drilling*, OFFSHORE, Aug. 1984, at 51, 51.

920. Scottish Economic Planning Dep't, North Sea Oil Information Sheet (June 1984).

921. Gazette Notice, *supra* note 911, at para. 8(e).

922. THE OILMAN WEEKLY NEWSLETTER, Jan. 12, 1982, at 1.

923. *Id.*

the ninth round occasioned charges of unfairness being levelled at the British government by the EEC Commission.<sup>924</sup> According to the EEC Commission, "the UK Government was discriminating against firms based in other [EEC] member states and was pursuing a 'Buy British' policy,"<sup>925</sup> a policy that would be contrary to the Treaty of Rome. The Commission has since dropped the case, but only after assurances from the Department of Energy that the alleged unfairness would not be repeated in the next round. This does not, however, mean an end to discretionary licensing, since the Commission's objections were directed only at certain wording, not at the discretionary system itself.<sup>926</sup>

The eighth and ninth rounds can be seen in proportional terms as more dramatic than the Watt program. About ten million acres were licenced as a result of the two rounds. Taking into account the fact that the OCS is about eight times as large as the UKCS, an equivalent American program would have to lease eighty million acres. In all but the seventh round, however, it has been the size of the blocks, rather than the procedure for their nomination, which has caused the comparison of the British system with areawide leasing.

#### 4. Taxation

In response to Chancellor Howe's invitation in early 1981 to discuss better methods of taxing UKCS oil and gas, the UKOOA drew up a proposed taxation system which would meet Treasury cash targets, but also reduce disincentives for development. The government refused to accept the UKOOA plan, however.<sup>927</sup> Although the Finance Act 1982<sup>928</sup> introduced a number of changes in oil taxation, the new levels of tax remained almost as high as previously. The SPD was abolished as of January 1, 1983,<sup>929</sup> but the PRT was increased from seventy to seventy-five percent.<sup>930</sup> Another factor compensating for the abolition of SPD was the introduction of the Advance Petroleum Revenue Tax (APRT).<sup>931</sup> The APRT was to be charged at the rate of twenty percent

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924. Frazer, 'Buy British' clauses to be dropped in North Sea awards, *THE SCOTSMAN*, July 5, 1985, at 15.

925. *Id.*

926. *Id.*

927. Stewart-Gordon, *supra* note 778, at 45.

928. Finance Act, 1982, ch. 39. *See generally* *The 1982-83 Budget: A Budget for Industry—And for Jobs Says the Chancellor*, 22 *EUR. TAX'N* 95, 95-96 (1982).

929. Finance Act, 1982, ch. 39, § 132(2).

930. *Id.* § 132(1).

931. *Id.* §§ 139-42; *see id.* at sched. 19.

on any participator's gross profits for any given chargeable year, but was to be offsetable against future PRT liability.<sup>932</sup> Here, the intention was to tax fields which, because of the various PRT reliefs, paid no PRT. As with SPD, however, there was an oil allowance of 500,000 metric tonnes of petroleum per field per year which was not chargeable.<sup>933</sup> The APRT took the place of the system of advance payments of PRT instituted by the Finance Act 1980.<sup>934</sup> The government further expected that the oil taxation provisions of the Finance Act 1982 would reduce UKCS revenues by seventy million pounds during 1983 to 1984.<sup>935</sup>

The high rates of oil taxation may well have been necessary from the government's point of view, but they certainly had a deleterious impact on the pace of oil field development. The Department of Energy blamed the lack of development on the falling price of oil, but in fairness it must be borne in mind that even when oil prices had hovered around the fifteen dollars per barrel mark in the late 1970's, there had been no lack of development commitments. Furthermore, depressed oil prices were not preventing costly foreign offshore developments from taking place.<sup>936</sup>

By 1983, economic indicators began to show that the United Kingdom was slowly pulling out of the recession,<sup>937</sup> thereby giving the Treasury an incentive to lighten the offshore fiscal burden. Development plans slowly began to be submitted again in 1982,<sup>938</sup> but the non-development era of 1980-82 had ensured that UKCS production would experience a substantial reduction after 1986.<sup>939</sup> Faced with this certainty and a possible termination of British self-sufficiency, the Conservatives acted in 1983 to enhance the UKCS's attractiveness as an oil province. The main aim was to encourage the development of small, remote, deepwater fields. However, the proposals did very little to ease taxation on existing production.

On March 15, 1983, Chancellor Howe, in his budget speech, out-

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932. *Id.* § 139(2).

933. *Id.* § 141(1).

934. *See* Finance Act, 1980, ch. 48, § 105. The system of advance payments instituted by § 105 of the Finance Act, 1980 was abolished, as of June 30, 1983, by the Finance Act, 1982, ch. 39, § 139(6).

935. *The Times* (London), Mar. 10, 1982, at 9, col. 4.

936. Stewart-Gordon, *supra* note 778, at 45.

937. *Britain: The Economy Before the Budget*, *THE ECONOMIST*, Feb. 26, 1983, at 65, 65-66.

938. Stewart-Gordon, *supra* note 778, at 45.

939. Energy Options for the U.K., an address by J.M. Raisman, Chairman and Chief Executive of Shell U.K. Ltd., to the Fellowship of Engineering, at the Institution of Electrical Engineers Hall, London 7 (Mar. 23, 1983).

lined the details of the government's new UKCS fiscal system.<sup>940</sup> The APRT was to be phased out with respect to all chargeable fields over a three and a half year time period. The rate would be fifteen percent from July 1, 1983 to December 31, 1984, ten percent from January 1 to December 31, 1985, and five percent from January 1 to December 31, 1986.<sup>941</sup> The rate would thereafter be abolished for all old fields already in production<sup>942</sup> and immediately abolished for all new fields coming on-stream.<sup>943</sup> While the termination of the APRT, much sought after by the UKOOA, improves corporate cash-flow,<sup>944</sup> it does nothing to reduce corporate liability to the PRT itself. It was estimated that the APRT changes would cause the Exchequer to lose fifty million pounds in 1983-84.<sup>945</sup>

The main provisions designed to facilitate expansion of UKCS oil development related to royalties, the PRT oil allowance, and a new relief related to exploration and appraisal costs. In March 1983, it was announced that legislation which abolished royalties on all future fields would be introduced by the Secretary of Energy.<sup>946</sup> "Future fields" were defined as those fields whose development plans were approved after April 1, 1982.<sup>947</sup> The only future fields not covered by this exemption were fields in the mainly gas-bearing Southern Basin.<sup>948</sup> The government thought that fields in this area had a reasonable guarantee of profitability under the old system.<sup>949</sup> An enabling statute which contained the preceding changes with regards to future fields, the Petroleum Royalties (Relief) Act 1983,<sup>950</sup> was passed into law shortly before the end of 1983.

The Finance Act 1983<sup>951</sup> returned the PRT oil allowance for future fields to pre-1979 levels. As a result, each future oil field could produce up to 500,000 metric tonnes of PRT-exempt petroleum per year.<sup>952</sup> Such

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940. The Times (London), Mar. 16, 1983, at 9, col. 2.

941. Inland Revenue, Press Release 2 (Mar. 15, 1983).

942. *Id.*

943. Letter from John Wakeham M.P., Minister of State at the Treasury, to G. Williams of the UKOOA (Mar. 15, 1983) (outlining budget proposals, particularly the abolition of APRT, intended to reduce tax burdens on UKCS oil production).

944. *Id.*

945. Inland Revenue, *supra* note 941, at 5.

946. U. K. Dep't of Energy, Press Notice No. 30 (Mar. 15, 1983).

947. Finance Act, 1983, ch. 28, § 36.

948. U. K. Dep't of Energy, *supra* note 946; *see also* Finance Act, 1983, ch. 28, § 36(2)(a) (sets out geographic descriptions of fields excluded from the exemption).

949. *See* Letter from John Wakeham, *supra* note 943, at 2.

950. Petroleum Royalties (Relief) Act, 1983, ch. 59.

951. Finance Act, 1983, ch. 28.

952. *Id.* § 36(1)(a).

exemptions were limited to a cumulative total of ten million metric tonnes.<sup>953</sup> Lastly, it was provided that licence participators lacking an approved development plan would be able to use only exploration and appraisal expenditure incurred with respect to only a UKCS field to offset PRT chargeable against any licence.<sup>954</sup> This was also a change which the UKOOA had strongly lobbied for<sup>955</sup> and is one of the few instances where losses or expenses incurred outside a given field may affect the rate of PRT within the field.

Chancellor Howe's package provided a major stimulus for development without losing a great deal in short-term Treasury receipts. It was estimated that the changes would cost roughly £800 million from 1983-87,<sup>956</sup> a mere 1.8% of estimated UKCS revenues likely to be derived during this period.<sup>957</sup> Very few of the future fields will be producing at peak capacity by 1987. But in terms of future development, the provisions are extremely significant, as their overall effect will be to reduce the average rate of tax on future fields from over seventy to sixty percent.<sup>958</sup> The new exploration allowance may be especially useful in encouraging the utilisation of the expensive technological equipment which will be required to explore uncertain and inhospitable areas such as the Rockall Trough.

The 1984 budget further assisted the offshore industry by reducing the marginal rate of tax and royalties on existing fields from 89.5 to 85.78%.<sup>959</sup> For offshore reservoirs designated as "future fields," which thus benefit by the Petroleum Royalties (Relief) Act 1983,<sup>960</sup> the marginal tax rate was cut from 88 to 83.75%.<sup>961</sup> The 1985 budget did not make many modifications in oil taxation, but did provide a source of annoyance for the oil industry when the anticipated enhanced oil recovery expenditure relief did not materialise.<sup>962</sup>

The tax changes of 1983 and 1984 have been instrumental in creating the new exploratory boom and a welter of developmental activity on the UKCS. In 1983, seventy-seven exploration wells were drilled and twenty-one significant discoveries were made.<sup>963</sup> By comparison, in

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953. *Id.* § 36(1)(b).

954. *Id.* at sched. 8, part. I, § 5A.

955. See Letter from John Wakeham, *supra* note 943, at 2.

956. *Id.* at 3.

957. *The Times* (London), Mar. 30, 1983, at 19, col. 3.

958. Letter from John Wakeham, *supra* note 943, at 2.

959. Inland Revenue, Press Release 1 (Mar. 13, 1984).

960. Petroleum Royalties (Relief) Act, 1983, ch. 59.

961. Inland Revenue, *supra* note 959, at 1.

962. See *THE OILMAN WEEKLY NEWSLETTER*, Mar. 23, 1985, at 5.

963. U.K. DEP'T OF ENERGY, *supra* note 906, at 41.

1982, sixty-eight exploration wells were drilled, and nine significant discoveries were made.<sup>964</sup> A report by the UKOOA in 1982 showed that in recent years thirty discoveries had been left undeveloped.<sup>965</sup> Undoubtedly, the fiscal regime and lower oil prices contributed to this lack of development. But after the 1983 budget, development plans were submitted with respect to many of these fields, and, in 1984, one hundred and six exploration wells and seventy-six appraisal wells were begun.<sup>966</sup> This represents the highest rate of exploratory activity yet. With the drilling of 108 development wells, 1984 represents the fourth most intensive year of development drilling in UKCS history.<sup>967</sup> Fifteen development plans were approved in 1984, and six were approved in the first two months of 1985.<sup>968</sup> The Department of Energy estimates that a further thirty-three development plans may be proposed during 1985.<sup>969</sup>

### 5. Towards a Market-Oriented Regime

The second stage of Conservative oil policy saw the creation, slowly in some sectors, of more truly market-oriented economic conditions. It has been speculated that the Cabinet changes of 1981, initially at least, paved the way for this occurrence, especially in relation to the flotation and privatisation of Britoil, BNOC's former operating arm. The rejection of depletion controls reflected the government's suspicion of energy forecasting and its strong reluctance to be seen as directly inhibiting private sector business. The policy of high taxation constituted a form of involuntary depletion, but taxation-induced field deferrals came too late, by and large, to reduce the hump of overproduction which the United Kingdom is currently experiencing.

The Conservatives responded to industry requests to hold licensing rounds every two years with the seventh, eighth, and ninth rounds. The opening up of the UKCS for exploration, viewed as essential by industry, has also been seen as necessary from the government's perspective in terms of continuing British self-sufficiency and providing an oil-flavored boost to the British economy. But for most of Mr. Lawson's tenure as Energy Secretary, the Cabinet felt compelled to maximise short-term revenues to cope with a bleak domestic situation, a policy decision which

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964. *Id.*; U. K. DEP'T OF ENERGY, *supra* note 534, at 33.

965. *The Times* (London), Mar. 30, 1983, at 19, col. 6.

966. U. K. DEP'T OF ENERGY, *supra* note 906, at 42.

967. *Id.* at 43.

968. *Id.*

969. *Id.* at 12.



could only be carried out at the expense of ongoing offshore development. The 1983 budget, with its cleverly devised assistance for "future fields," served to advance the goals of boosting future offshore production and enhancing further oil-related economic activity without significantly diminishing short-term Treasury cash flow. The 1984 budget was a further important contribution.

## VI. THE COMPARATIVE SUCCESS OF RECENT AMERICAN AND BRITISH OFFSHORE OIL DEVELOPMENT

### A. *The Shaping of American and British Offshore Oil Strategies*

A major goal of Mr. Reagan's and Mrs. Thatcher's policies has been to encourage free enterprise exploration and development of offshore areas. Secretaries Watt, Clark, and Hodel have faced formidable opposition in the implementation of this objective, an experience not shared by their British counterparts. It is submitted that the American constitutional system, the powers of the states, the special interest groups, and the substantive American offshore oil laws make the formulation and pursuit of a coherent OCS energy strategy difficult to achieve. Great Britain has a comparable constitutional system; "states" in the form of the English, Scottish, and Northern Irish nations; special interest groups; and oil and gas laws. However, these factors have not thwarted Conservative oil policy. Instead, difficulties in British energy policy have, until very recently, originated from the fact that the government's goals have sometimes contradicted one another.

#### 1. The Political Systems

It would take a major political coup for either of the two main American political parties to gain control of the Presidency, the Congress, and the Supreme Court. For the time being, there is a Republican President, and it is generally accepted that the present Supreme Court is conservatively inclined. With regard to the latter, it should be noted that the two OCS cases appealed to the Supreme Court during Mr. Reagan's period of office, *Watt v. Energy Action Educational Foundation*<sup>970</sup> and *Secretary of the Interior v. California*,<sup>971</sup> were won by the administration. The Congress, however, has proved to be a stumbling block for the present administration's expedited leasing program. Because the President is

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970. 454 U.S. 151 (1981).

971. 104 S. Ct. 656 (1984).

separately elected and is not nominated by the Congress, it is impossible to guarantee that the executive and legislative branches will agree on all policy issues. Though there is currently a Republican Senate, the House of Representatives has had a Democratic majority for many years. Making matters more complex is the fact that the conflict between institutions is not confined to the normal situation of differing political control. Party discipline in the United States is much less strict than in the United Kingdom, and, with respect to OCS issues, congressmen and senators are as likely to act on state interests as on party dogma. An excellent example of the latter occurrence has been the endorsement and defense of the Watt program by Congressman John Breaux and Senator Bennett Johnston, both Louisiana Democrats.<sup>972</sup> Conversely, a determined Congress can effectively disrupt presidential plans or even substitute policy and legislation of its own. The appropriations moratoria, which have caused grievous disruption to the OCS program, demonstrate the influence which the Congress wields over American energy policy.

Like the United States, the United Kingdom has a tripartite form of government composed of the Prime Minister, the Parliament, and the Superior Courts. However, there is only one effective UKCS decision-maker, the Cabinet, which, in recent times, has become increasingly dominated by the Prime Minister. In Great Britain, the executive level of government is nominated by the Parliament, so there could never be, for example, a Conservative government with a Labour majority in the House of Commons. Thus the executive level is always of the same political hue as the parliamentary majority. Political loyalty is very strong, and it is extremely rare for M.P.'s from the government's own party to vote with the opposing party. Consequently, a British government which has a reasonable parliamentary majority can virtually pass whatever legislation it desires. The Labour government of 1974-79 was one of the few recent British administrations which had a very narrow majority, a major reason why Scottish nationalism loomed so large as an issue during that era. The 1979 and 1983 elections gave the Conservative party large majorities, and there has never been any doubt since 1979 that the various strands of United Kingdom energy policy would meet with the approval of Parliament. The British courts have as yet played no significant role in the development of United Kingdom oil and gas law, as there has been only one British oil and gas case, *Earl of Lonsdale v.*

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972. See Kelly, *Furor building over OCS program*, DRILLING CONTRACTOR, Sept. 1982, at 66, 78.

*Attorney General.*<sup>973</sup>

In the American political system, the semiautonomous states often perceive themselves as having different interests than the federal authority. A particularly good example is California, which sees Californian OCS development as a threat to its natural beauty, wildlife, fishing industry, tourism, and indigenous heavy crude oil industry. California and other states have used their influence in Congress, and their ready access to the courts via the OCSLAA and the environmental statutes, to attempt to alter federal oil and gas policy. Any OCS leasing program is likely to attract the opposition of at least some of the coastal states. Through Congress and statute, the states have a powerful say in federal oil and gas decisions.

The United Kingdom is a parliamentary and royal union composed of four nations: Scotland, Wales, Northern Ireland, and England. None of these nations retains a separate legislature, although Northern Ireland did have an assembly which dealt with purely Northern Irish affairs till 1972. Stormont, as it was called, functioned in a manner comparable to an American state legislature.<sup>974</sup> As noted previously, Scotland came close to seceding from the United Kingdom in the mid-1970's.<sup>975</sup> Although it had great influence on the previous Labour government, Scotland has had no say in Mrs. Thatcher's policies, energy-related or otherwise. In March 1979, a referendum was held to ascertain whether the Scots were in favor of Labour's scheme for legislative devolution, the Scotland Act of 1978.<sup>976</sup> This Act stipulated that the proposed Scottish legislature would not be set up unless at least forty percent of the Scottish electorate voted in its favor.<sup>977</sup> While a majority did in fact vote in favor of the legislation, the required "super majority" was not obtained. With the failure of the home rule plan, the SNP withdrew its support for Mr. Callaghan's administration, thereby precipitating the May 1979 general election. In that election, the SNP vote collapsed and left the party with only two parliamentary seats. Scotland returned a solid Labour majority, but it was of no avail in the now Conservative dominated Parliament. Scotland made little impact on UKCS energy policy during the last Parliament and saw no significant nationalist revival in the early 1980's, as the last election again elected a majority of Labour M.P.'s. Conse-

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973. [1982] 3 All E.R. 579 (Ch.).

974. P. DALTON & R. DEXTER, CONSTITUTIONAL LAW 9-10 (1976).

975. See *supra* notes 598-602 and accompanying text.

976. Scotland Act, 1978, ch. 51; see *Assembly Substitute*, THE ECONOMIST, June 23, 1979, at 25.

977. Scotland Act, 1978, ch. 51, § 85.

quently, autonomous areas of the United Kingdom, unlike the American coastal states, have posed no recent opposition to centrally decided offshore oil and gas policy.

## 2. Environmentalists

It has already been noted how important a role the American environmentalist lobby has played in the history of the OCS. Environmentalist efforts, allied with those of the states, were instrumental in causing the failure of Project Independence and the other leasing programs of the 1970's. Like the states, environmentalists have affected energy policy through Congress and the courts. A testimony to their activity in the former is the fact that over seventy-four different sets of regulations govern OCS oil and gas operations.<sup>978</sup> While the inhabitants of southern states, such as Oklahoma, Texas, and Louisiana, have learned to live with the oil industry, New Englanders and Alaskans, for example, off whose shores much of America's future supplies may lie, are suspicious of OCS development. The Santa Barbara blowout greatly contributed to making the American public, particularly the inhabitants of the frontier states, "oil conscious." This oil consciousness has naturally tended to be heightened by the fact that the most lucrative OCS areas outside the Gulf of Mexico—the Californian, Alaskan, and North Atlantic OCS—have shorelines of magnificent natural beauty, varied wildlife, and thriving tourist and fishing industries which could possibly be damaged by oil and gas extraction. The OCSLAA and the environmental statutes have afforded the environmentalists and others numerous grounds on which to challenge DOI policy in the courts. These challenges have been less successful in recent years, but the environmentalist role in the leasing processes remains a major one.

It would be quite wrong to suppose that there are no environmentalists in the United Kingdom. The British environmental groups which do exist, however, have directed their efforts at nuclear power and nuclear weapons, rather than at the oil industry. Though the North Sea has also had a major blowout in the Ekofisk field in the Norwegian Continental Shelf<sup>979</sup> and though the North Sea as a fishing ground is several times as productive as the Georges Bank,<sup>980</sup> the British have never experienced

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978. AM. PET. INST., *SHOULD OFFSHORE OIL BE PUT OFF LIMITS?* 127 (1984).

979. See Hancock & Stone, *Liability for Transnational Pollution Caused by Offshore Oil Rig Blowouts*, 5 HASTINGS INT'L & COMP. L. REV. 377, 389 (1982).

980. MINERALS MGMT. SERVICE, U.S. DEPT OF THE INTERIOR, *FROM POLICY TO PRODUCTION* 80 (1983).

the same "oil consciousness" as their American counterparts. There has never been a sizeable onshore oil industry in the United Kingdom, and all but one of the presently developed fields (the exception being the Beatrice field in the Moray Firth) are many miles offshore and cannot be seen from land. These factors account for the fact that the British public has little conception of the oil and gas activity being carried out on the UKCS. But, as evidenced by Shell Oil's attempt to drill exploratory wells in the English New Forest, public reaction to growing onshore exploration has been much less quiescent.<sup>981</sup> The weak economic situation and the comparative success of the offshore oil industry have also contributed to the absence of continental shelf environmentalism in the United Kingdom. Few groups in Britain wish to inhibit the development of an industry which brings many jobs and much investment in times when both are scarce.

### 3. Legal Constraints

The law relating to American OCS oil and gas, a product of the agitation and compromises of the late 1960's and the 1970's, clearly bears the marks of state and environmentalist influences. The OCSLAA and environmental statutes such as NEPA, which afford private parties standing to sue, provide a considerable and intricate mass of procedural and policy direction for the Secretary of the Interior. The procedural requirements, such as the drawing up of EIS analyses, CZMA consistency determinations, and the extensive state, local government, and public consultation of the OCSLAA processes, have made the administration of OCS leasing and operations more difficult. The practical effect of the continuous elaboration of congressional goals has been a limitation in the Secretary of the Interior's discretion and the encouragement of litigation. For instance, section 18 of the OCSLAA, with all of its exhaustive desiderata, makes the preparation of a five-year leasing program an unenviably difficult task.<sup>982</sup>

United Kingdom oil and gas law is very different. Up until 1971, statutory British oil law was comprised only of sections 2 and 6 of the PPA.<sup>983</sup> These provisions anticipated a discretionary licensing system whose rules could be made up by the relevant ministers as they went along. With regard to licensing, there is not at present a single statutory

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981. *The Times* (London), Jan. 15, 1982, at 3, col. 2.

982. 43 U.S.C. § 1344 (1982).

983. Petroleum (Production) Act, 1934, 24 & 25 Geo. 5, ch. 36, §§ 2, 6.

or regulatory provision which requires the Secretary of Energy to consult with anyone before he announces UKCS licence offerings. However, since 1980, the Department of Energy has made a practice of inviting suggestions and input from potentially interested parties such as fishermen.<sup>984</sup> There are no British equivalents to NEPA, CZMA, or ESA, and many of the landmarks of the OCSLAA have no counterparts in the British system. Moreover, there are no statutory statements of goals, no five-year leasing plans, no authorisations of bidding systems, no CEIP's, and no information programs. There is, however, a Fisherman's Compensation Fund, which is financed by the UKOOA and administered by representatives of fishermen's organisations.<sup>985</sup> The Fund, which is similar to its United States equivalent in that it is not intended to displace tort liability, provides compensation for damage to gear or boats, and for lost fishing time.<sup>986</sup> Additionally, model clause 20 grants to the Secretary of Energy the power to require licensees to retain special funds sufficient to "discharge any liability for damage attributable to the release or escape of petroleum in the course of activities connected with the exercise of rights granted by this licence."<sup>987</sup> Where OCS law tends to give the Secretary of the Interior duties and responsibilities, UKCS law tends to give the Secretary of Energy discretion. Britons have never, save once, attempted to use the courts to question the Department of Energy's decisions.<sup>988</sup> Britain's oil regulations simply do not encourage them to pursue such a course.

#### B. *Implementation of the Reagan and Thatcher Offshore Agendas*

It is because of the preceding constitutional, political, socioeconomic, and legal factors that the United States has found difficulty in implementing its energy policy. This is not necessarily a criticism of the American system, for it would be quite impossible to govern such a huge country with a British-style unitary Parliament. The rise of environmental and other special interest groups and the passing of environmental legislation and the OCSLAA may or may not have been an appropriate reaction to the Santa Barbara blowout, the Arab oil embargo, and Pro-

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984. Letter from Mr. Francis M. Reid, Dep't of Agriculture and Fisheries for Scotland, to the Author (Aug. 23, 1984).

985. *Id.* The fund is an administrative, not a regulatory or statutory, creation.

986. *Id.* The fund is used to compensate the injured party only when the oil-related damage cannot be attributed to a particular company.

987. Petroleum (Production) Regulations, 1982 STAT. INST. NO. 1000, sched. 5, cl. 20(9).

988. *See* Earl of Lonsdale v. Att'y General, [1982] 3 All E.R. 579 (Ch.); *see also supra* note 520-27 and accompanying text (discussing *Earl of Lonsdale*).

ject Independence. The point sought to be made is that the American political system, societal pressures, and the offshore oil laws have all allowed for effective opposition to the Department of Interior's OCS policies.

Contrastingly, there has been no such opposition during the Thatcher administration. Incoherencies in the Conservatives' energy strategy have come from the contradictory nature of some of the government's goals. In what was identified above as Stage One of their North Sea oil policy,<sup>989</sup> the Conservatives discouraged new developments, yet hoped for a development dependent stimulus to the British economy in the form of new orders for rigs, pipelines, and other technology. Until recently, the onerous UKCS taxation regime effectively prevented the development of new fields at a time (1982-83) when these fields were needed to prolong British self-sufficiency, another prime Conservative objective. Though the present government is one of the most market-oriented in recent times, it has not dispensed with BNOC's trading arm, which is seen as essential to British control of supply. These paradoxes are largely attributable to Britain's economic position. Depletion policy became relevant only because the United Kingdom, alone among major Western industrialised countries, has a current oil surplus. The taxation regime was necessary because of the weakness of British industry and the corresponding legacy of unemployment. BNOC's oil supply controls were retained because of the United Kingdom's membership in the competitive EEC, a major consumer of oil, and because of the nation's dependence on a predominantly foreign-based oil industry possessing an unknown degree of loyalty to Great Britain.

Presently, the worst conflicts in United Kingdom energy policy have been resolved. Though the government still has a large North Sea "tax take," taxation is no longer obstructing development, the key to future self-sufficiency. In view of the current need to boost production, depletion policy has also been dropped. However, BNOC's oil trading role is likely to be a lasting feature of the UKCS regime.

It would be erroneous to assume that Republican OCS objectives have in no case conflicted. Nevertheless, the policies of Secretaries Watt, Clark, and Hodel have consistently demonstrated a harmony not evident for long periods in the United Kingdom. Since 1981, the Department of the Interior has consistently encouraged exploration and production at the expense of OCS bonuses. OCS oil taxation, which is composed of

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989. See *supra* notes 716-822 and accompanying text.

both corporate and windfall profits taxes, takes, on average, about sixty percent of the oil companies' gross profits. This is one of the lowest rates in the world and, unlike the British system, has not tended to discourage offshore developments.<sup>990</sup> It will be recalled, however, that Secretary Watt was committed to the expansion of OCS leasing without adverse environmental effects. Theoretically, there tends to be a conflict between the maximisation of exploration and development and the preservation of the environment. It was really this conflict which caused the failure of the American OCS programs of the 1970's. Thus the achievement of Secretary Watt was the creation of an expedited leasing program that contained market-oriented, streamlined regulations complying with the OCSLAA and the stringent environmental statutes.

The United Kingdom's fear that the multinational oil corporations might develop the UKCS without necessarily benefitting Britain is a continuing justification for the discretionary licensing system and BNOC. Because the oil industry in America is overwhelmingly domestic and leads the world in oil expertise and technology, the United States does not feel the same need for such governmental controls. Moreover, the United States has prepared for oil supply shortages or other emergencies with the Federal Strategic Petroleum Reserve.<sup>991</sup> It should be noted, however, that the OCSLAA does give the federal government some leverage over OCS oil and gas.<sup>992</sup> BNOC, even in its present limited marketing role, remains as one of the major differences between the American and British oil regimes. It is difficult to conceive of an American national oil company, although, interestingly, the idea has recently been suggested in Congress in the form of the Federal Oil and Gas Corporation Act.<sup>993</sup>

### 1. The Watt Program

An analysis of the recent success of the United States and the United Kingdom in carrying out their offshore objectives will now be undertaken. With regard to the United States first, it will be recalled that Mr. Watt's goals were: (1) to maximise OCS exploration and produc-

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990. See *New Economics call for change*, OFFSHORE, May 1984, at 79, 79; The Times (London), Sept. 7, 1982, at 19, col. 2.

991. Holcombe, *Strategic Petroleum Reserve*, 26 OIL & GAS TAX Q. 457 (1977-78).

992. See Vass, *A Comparison of American and British Offshore Oil Development During the Reagan and Thatcher Administrations*, 21 TULSA L.J. 23, 43-54 (1985) [hereinafter cited as Vass I].

993. H.R. 20, 98th Cong., 1st Sess. (1983). See generally Williams, *Oil and Gas and the Federal Lands*, 1976 UTAH L. REV. 507, 516-17 (discussing the idea of a state-owned American corporation participating in oil and gas developments).



tion; (2) to inventory the federal offshore; (3) to boost the American economy; (4) to create market-oriented conditions; and (5) to protect the environment.<sup>994</sup>

*a. Exploration and production*

Scrutiny of the pace of leasing and subsequent exploration casts much light on the success of the first two goals. Perhaps a little surprisingly, the 1.9 million OCS acres leased in 1982 actually represents a drop of about 500,000 acres when compared to the 1981 figure.<sup>995</sup> But, starting with the advent of areawide leasing during the Mid-Atlantic lease sale of April 1983, the first five areawide sales leased just over 6.5 million acres.<sup>996</sup> Most of the areawide leases have been awarded in the West and Central Gulf of Mexico, largely because other sales, such as the Mid and South Atlantic and the Eastern Gulf, have been in less lucrative areas and because the 1984 Southern Californian and North Atlantic offerings were postponed. The MMS's Alaskan lease sales have helped to open up that state's largely unexplored frontier territory, but California and Massachusetts have resisted expedited leasing, and around eighty-five percent of the Californian OCS is currently out of bounds. Litigation and the appropriations moratoria have ensured that there have been no North Atlantic lease sales during the present government's incumbency. The three Californian sales which were held involved substantial tract deletions, and the fourth, Lease Sale 80, has been deferred. In view of the fact that the Californian OCS and the Georges Bank are perceived as highly prospective, DOI should regard its leasing record in these areas as a comparative failure.

The efforts of Secretaries Watt, Clark, and Hodel have induced significant exploratory drilling in many parts of the OCS. A focal point of activity has been the Gulf of Mexico, where 253 exploration wells—more than twice the UKCS equivalent<sup>997</sup>—were drilled in 1983.<sup>998</sup> The rate of offshore drilling in the Gulf continued to increase in 1984. For instance, sixty-three mobile rigs, compared with thirty-one in June 1983,<sup>999</sup> were exploring the Texan OCS in June 1984. During the first six months of

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994. See Vass I, *supra* note 992, at 57-58.

995. MINERALS MGMT. SERVICE, *supra* note 549, at 12-13.

996. *Id.*

997. One hundred and twenty-eight exploration and appraisal wells were commenced in the UKCS during 1983. Letter from Mr. M. Hay of the Inland Revenue Policy Division (Oil) to the Author (July 9, 1984).

998. LeBlanc, *Drillers target central Louisiana tracts*, OFFSHORE, July 20, 1984, at 45, 46.

999. *Market Trends*, OFFSHORE, July 5, 1984, at 5.

1983, twenty-four discoveries similar to the small fields now being found in the North Sea were reported in the Gulf of Mexico.<sup>1000</sup> The two Western and Central Gulf areawide sales of 1983 doubled the number of leases held by industry in the Texan and Louisianian OCS, and the April 1984 sale further contributed to corporate holdings. It is this vast amount of acreage, much of it in deepwater areas on the periphery of previous developments, which is fueling the rapid pace of mobile rig exploration in the Gulf of Mexico.

Although exploration rates have been far less spectacular in the Californian OCS, it is in this sector that the most promising OCS discovery has been located. The Point Arguello field, probably about half the size of the British Forties field and a tenth of the size of Prudhoe Bay, was discovered by Chevron in 1982.<sup>1001</sup> Twelve exploratory wells were drilled in 1981, and the number increased to nineteen in 1982.<sup>1002</sup> But exploration has declined since then, and in April 1984 there were only nine exploratory rigs operating in the Californian OCS.<sup>1003</sup>

Industry attempts to find an OCS equivalent to Prudhoe Bay in the Alaskan offshore are proving to be as great a challenge to oil technology as the development of the North Sea. The exploration of some of the best prospects off northern Alaska (i.e., the Diapir field) have necessitated the creation of man-made islands.<sup>1004</sup> In such tough terrain it is inevitable that fewer wells will be drilled, but even so the level of less than ten wells drilled per year for the past number of years is lower than might have been expected.<sup>1005</sup> Despite the recent, costly failure of Sohio's Mukkluk well and Arco's forty-four million dollar dry hole in the Gulf of Alaska, the rate of exploratory drilling is clearly on the increase, and a single commercial find (of which there has yet been none) would in all likelihood be the signal for a massive expansion.<sup>1006</sup>

Six exploratory wells were begun in the Atlantic OCS in 1982, but like all previous efforts, they proved to be fruitless.<sup>1007</sup> As in Alaska there have been a number of very expensive dry holes, the latest having

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1000. LeBlanc, *New leases spur Gulf rig activity*, OFFSHORE, Jan. 1984, at 51, 51.

1001. *The World Offshore*, OFFSHORE, Apr. 1984, at 11.

1002. MINERALS MGMT. SERVICE, U.S. DEP'T OF THE INTERIOR, OUTER CONTINENTAL SHELF OIL AND GAS LEASING AND PRODUCTION PROGRAM, ANNUAL REPORT FISCAL YEAR 1982, at 10 (1983).

1003. *See Offshore Drilling to Increase in 1984*, OFFSHORE, May 1984, at 96, 105.

1004. *\$100 million island is US record*, OFFSHORE, Jan. 1984, at 36, 36.

1005. Only three exploration wells were drilled in 1982. MINERALS MGMT. SERVICE, *supra* note 1002, at 11.

1006. Rintoul, *Drillers Seek Alaska Supergiant*, OFFSHORE, Jan. 1984, at 29.

1007. MINERALS MGMT. SERVICE, *supra* note 1002, at 12.

been drilled in 6448 feet of water by Shell in the Baltimore Canyon.<sup>1008</sup>

*b. The OCS inventory*

When taken together, the preceding record of recent OCS exploration reveals that the Reagan policies have certainly been successful in encouraging the inventorying of the Gulf of Mexico. The success of the goal of expanding exploration in the frontier OCS areas, however, has been much less convincing. California and Alaska, still relatively pristine, retain considerable future potential. And, despite the solid record of previous failure, the oil industry still regards the North Atlantic OCS as possibly hydrocarbon-bearing. Unfortunately, the leasing moratoria must be regarded as casting doubt on the efficacy of the expanded leasing program outside the already mature Western and Central Gulf of Mexico. There can be no exploration or discoveries in the frontier OCS without the availability of large amounts of lease acreage. Even after five years of the Reagan administration, only three percent of the total OCS wells drilled since 1954 have been drilled outside the Gulf of Mexico, and eighty-seven percent of the Gulf wells have been drilled in the Louisiana OCS.<sup>1009</sup>

*c. Socioeconomic impacts and environmental protection*

It is submitted that Secretary Watt's offshore oil regime has successfully created market-oriented operating conditions: the five-year program helped to open up the OCS to the oil industry, areawide leasing now largely depends on industry for tract selection, and the bidding process clearly relies upon the limits of corporate estimations of fair market value. The federal offshore accounted for eleven percent of the United States' domestic oil supply in 1983.<sup>1010</sup> Production has been on a slow upturn since 1981, increasing from an average of 1.06 million barrels per day in that year to 1.25 million barrels per day in 1983.<sup>1011</sup> Much of this increase can be attributed to an expansion of activity in the Gulf of Mex-

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1008. See *Shell, Chevron keep East Coast Alive*, OFFSHORE, Jan. 1984, at 47, 47.

1009. *Department of the Interior and Related Agencies Appropriations for 1985: Hearings Before the Subcomm. on the Department of the Interior and Related Agencies of the House Comm. on Appropriations—Part 5*, 98th Cong., 2d Sess. 472 (1984) (statement of Paul L. Kelly, Vice-President of Industry and Government Relations, Rowan Companies, Inc., Houston, Tex.).

1010. *Offshore Oil and Gas Oversight: Before the Subcomm. on Panama Canal/Outer Continental Shelf of the Comm. on Merchant Marine and Fisheries*, 98th Cong., 2d Sess. 226-32 (1984) (statement of C.B. Wheeler, Senior Vice-President of Exxon Co.).

1011. See *Offshore crude, gas production increase*, OFFSHORE, July 20, 1984, at 52, 57.

ico.<sup>1012</sup> No frontier oil has yet contributed to domestic production, but given the long lead times involved this is not surprising. Obviously, the OCS is still not as important to the United States as the UKCS is to Britain. The United Kingdom offshore produced nearly twice as much oil as the OCS in 1983, with an average daily rate of 2.27 million barrels.<sup>1013</sup> American oil imports steadily declined after 1981, and bottomed out at less than four million barrels per day in early 1983 because of conservation and the recession.<sup>1014</sup> The balance of payments bill for 1982 fell to sixty billion dollars.<sup>1015</sup> But imports have recently risen steeply again, and, by the beginning of 1984, the rate had gone back up to over five million barrels a day, about a third of total consumption.<sup>1016</sup>

The Watt program has meant a major boom for the differing segments of the offshore industry. By the summer of 1981, a fifty percent expansion of the world's offshore drilling fleet had begun at a total cost estimated to be in excess of twelve billion dollars.<sup>1017</sup> The American geophysical fleet, which had carried out extensive surveying before the approval of the current five-year plan, grew by more than forty percent in this period. Contracts for more than \$800 million worth of new supply ships were awarded for completion before the end of 1983.<sup>1018</sup> Service and supply industries have spent about twenty billion dollars developing equipment necessary for the exploration of frontier areas.<sup>1019</sup> Expenditure has been particularly heavy in the development and purchase of the highly complex technology required for the Alaskan OCS. The recently constructed Mukkluk Island, for example, cost over \$100 million.<sup>1020</sup> OCS leasing, however, has had even wider economic effects because the American oil industry employs hundreds of thousands of people. In 1981, about 361,000 persons were employed both onshore and offshore in California and Alaska alone, and fifty-one billion dollars was invested in oil-related physical assets in these states.<sup>1021</sup> In a recent study undertaken by the Economics Department of Louisiana State University, it

1012. LeBlanc, *New Leases spur Gulf Rig Activity*, OFFSHORE, Jan. 1984, at 51, 51.

1013. *See Offshore crude, gas production increase*, *supra* note 1011, at 57.

1014. Remarks of Secretary William Clark to the United States Dep't of the Interior OCS Policy Committee, in Washington, D.C. (Jan. 12, 1984).

1015. MINERALS MGMT. SERVICE, *supra* note 980, at 101.

1016. Remarks of Secretary William Clark, *supra* note 1014.

1017. Palmer & Kelly, *America's Five-Year Offshore Leasing Plan—Its Importance in Increasing Domestic Petroleum Reserves and the Role of Industry in Its Development and Implementation*, in 21 EXPLORATION & ECON. OF THE PET. INDUSTRY 233 (1983).

1018. *Id.*

1019. AM. PET. INST., *supra* note 978, at 144.

1020. *See \$100 million island is U.S. record*, OFFSHORE, Jan. 1984, at 36, 36.

1021. MINERALS MGMT. SERVICE, *supra* note 980, at 68.

was found that in 1981 the offshore industry in both state and federal waters employed 41,781 people in Louisiana.<sup>1022</sup> The industry has also provided indirect employment to another 85,000 persons in such sectors as construction, maintenance, and business services.<sup>1023</sup> Given the current exploratory surge in the Gulf, it is reasonable to conclude that these figures may reflect a lower level of oil-related employment than that which currently pertains.<sup>1024</sup> It would, however, be wrong to suppose that the economic benefits of offshore development have been confined to oil-producing coastal states. Much of the steel used in building oil rigs, for example, is made in Ohio and Pennsylvania. Engines powering the rigs are made by Illinois and Michigan corporations. Highly specialised drilling machines are made in such states as Nevada, Wyoming, Oklahoma, and Utah.<sup>1025</sup> The offshore industry and its various contractual suppliers have, in their response to the Reagan administration's expedited leasing schedules, undoubtedly created an impact on the American economy.

Another way in which the Watt program has assisted the American economy is through the raising of OCS revenues for the federal Treasury. Although the United States government rightly envisaged that the new five-year plan would cause a drop in the average bonus bid per tract, areawide leasing, with its high quality offerings, has helped to increase federal receipts. From the viewpoint of the Treasury, revenues from the OCS program compare favorably to the UKCS fiscal regime. In 1982, OCS revenues, excluding taxation, totalled \$7823 million.<sup>1026</sup> By the end of 1983, Britain had licenced a total of sixty-six million acres of the UKCS,<sup>1027</sup> and the United States had leased about thirty million OCS acres.<sup>1028</sup> Although UKCS production levels are also about double OCS levels,<sup>1029</sup> in fiscal year 1982, the UKCS yielded the British Exchequer a total, including tax, of £6452 million.<sup>1030</sup> With higher federal revenues projected for 1983 and 1984, it is very probable that the American and British offshore industries are presently contributing similar amounts to public funds. American industry has not objected to the payment of

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1022. AM. PET. INST., *supra* note 978, at 139.

1023. *Id.*

1024. *Id.*

1025. *Id.* at 143.

1026. MINERALS MGMT. SERVICE, *supra* note 549, at 16.

1027. AM. PET. INST., *supra* note 547.

1028. MINERALS MGMT. SERVICE, *supra* note 549, at 16.

1029. *See Offshore crude, gas production increase, supra* note 1011, at 57.

1030. U. K. DEP'T OF ENERGY, *supra* note 534, at 20.

lease bonuses, which, once paid, are irrelevant to future investment decisions. In sum, it appears that the expansion of lease sales has done much to encourage wider participation offshore, particularly with regard to recent Gulf of Mexico lease sales. It is the opinion of the industry periodical, *Offshore*, that "the areawide leasing concept . . . is the principal reason for the surge of independents into the offshore arena."<sup>1031</sup> This trend has further promoted exploration because smaller companies cannot afford to delay the investigation of their lease equity.<sup>1032</sup>

Turning to the last goal, environmental protection, there have been no significant OCS oil spills or blowouts since 1981.<sup>1033</sup> From all appearances, it would seem that the offshore oil industry's safety and environmental record has retained its credibility.

## 2. Conservative Goals

The UKCS goals of Mrs. Thatcher's Conservative government were: (1) to encourage exploration; (2) to create a market-oriented operating climate; (3) to use UKCS oil to boost the British economy; (4) to maximise oil revenues; (5) to attempt to prolong United Kingdom self-sufficiency; and (6) to continue national controls over oil supply.<sup>1034</sup>

### *a. Exploration*

The two major factors in Conservative attempts to expand exploration were the diminution and eventual termination of BNOC's operating role and the holding of licensing rounds offering vast amounts of acreage. It is estimated that the three latest licensing rounds will licence a total of about fifteen million acres, probably more than the area that will be leased under the present American five-year program. The licence criteria of the ninth round have further assisted in the licensing of frontier blocks. Industry was eager to gain acreage in the seventh round, but was less interested in the eighth round because of the fiscal regime and the oil glut. Alterations to the taxation system have stimulated exploratory work, and the ninth round has been a considerable success.<sup>1035</sup> Exploration and appraisal drilling have increased every year since the Conservatives came to office, reflecting both the success of the government's

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1031. Redden, *Operators pursue Gulf deepwater tracts*, OFFSHORE, June 1984, at 48, 51.

1032. *Id.*

1033. AM. PET. INST., *supra* note 978, at 131.

1034. *See supra* notes 692-96 and accompanying text.

1035. *See supra* notes 966-69 and accompanying text.

market-based policy and industry's need to discover new reserves.<sup>1036</sup> More exploration and appraisal wells were drilled than ever before in 1983, and the level of activity in 1984 was even greater.<sup>1037</sup> Proportionally far more exploration wells have been drilled on the UKCS than on the OCS.

*b. Market utilisation and other socioeconomic impacts*

In the first stage of the present government's offshore strategy, the possibility of the use of depletion controls, BNOC's continued existence as an upstream oil corporation with important trading activities, and the increasing fiscal burden detracted somewhat from the Conservative administration's encouragement of free enterprise development of the UKCS. By the end of the second stage, however, very favorable market conditions were created, particularly with reference to the development of future fields.<sup>1038</sup>

UKCS oil has had a profound effect on the British economy over the last five years. The UKCS puts Britain in the unique position of being the only major Western power self-sufficient in oil. In view of the comparative weakness of British industry, Britain's oil-fueled balance of payments surplus is especially valuable. It is estimated that without North Sea oil, there would have been a £5.8 billion balance of payments deficit for 1983.<sup>1039</sup> A report undertaken for the Institute of Fiscal Studies in 1981 by the economists Forsyth and Kay showed that "North Sea oil adds, directly and indirectly, at least 10 percent to our national income."<sup>1040</sup> In 1982, a year which saw the British jobless total rise to around three million, it was calculated that unemployment would have been about 700,000 higher without North Sea oil.<sup>1041</sup> The offshore oil industry currently employs 100,000 people directly, about 65,000 of them in Scotland.<sup>1042</sup> Capital investment has increased every year since 1979, and a total of £8.5 billion was spent from 1979 through 1982.<sup>1043</sup> In 1982, oil-related spending amounted to twenty-five percent of United

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1036. U. K. DEP'T OF ENERGY, *supra* note 534, at 33.

1037. Letter from Mr. Alick Buchanan-Smith, *supra* note 910.

1038. *United Kingdom Energy Outlook*, ESSO MAGAZINE (supplement), Winter 1983-84, at 7.

1039. SHELL U.K. LTD., *THE NORTH SEA AND BRITISH INDUSTRY: THE NEW OPPORTUNITIES* 7 (1984).

1040. Address by J.M. Raisman, *supra* note 715.

1041. SHELL U.K. LTD., *supra* note 1039, at 11.

1042. See Letter from The Rt. Hon. the Lord Gray of Contin, P.C., *supra* note 669.

1043. U.K. DEP'T OF ENERGY, *supra* note 534, at 21.

Kingdom industrial investment.<sup>1044</sup> It has been projected that nearly sixty billion pounds will have to be spent if the UKCS is to provide an oil supply sufficient to meet the United Kingdom's needs till the year 2000.<sup>1045</sup> Over fifty billion dollars has already been spent in the exploration and development of the UKCS.<sup>1046</sup> These levels of spending can be put into perspective by noting that Britain has a gross national product an eighth of the size of America's and that the Apollo space program cost \$25.5 billion.<sup>1047</sup> North Sea oil is much more important to the United Kingdom than OCS reserves are to the United States, as it is easily the most significant industrial asset that Britain possesses. Present policies do seem to be successful in using this asset to create wealth.

It was noted above that the British government has consistently attempted, largely through the discretionary allocation licensing system, to maximise United Kingdom involvement in UKCS development.<sup>1048</sup> Although the Conservatives have been reasonably successful in pursuing this economic goal, there have been some notable failures. In recent years, some seventy percent of the contracts relating to offshore work have gone to British companies.<sup>1049</sup> But United Kingdom firms, in 1982 for instance, only undertook twenty-nine percent of the exploration and appraisal drilling.<sup>1050</sup> There are still lamentably few British independent oil companies.

The latest government initiative to improve British participation was the Department of Energy's decision to include a new licence criterion in the ninth round. In that round, heavy emphasis was placed on the extent to which the applicant has involved, or plans to involve, U.K. owned and controlled organizations in his exploration, development, and production activities on the UK Continental Shelf through the generation of new technology, the placement of research and development contracts and the provision of opportunities for the design, demonstration, and testing of products and techniques.<sup>1051</sup>

Commenting on this change, Mr. Alick Buchanan-Smith, Minister of State for Energy, recently said, "[w]e are moving into new frontier areas . . . [a] challenge [that] offers an opportunity for the U.K. to be a world leader in offshore oil and to build up an industry which can be active for

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1044. *Id.*

1045. Uthlaut, *North Sea Prospects*, ESSO MAGAZINE (supplement), Winter 1983-84, at 11.

1046. SCOTTISH DEVELOPMENT AGENCY, *supra* note 587, at 3.

1047. *Id.*; see *The English-speaking slump*, THE ECONOMIST, Aug. 18, 1979, at 13, 13.

1048. SHELL U.K. LTD., *supra* note 1039, at 12.

1049. U.K. DEP'T OF ENERGY, *supra* note 534, at 24.

1050. *Id.*

1051. Gazette Notice, *supra* note 911, para. 8(g).



many years to come."<sup>1052</sup>

The importance of oil revenues to the Conservatives' economic strategy has already been noted.<sup>1053</sup> In 1982, oil taxation swelled Treasury cash flow by eight billion pounds, about ten percent of the government's total tax receipts.<sup>1054</sup> The level of receipts increased to nine billion pounds in 1983.<sup>1055</sup> The high tax rates of 1980-83 were very significant in enabling the government to continue its monetarist policies in the recession-laden months of the early 1980's.

The goals of Conservative oil policy have, by and large, been met. The licensing rounds have, and are, opening up the UKCS to private enterprise. There has been an impressive record of exploratory activity, with numerous new discoveries. It is probable that these discoveries will, with future finds, prolong British self-sufficiency into the 1990's. The removal of BNOC's operating arm, a disavowal of depletion policy, and reductions in taxation have done much to attract new offshore interest. North Sea oil has been a vital influence in the British economy over the last few years and appears to be ready to continue this role. Oil taxation, as the Conservatives had hoped, has been a crucial factor in the administration's financing, as the British government has doggedly retained its controls over oil supply. Overall, it would appear that Mrs. Thatcher's energy objectives have been more satisfactorily achieved than have Mr. Reagan's.

### C. Recommendations

Assuming the continuation of present policies and goals in both the United States and the United Kingdom, it is submitted that legal and administrative changes could be made which would further assist in the achievement of these objectives. The following are some suggestions.

#### 1. United States

##### a. Coastal revenue sharing

The American oil industry supports coastal revenue sharing because it believes that such a legislative provision would reduce the opposition of coastal states to OCS leasing. But the federal government, afraid of the

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1052. OFFSHORE, July 20, 1984, at 6.

1053. See *supra* notes 792-94 and accompanying text.

1054. Uthlaut, *supra* note 1045, at 10.

1055. North Sea Oil and All That, an address by J.M. Raisman, Chairman and Chief Executive of Shell U.K. Limited, to the Energy Industries Club, in London (Apr. 17, 1984).

effect on Treasury receipts, has so far been opposed to increased state revenue sharing.<sup>1056</sup> It may be possible, however, to use coastal revenue sharing to increase both the rate of leasing and federal revenues. It was noted above that areawide leasing has greatly swollen bonus monies received by the MMS.<sup>1057</sup> The largest rewards have accrued from the Gulf of Mexico, because more tracts have been offered in that mature oil province than elsewhere. This has been due to the fact that there has been considerable opposition to offshore leasing in the Pacific, Atlantic, and Alaskan regions. But industry remains interested in these areas. If area-wide lease sales could be held, for example, in the Californian and North Atlantic OCS as easily as they are arranged in the Gulf, then a large influx of bonuses would also be forthcoming from frontier territories. Were coastal states to be granted, for instance, a ten percent share in lease bonuses, then the states would have a direct interest in the rate of leasing. The strongest incentives to cooperate with the federal program would be provided to those states with the most lucrative adjacent OCS. These states, California, Alaska, and the New England states, have to date been DOI's most intransigent opponents. Such a scheme would have the added attraction of providing a rapid cash flow to both the states and the federal Treasury. There is reason to believe that such a coastal revenue sharing concept would indeed facilitate a reduction in coastal opposition to federal offshore activities. The record of California is instructive. Though California has been a staunch opponent of OCS leasing, it has permitted the drilling of more than 3000 wells in its own state waters.<sup>1058</sup> By comparison, only 2000 wells had been drilled on the UKCS as of 1982.<sup>1059</sup>

If the coastal states were persuaded by this proposition, then the federal government would almost certainly stand to make an overall gain in revenues from the OCS. But if the states failed to respond, then the result would be a net loss in revenues because there would be nothing to offset the ten percent loss in Gulf of Mexico bonuses. Despite the latter possibility, it is submitted that it would be worthwhile experimenting with such a plan for a trial period of, perhaps, eighteen months.

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1056. See Vass I, *supra* note 992, at 86-87.

1057. See *supra* note 1026 and accompanying text.

1058. *OCS Oversight—Part 2: Hearings Before the Subcomm. on the Panama Canal/Outer Continental Shelf of the House Comm. on Merchant Marine and Fisheries*, 97th Cong., 1st Sess. 56 (1981) (testimony of Secretary James G. Watt).

1059. SCOTTISH DEVELOPMENT AGENCY, *supra* note 587, at 5.

b. *Enlargement of OCS tracts*

Apart from litigation and moratoria, a major obstacle to the achievement of the administration's expedited leasing policies has been the size of OCS tracts. The rapid development of the North Sea and the present exploratory boom is largely attributable to the British Department of Energy's policy of offering and licensing vast amounts of acreage. In the seventh round, for example, about five million acres or fifty percent of the area offered was licensed.<sup>1060</sup> Areawide leasing has also offered large parts of the federal offshore to the oil industry. But in the first fourteen months of the new system only 6.4% was actually leased.<sup>1061</sup> British blocks are more than ten times as large as American tracts, and Norwegian blocks are about twenty times larger.<sup>1062</sup> As the MMS readily admits, "a single tract will rarely be commercially producible . . . by itself."<sup>1063</sup> It is therefore proposed that future OCS tracts should be generally expanded to four times their present size. A multiplication of four allows previous grid lines to continue in use. It should be noted that this expansion would not necessarily involve a change in the law, as such an action is within the Secretary of the Interior's discretion, as laid down by section 8(b)(1) of the OCSLAA.<sup>1064</sup> If the future norm favored larger OCS tracts, however, a change in the statute might be desirable.

It is suggested that the consequences of such an innovation would be as follows. Areawide leasing has shown that if massive amounts of quality offshore acreage are put on the market, then industry is prepared to invest a great deal of money in cash bonuses, and many more tracts will be leased, albeit at a lower dollar amount per acre.<sup>1065</sup> But because competitive bidding directs industry funds to the most lucrative tracts, only a certain number of tracts can be leased. Assuming the continuation of a substantially similar system of areawide leasing, the introduction of forty-square mile tracts would not necessarily diminish the number of tracts sought by the oil corporations. There would still be the same

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1060. U. K. DEP'T OF ENERGY, *supra* note 534, at 32.

1061. MINERALS MGMT. SERVICE, *supra* note 980, at 71.

1062. Daintith & Gault, *supra* note 581, at 31.

1063. MINERALS MGMT. SERVICE, *supra* note 980, at 73.

1064. 43 U.S.C. § 1337(b)(1) (1982).

1065. The National Ocean Industries Association asserts that bonuses for OCS leases have been dropping since 1980. Factors which have caused this, apart from the large increase in the availability of lease acreage, are lower anticipated future world prices, higher development costs, and a reduction in the quality of Gulf of Mexico near-shore offerings. See National Ocean Industries Association, *An Industry Perspective on the First Year of the OCS Areawide Leasing Program in the Gulf of Mexico* (Sept. 11, 1984) (draft report).

number of companies desiring to participate in OCS exploration and development. They might form larger consortia and so submit fewer bids, but since they would not be obligated to expand their exploration programs commensurate with the increase in acreage, there is no reason why this should happen. Money available for bidding would certainly not increase with the size of the tracts, and there would inevitably be a further drop in the dollar amount paid per acre.

The benefits of such a tract expansion would be threefold in nature. First, it has been the shortage of acreage in frontier areas which has been a leading cause of the rather disappointing exploration rates. Yet it is the frontier areas which are likely to contain the largest oil and gas accumulations. Thus larger tracts would significantly increase industry holdings and hence probably lead to a higher rate of exploration. Second, while forty-square mile tracts would not cause a quadrupling of the pace of OCS exploration, they would facilitate a more thorough offshore inventorying, which is one of DOI's declared goals. Third, the proposed tracts would tend to be more economically viable.

Circumstances could arise, however, where it might be difficult or inappropriate to utilize the envisaged larger tracts. In much of the Gulf of Mexico, for instance, it would be impossible, because of extensive earlier leasing, to lease many squares of the aforementioned size. The solution there would be to continue to use the previous system. The larger delimitations might also be inappropriate where it becomes obvious that a great deal of prime acreage is concentrated in one or two tracts. The Santa Maria Basin in California, which has been made an industry target because of the Point Arguello discovery, could be cited as a case in point.<sup>1066</sup> The retention of smaller tracts would serve to widen participation in such lucrative acreage.

It is submitted that the adoption of forty-square mile tracts would not be susceptible to successful litigious attack. Areawide environmental analysis and areawide leasing have both been judicially approved,<sup>1067</sup> and it would be easy to assimilate the larger tracts into the streamlined leasing process. Not even tract evaluation would need to be changed, as the minimum bid of \$150 per acre could simply be retained along with the other procedures. Secretary Watt's concept of fair market value, with its lowered proportional cash bonuses and its anticipated raising of royalties and taxes, was held in *Watt II* to meet the requirements of the OC-

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1066. See *Oil and Gas in Washington*, WORLD OIL, Feb. 1, 1984, at 23.

1067. See *California v. Watt*, 712 F.2d 584, 590-94 (D.C. Cir. 1983).

SLAA.<sup>1068</sup> This leasing proposal, which embodies the former Secretary's rationale, would, it is believed, meet with similar approval. While it might be thought that a fourfold increase in tract acreage is ambitious, compared to the British experience such a tract would be regarded as small. In any event, in order to further allay criticisms relating to the enlarged tract size, a British-style surrender requirement of perhaps a third to a half of the acreage after the initial term could be introduced.<sup>1069</sup>

*c. Sequential bidding*

The total number of bonus bids in any given lease sale accurately reflects industry interest in certain offered tracts. On tracts perceived as especially attractive multiple bids will be submitted. Since areawide leasing expanded the lease market, a much higher percentage of tracts have been awarded on a single bid basis.<sup>1070</sup> Nevertheless, a significant number of cash bonuses are still being returned to unsuccessful bidders. Industry lease acreage, OCS participation, and federal receipts would to some extent be increased if such bidders were allowed to reinvest their committed finance in alternative tracts. It cannot be guaranteed that all or any of the rejected bonuses would actually be used in fresh bidding, because areas eliciting no initial submissions will have been viewed unfavorably. However, it is highly likely that some new bidding would be the result of this sequential system.

Sequential bidding would make lease sales somewhat more complex, as there would in fact be two or even more "rounds." It is projected that costs, however, would be more than offset by increased bonuses.<sup>1071</sup> Six to eight months could be left to elapse between the announcement of initial awards and the timing of a second round of bidding. This interlude would give industry some time to undertake additional geophysical and geological work. The strategies of successful bidders in the first round would also be of assistance to second round bidders.<sup>1072</sup>

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1068. *Id.* at 606-08.

1069. See Petroleum (Production) Regulations, 1982 STAT. INST. No. 1000, sched. 5, cl. 4.

1070. OUTER CONTINENTAL SHELF RESOURCE DEVELOPMENT NEWS, Sept. 1983.

1071. See McDonald, *The Economics of Alternative Leasing Systems on the Outer Continental Shelf*, 18 HOUS. L. REV. 967, 981 (1981).

1072. The United States Department of Energy did consider promulgating regulations which authorized sequential bidding in the autumn of 1979. But no such regulations were actually passed. See *OCS Oversight—Part 2*, *supra* note 1058, at 12.

*d. Enhanced oil recovery*

Presently, it is impossible to economically produce most of the oil and gas in hydrocarbon reservoirs. The average recovery rate in the North Sea, at fifty percent, is high by world standards.<sup>1073</sup> In 1981, the United States Geological Survey estimated that the United States contained up to 250 billion barrels of oil that could not be economically produced.<sup>1074</sup> If even ten percent of that total could be made available, the American oil supply situation would be transformed. But up until now, oil companies have preferred to concentrate their funds on new exploration and development.

It is clear that enhanced oil recovery (EOR) offers immense potential for the future. But the new technologies necessary to markedly increase production from existing fields are likely to prove very expensive. In an attempt to mitigate this expense, various fiscal incentives designed to encourage EOR are currently built into the federal oil tax system. Under the Crude Oil Windfall Profit Tax Act of 1980,<sup>1075</sup> for instance, incremental tertiary oil is categorized as tier three oil.<sup>1076</sup> Revenues accruing from the sale of tier three oil are chargeable at the low rate of thirty percent.<sup>1077</sup> The other two tiers of taxable oil, tiers one and two, are generally chargeable at the rates of seventy and sixty percent respectively.<sup>1078</sup> A further mitigative measure could be implemented by offsetting all or part of EOR expenditures against federal royalties.

The British government has also considered ways of encouraging EOR. It was announced in the 1984 budget that, following consultation with industry, there would be a review of the tax position of EOR activities on the UKCS.<sup>1079</sup> Consequently, it was expected that the resulting changes would be announced in the 1985 budget. Ultimately, however, no concessions were made to the oil industry on this issue.

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1073. Address by J.M. Raisman, *supra* note 1055.

1074. AM. PET. INST., TWO ENERGY FUTURES: A NATIONAL CHOICE FOR THE 1980's, at 43 (1980).

1075. Pub. L. No. 96-223, 94 Stat. 229 (1980) (codified at 26 U.S.C. §§ 4986-4998 (1982)).

1076. See 26 U.S.C. § 4993(e) (1982).

1077. *Id.* § 4987(b)(3). See generally Bell & MacKenzie, *Windfall Profit Tax and DOE Regulation: Problems in Property Definition*, 32 INST. OIL & GAS L. & TAX'N 301, 322 (1981) (discussing the tertiary recovery of crude oil).

1078. 26 U.S.C. § 4987(b)(1) (1982).

1079. Inland Revenue, Press Release (Mar. 13, 1984).

## 2. United Kingdom

### *a. An auction experiment*

Because the cash bonus system used in American competitive leasing does not discourage further development, areawide sales have resulted in a major monetary influx for the American Treasury without significantly damaging industry's capacity to develop discoveries. The British system has also been successful in raising revenues, but it is awkward by comparison. In American terms, acreage on the UKCS is obtained, in conjunction with other discretionary criteria, by an exploration bid, with royalties and taxes constituting the other elements in the government's economic rent. During the years 1980-83, excessively high levels of taxation all but destroyed industry's incentive to develop. The British exploration bid, which is different from the OCSLAA version, has not entailed wasteful drilling, because United Kingdom operators do not have to compensate the government for shortfalls between actual and projected exploration. Though failure to carry out a work programme can prejudice an oil company with respect to future licensing rounds, this effect would be minimised if it could be shown that exploration would be fruitless anyway. It is not proposed that the work programme system be completely abolished. The government has great confidence in it, and it has functioned well in practice.

Accordingly, it is suggested that the United Kingdom should retain the work programme system, but begin large-scale experimentation with competitive bonus bidding. If auctioning could be used to partly switch UKCS revenues away from taxation, then offshore development would be further encouraged. United Kingdom governments have historically been wary of cash bonuses, largely because of the anticipated effect on British participation, a notion reflected by the fact that the total sum of UKCS auction and nomination receipts is less at today's exchange rates than the highest ever single OCS bid.<sup>1080</sup> Nevertheless, it is submitted that an auction experiment could be devised which would greatly encourage frontier development, speed Exchequer cash flow, and do much to guarantee British participation.

The auction experiment could be performed in the following fashion. In the next round of licensing, the British government should, as they did in the seventh round, offer both a substantial number of specified discretionary blocks and open up a vast UKCS area to industry nom-

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1080. *OCS Oversight—Part 2*, *supra* note 1058, at 52.

ination. The nominations zone should only consist of frontier territory. The discretionary blocks would be licenced in the normal fashion and would therefore ensure the success of the round whatever the results of the auction experiment. It would be announced in the *Gazette* notice that, pursuant to a certain deadline, bonus bids would be invited with respect to blocks in the nominations area. All bids would have to allow for any relevant BNOC oil trading rights and twenty percent British participation. A minimum bid per block could be fixed at ten million pounds. This bid would be similar to OCS minimum rates, but would double the nominating fee sought in 1980.<sup>1081</sup> It would be further provided that the PRT chargeable against discoveries in auction areas (which could be referred to as "auction fields") would be reduced by five percent from future rates applicable at the date of first production with every £400 million submitted in total bonuses. Also, a twenty percent ceiling would be put on possible tax reductions.

This proposal would utilise the best of both the competitive and the discretionary systems. The nominations procedure, a successful feature of the OCS system and the seventh British round, would elicit corporate expertise to licence prime acreage. This latter factor, along with possible tax relief, would constitute a strong incentive to bid. There has as yet been no recent British "licence sale," held under favorable conditions, which could give guidance to the amounts of bonus money which the British oil industry would be willing to invest. It may be helpful in this respect to compare the UKCS against the Gulf of Mexico. The former is by most yardsticks a more lucrative oil province than the latter; in 1983, the UKCS produced about twice as much oil as the Gulf.<sup>1082</sup> Given that the second areawide lease sale in the Louisianian OCS provided the federal Treasury with about \$3.5 billion<sup>1083</sup> and given the fact that many oil companies operating on the UKCS are American subsidiaries and hence have some access to international financing, one might reasonably hope that an areawide auction of British blocks would attract at least one-third to one-half as much as the second areawide lease sale. A successful auction would constitute a considerable boost to the Exchequer, which, it will be recalled, gained only £548 million on the sale of Britoil.<sup>1084</sup> Depending on bidding levels and on how many oil and gas accumulations are left to be discovered in frontier areas, the auction might actually

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1081. See *supra* note 783 and accompanying text.

1082. *Offshore Production makes significant gains*, OFFSHORE, May 1984, at 110, 113.

1083. MINERALS MGMT. SERVICE, *supra* note 549, at 9.

1084. See *supra* notes 867-72 and accompanying text.



cause overall oil revenues to increase. The British participation proviso would be unlikely to attract opposition from the oil industry, as the requirement would be insignificant when compared to the sixth round condition that BNOC had to be offered more than a fifty-one percent equity share in every licence application. Difficulties might arise, however, with regard to the laws of the EEC, of which Britain is a member state. EEC rules forbid the creation by one member state of trade laws which discriminate against other member states.<sup>1085</sup> A twenty percent British participation requirement might well be interpreted as discriminatory. A solution to this possible problem would be to change the proviso so as to require twenty-five percent EEC participation. Since almost all of the non-British UKCS operations have been undertaken by North American companies, a twenty-five percent EEC proviso would in practice ensure at least twenty percent British involvement in each licence.<sup>1086</sup>

*b. BNOC's oil trading role*

BNOC's marketing division has been seen by the Conservatives as a vital guarantor of Britain's oil supply. It is also clear that private oil companies resent this state activity and believe that BNOC is unsuited to its designated task in times of market uncertainty. Regardless of the changes that may eventually be introduced into the realm of state oil trading, it is almost certain that emergency powers will be retained. It is equally probable that BNOC will remain as the instrument of control. Despite these likely conditions, it may still be possible to facilitate more market-oriented oil trading under normal conditions. In particular it is suggested that the government should, with the agreement of the oil industry, divest BNOC of its current fifty-one percent purchase options. Criteria for future licensing rounds should reflect this change. The state oil corporation's trading role should be reduced to fifteen percent, thereby keeping it active and in tune with the market, but alleviating its former dominant position. Under ordinary conditions this reduction would not matter greatly, as the policy of successive British governments and BNOC has generally been to let the world oil market determine BNOC's offering price.<sup>1087</sup> In place of BNOC's former powers, it should

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1085. Woodcliffe, *North Sea Oil and Gas—The European Community Connection*, 12 COMMON MKT. L. REV. 7, 14 (1975). For a further discussion on the interaction between United Kingdom oil and gas law and EEC law, see Evans, *The Development of a Community Policy on Oil*, 17 COMMON MKT. L. REV. 371 (1980); Evans, *United Kingdom North Sea Oil Policy and EEC Law*, 7 EUR. L. REV. 355 (1982).

1086. See K. DAM, *supra* note 542, at 40.

1087. Forster & Zillman, *supra* note 600, at 81.

be statutorily stipulated that in every future contract for UKCS oil or condensate there will be an implied term allowing the British government the right, in times of emergency, to purchase up to sixty percent of production at fair value. Although decisions as to what constitutes an "emergency" and "fair value" would be matters of ministerial discretion, post-crisis arbitration would be allowed with respect to the latter. Assuming the continuation of the present legal requirement that all UKCS oil and gas must first be landed in the United Kingdom before being exported, it is submitted that BNOC's reduced role and the new implied term would be adequate to protect British interests.

## VII. CONCLUSION

In the United States, the Republican administration of Ronald Reagan has pursued the goals of decreased foreign dependence and oil-fired economic regeneration with an ambitious expedited leasing program. In the past, only comparatively tiny parts of the OCS were leased. In accordance with the American economic ethos, the development of OCS riches was solely entrusted to private enterprise, which used a competitive bidding system with cash bonuses as the sole bid variable. The Reagan administration's new streamlined procedures have channeled significant industry input into the leasing process, as the new areawide system has greatly increased industry lease holdings. But because of litigation and appropriations moratoria, most of the new lease holdings have occurred in the Gulf of Mexico and, to a lesser extent, in Alaska. There has also been a considerable quickening of the pace of exploration, but again this has been concentrated in the Gulf. The approach of the new Secretaries of the Interior, William Clark and Donald Hodel, has been to continue, albeit less ambitiously, the basic policies of the Watt program. The opposition of coastal states and environmentalists, accompanying litigation, and appropriations moratoria seriously threaten the viability of the present five-year program. The American institutional and political structure and the complex laws relating to OCS oil and gas do much to facilitate challenges to federal offshore decision-making. The OCS holds great potential, especially in the Alaskan frontier areas, but at the present it makes only a limited contribution to the American economy and oil supply. Because of the long lead times essential to offshore oil exploration and production, it is not yet possible to conclude whether the OCS program will actually result in a massive increase in domestic production. Thus far, however, the expedited leasing policies have been

moderately successful in at least creating opportunities for exploration in prospective waters.

Britain's economic situation, her production relative to consumption, and her position vis-à-vis the oil industry have required the Conservative government, although philosophically similar to its American ally, to adopt a somewhat different oil policy. In the context of Britain's declining heavy industries and the recession of 1979-82, it became necessary for the British government to attempt to maximise UKCS oil revenues. The oil crisis of 1979-80 served to reiterate the need for strong governmental controls over oil supply, and effectively guaranteed BNOC's future as the leading North Sea oil trader. UKCS overproduction prompted the Department of Energy to consider depletion controls, and the fact that North Sea development inevitably involves substantial foreign participation caused the Conservatives to continue the discretionary allocation licensing system. Conservative policy throughout, however, has been geared to the maximisation of exploration and privatisation. These goals have manifested themselves in three massive licensing rounds and the termination of BNOC's and BGC's operating roles in the oil business. In more recent times, desires to prolong self-sufficiency have resulted in a slackening of the tax burden, at least with respect to "future fields," and the encouragement of new production. British oil policy has by now become similar to the policies pursued in America. The Conservatives' market-oriented stance has entailed some experimentation with the corporate nomination procedures and bonus bidding, two dominant features of the Watt program. But no experiment has yet established the true potential for bonus bidding in licensing rounds. In the event that an experiment with bonus bidding proves successful, the tax burden of offshore operators may be reduced to the mutual benefit of both government and industry.

The large Tory majorities in the last two elections, the lack of public interest in offshore oil and gas, and the structure of United Kingdom oil and gas law have combined to ensure that there has been no effective opposition to government energy policy. As a result, the British government's goals are being successfully achieved. The UKCS has had an enormous impact on the British economy and has provided a balance of payments surplus, billions of pounds in Treasury receipts, and hundreds of thousands of jobs. Impressively higher rates of exploration have been encouraged, and the development of smaller fields and frontier areas is now under way.

*Author's Note:* Since the writing of this essay, the Thatcher administration has taken significant steps in meeting its policy of privatisation. The government's remaining forty-nine percent share in Britoil will be sold off to the private sector in mid-1986.<sup>1088</sup> The shares will be priced at 185p each and should generate eight to ten billion pounds.<sup>1089</sup> The government plans to retain its special share.<sup>1090</sup> The sale of these state assets should play a vital part in the current administration's plan to cut personal taxes before the next general election.

Perhaps the most significant act of denationalisation has been the decision to abolish the BNOC. BNOC's marketing difficulties have resurfaced with the recent decline in the price of oil. Up until March 1985, the Department of Energy favored the retention of BNOC because of its alleged capacity for adding a measure of short-term stability to the oil market.<sup>1091</sup> Specifically, BNOC can set price rates which are fixed for months at a time. Unfortunately, most oil is now sold in short-term spot markets instead of pursuant to term contracts. Thus the present continuing decline in the price of oil and the currently available supply of cheap oil in the spot market effectively undercuts BNOC's term prices. BNOC can now barely sell one-fifth of its one million barrels of participation oil per day at officially set prices.<sup>1092</sup> As a result, most of BNOC's oil is currently sold at a loss on the spot market. By January 1985, nationalised oil trading was costing the taxpayer one million pounds per day.<sup>1093</sup>

Early in March of 1985, the House of Commons Select Committee on Energy strongly criticised BNOC's role in the market. Shortly thereafter Secretary of Energy Walker made an announcement before the House of Commons and stated that "BNOC could avoid the risk of losses only by linking its prices for participation oil closely and continuously to movement in the spot market."<sup>1094</sup> But to do this would mean that it would no longer be possible for BNOC to contribute even short-term stability to oil prices. Hence, reasoned the Secretary, the BNOC should be abolished. The Oil and Pipelines Bill,<sup>1095</sup> currently before Parliament, purports to do just that. If enacted, the Bill would provide for a

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1088. *One Burnt, Twice as Generous*, THE ECONOMIST, Aug. 3, 1985, at 69, 69.

1089. *Id.*

1090. *Id.* at 70.

1091. U. K. DEP'T OF ENERGY, *supra* note 906, at 82.

1092. *See Grease the oil price slide*, THE ECONOMIST, Jan. 5, 1982, at 11, 11.

1093. *Id.*

1094. *See* U. K. DEP'T OF ENERGY, *supra* note 906, at 82.

1095. H.C. Bill 165, 1984-85 Sess. (1985).

new statutory body, the Oil and Pipelines Agency.<sup>1096</sup> This agency would be charged with disposing of selected assets of the BNOB.<sup>1097</sup> After BNOB had been abolished, the Oil and Pipelines Agency would assume responsibility for three main functions. First, it would undertake the marketing of government royalty oil.<sup>1098</sup> Presumably, price fixing for royalty oil would be related to prices on the spot market. The Agency would also be provided with powers to guarantee the security of supply for the United Kingdom.<sup>1099</sup> BNOB's participation agreements would not be revoked even though the Agency would normally trade participation oil. The Secretary of Energy would continue to retain his power to activate these agreements in an emergency.<sup>1100</sup> Should such a happening occur, the Agency would market the participation oil.<sup>1101</sup> Finally, the Agency would be charged with acting as the Department of Energy's agent with regards to the government's oil pipeline system.<sup>1102</sup>

It should also be briefly noted that current American leasing and exploratory work continues at a brisk pace. In 1984, the DOI leased 7,304,655 OCS acres,<sup>1103</sup> an increase of nearly one million acres over the 1983 total.<sup>1104</sup> Leases were awarded for over two million acres in the Alaskan OCS, five million acres in the Gulf of Mexico, and approximately fifty thousand acres in the Pacific OCS.<sup>1105</sup> No leases were awarded in the Atlantic OCS. In comparison to the 383 exploratory wells drilled in 1983, 627 exploratory wells were drilled in the OCS during 1984.<sup>1106</sup> This dramatic increase was mainly due to the exploratory boom in the Central and Western Gulf of Mexico, as deepwater Gulf activity in particular experienced a rapid expansion. Seventy-one exploratory wells in depths of water over 600 feet—three times the total number of exploratory wells drilled in such depths prior to 1983—were drilled in the Gulf in 1984.<sup>1107</sup> The Alaskan OCS has also been the locus of increased exploration as eleven exploratory wells—eight more than in

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1096. *Id.* at cl. 1.

1097. *Id.* at cl. 4(1).

1098. See U. K. DEP'T OF ENERGY, *supra* note 906, at 82.

1099. H.C. Bill 165, cl. 2.

1100. See U. K. DEP'T OF ENERGY, *supra* note 906, at 82.

1101. H.C. Bill 165, cls. 2(1)(a), (b); (2)(a).

1102. See U. K. DEP'T OF ENERGY, *supra* note 906, at 82.

1103. MINERALS MGMT. SERVICE, U.S. DEP'T OF INTERIOR, OUTER CONTINENTAL SHELF OIL AND GAS LEASING PROGRAM, ANNUAL REPORT FISCAL YEAR 1984, at 2 (1985).

1104. Leases were awarded for 6,587,879 OCS acres in 1983. MINERALS MGMT. SERVICE, *supra* note 549, at 16.

1105. MINERALS MGMT. SERVICE, *supra* note 1103, at 2.

1106. *Id.* at 11.

1107. *Id.* at 13.

1983—were started in 1984.<sup>1108</sup> In the first commercial find in the Alaskan OCS, Shell Western discovered commercial quantities of oil in OCS tracts adjacent to the Seal Island area, which is located in Alaskan state waters.<sup>1109</sup> Exploratory work in the Pacific OCS remained at about the same level, although many of the thirty-two wells begun in 1984 were drilled to further appraise discoveries made in the Santa Maria basin.<sup>1110</sup> In keeping with the general dearth of activity in the Atlantic OCS, only three wells were drilled in that region during 1984.<sup>1111</sup>

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1108. *Id.* at 11.

1109. *Id.*

1110. *Id.*

1111. *Id.*