Oil & Gas UK: Submission to Scottish Affairs Committee – Future of Oil & Gas

Introduction:

Oil & Gas UK is the leading representative organisation for the UK offshore oil and gas industry. Its membership comprises oil and gas producers and contractor companies right across the UK.

Thank you for the opportunity to submit written evidence to the Committee’s inquiry into oil and gas, our responses to the questions are below.

1. What challenges does Scotland’s oil and gas industry face, and how can they be addressed?

The industry is coming through a significant downturn. Companies responded to the fall in oil price initially with challenging cuts in activity, resulting in significant job losses. It should be noted, however, that the oil and gas industry still supports circa 300,000 jobs across the UK, with roughly 45 per cent based in Scotland.

The downturn has also impacted margins, revenue and investment levels across the whole supply chain. Yet, EY’s 2018 Review of the UK oilfield services industry found that in 2016 the supply chain still generated £30billion turnover.

The efficiency improvements as well as cost reductions have meant that the basin is in a more competitive position than it has been in years and as a result there are now some positive signs of capital investment returning to the UKCS, with between 12 and 16 projects awaiting financial investment approval. Such approval could unlock around £5billion of investment. However, it’s important to note that the reserves within these developments amount to less than a year’s production for the UKCS. We still have to find a way to at least sustain and ideally increase investment or we risk accelerated production decline from the UKCS post 2020 and beyond. Industry will need to continue the good work led by the Efficiency Task Force to meet the challenge on remaining cost competitive.

Oil and gas is a global industry with significant competition for investment and it is this that is one of the greatest challenges facing the industry at present. International companies constantly assess the attractiveness of projects within their own global portfolios to decide whether to invest in the UK or in other parts of the world. We need to ensure the investment case in the UK is strong for 2018 and beyond so that activity increases, particularly in exploration and development drilling which remain at an all-time low. Indeed, Oil & Gas UK is forecasting a drop in exploration well counts of 21% for 2018 due to this intense international competition for capital as well as technical and commercial challenges. Appraisal well counts are also forecast to reduce by 6% in 2018, partly due to the limited exploration in recent years.

The UK industry has come into 2018 with determined optimism, crucial if we are to stay competitive in a global industry. This is key to attracting the investment required to increase current activity, fund new exploration and exploration of existing fields and in turn sustain the supply chain in the UK. If we maintain this strong UK domestic
market as a base, the supply chain can be supported to reach out to the global markets and achieve its export potential.

Maintaining our licence to operate is key. Ours is a major hazard industry and safe operations are at the heart of the oil and gas industry’s work. We have a highly skilled workforce that is in high demand. They have driven production efficiency and cost improvements without compromising the rigorous regulations and best practice in place throughout the industry to keep our people and the environment in which we work safe. Oil & Gas UK’s 2017 Health and Safety report showed a further reduction in the sector’s three-year rolling average, non-fatal injury rate, (from 430 in 2015 to 415 in 2016) where UK oil and gas remains lower than other comparable industrial sectors. Our work to improve safety performance is relentless and we can never be complacent about our safety focus.

Industry is also directly addressing the investment challenge by reducing operating costs in a sustainable way. Since 2014, Unit Operating Costs have halved helping to significantly improve the competitiveness of the basin. The Oil & Gas UK led Efficiency Task Force, has played a key role in ensuring these efficiency improvements are sustainable by sharing best practice, for example, Maersk Oil using drones to optimise offshore inspections. In 2016, McKinsey estimated that two thirds of the improvements should be sustainable for the long term.

Operators have improved efficiency and, in addition, a combination of production efficiency improvements and new fields coming on stream have driven four consecutive years of production increases, reversing 14 years of decline. This is a remarkable achievement for a mature basin. For 2018, Oil & Gas UK forecast total production to increase by a further 5% so that we expect to be 20% up on output from 5 years ago.

We have also worked closely with the UK and Scottish Governments to ensure that government policy in Scotland and the rest of the UK supports a sustainable future for the oil and gas industry and one that continues to contribute hundreds of thousands of highly skilled jobs, billions of pounds in taxes and supports the security of energy supply for the country. Working closely with HM Treasury we have delivered a much more globally competitive and stable fiscal environment that must be sustained if we are to continue to attract investment to the basin. The Oil & Gas Authority (OGA) has also helped to deliver a more enabling and efficient regulatory environment.

Industry is embracing new technology and innovation. The Oil and Gas Technology Centre has recently celebrated its first anniversary and with industry support has co-invested £37 million, working on 70 projects to develop and deploy new technology that could transform the future of the UK North Sea. For example, industry embracing new technology can improve the economics and unlock the development of small pools (smaller yet to be developed quantities of oil & gas).

Finally, industry is working hard to improve its culture and increase the already significant levels of collaboration between companies that has helped industry to deliver effectively in the past. Deloitte and Oil & Gas UK run an annual sector survey, which last year found the Collaboration Index score had increased to 7.1 from 6.6 (out of 10). It also found that 95% of operators and suppliers say collaboration is an integral part of their day-to-day business.

Maintaining our highly skilled workforce remains a challenge for the industry. A recent report from global energy skills body OPITO, in partnership with Robert Gordon University’s Oil and Gas Institute showed that while overall direct employment is likely to fall as the basin continues to mature, the industry will need over 40,000 new people to deliver the ambition in Vision 2035 and to continue to diversify in response to the energy transition towards a
lower carbon energy mix. The focus is on working in partnership across the industry to ensure we maintain the experience in our workforce while continuing to attract the brightest and the best new entrants. Our success in this will require governments in Holyrood and Westminster to ensure they continue to focus on STEM subjects in schools and provide support for science centres as well as ensuring that universities and colleges are well funded and linked to industry to match industrial demand with course provision. Safeguarding the long term future for the industry and recognising this in energy policy will also be a key to ensuring the ongoing attractiveness of the industry to young people as a career choice.

We also note that the implementation of the Apprenticeship Levy across the UK means the oil and gas industry is essentially paying twice for apprentices. Companies participating in the Upstream Oil and Gas Technical Apprenticeship programme pay more than £6.5million into the levy but cannot draw down funds because the levy is administered in a different way in England to Scotland.

Although the supply chain has faced a very tough time, with revenue falling by £10 billion between 2014-2016, recent data shows Earnings Before Interest, Taxation, Depreciation and Amortisation (EBITDA) fell by a comparatively modest £1.7 billion on average over the same period. This is the result of companies having to respond to the challenging market conditions, rationalising and reviewing their business models and performance. We are pleased that the Oil & Gas UK Efficiency Task Force, which shares stories of best practice and hosts popular roadshows to drive change, champion innovation and challenge old habits, is also helping to provide momentum and sustain change.

We need to maintain and indeed build on this good progress to keep the UKCS competitive and attract investment. This puts industry in a strong position to manage future volatile commodity pricing, as despite the current higher prices, the longer-term oil price outlook continues to be in the mid-$50 range.

2. How can the economic return from Scotland’s oil and gas reserves be maximised?

Vision 2035 is an industry-owned vision led by Oil & Gas UK which sets an ambitious aim to double the productive life of the basin through maximising economic recovery and doubling the UK’s share of the global goods and services market. Together, this could lead to billions of cumulative revenue by 2035, a substantial proportion of which will benefit companies and the workforce in Scotland.

A relentless focus on cost and efficiency improvements, including the rapid adoption of effective technologies will be critical to maximising the economic return and the steps outlined above show how industry is working to keep the UKCS competitive.

The industry has also proposed to the UK Government a sector deal, which if accepted would be an important component to delivering the Vision 2035 and will lead to the creation of centres of excellence in Scotland with key links throughout the rest of the UK, focused on transformational technology, underwater innovation and decommissioning. These centres will play an important part in maintaining the global recognition of the expertise in oil and gas based in Scotland and the UK.
3. **What action is the UK Government taking to support the long-term future of the oil and gas industry in Scotland, and how effective has this been?**

The industry has a good record of working in partnership with the UK Government in recent years. We now have a globally competitive fiscal and regulatory regime and welcome the stability and certainty of recent years. Following Sir Ian Wood’s review of the industry, we have seen the successful introduction of an industry regulator, the Oil and Gas Authority, which has actively engaged with industry, securing funding for seismic activity and developing new initiatives in service of Maximising Economic Recovery, such as area planning.

In 2014, HM Treasury published the Driving Investment Plan, which has retained political support since its inception with successive Treasury and Department for Business, Energy and Industrial Strategy (BEIS) Ministers repeating the Government’s commitment to following its strategy. A more competitive tax regime, including changes to headline taxes, Decommissioning Relief Deeds and the imminent introduction of Transferable Tax History are all helping to make the UK a more attractive basin in which to do business. Our members tell us at Oil & Gas UK that the UK Government’s commitment to a published plan gives investors more confidence in the UK as a place to invest and so the importance of fiscal stability remains central to the basin’s future success and sustainability and we look forward to Government delivering on its commitments made at the Budget last year.

In 2017, industry welcomed the establishment of the Oil and Gas Technology Centre, which used £180 million of Aberdeen City Region Deal funding and is supported by the UK Government, Scottish Government, Aberdeen City Council, Aberdeenshire Council and Opportunity North East.
Finally, we would note that the oil and gas sector is often competing with national champions from other countries that have very strong state support. Therefore, support from the UK Government and the devolved administrations for companies exporting or seeking to invest abroad is particularly important. The industry values Department for International Trade (DIT) officials with a solid understanding of the sector (the Oil and Gas team specifically), Ministerial visits, Prime Ministerial Trade Envoys, and regional Trade and Investment Commissioners.

4. **How well do the different stakeholders (UK Government, Scottish Government, companies) work together?**

The oil and gas industry is UK wide, with clear hubs in certain parts of the country, for example Aberdeen and Aberdeenshire, the Highlands and Islands, the North East of England and the East of England. However, our workforce and members are spread right across the UK and as such we believe that it is critical that both the Scottish and UK Governments continue to work together to ensure that the support they provide our members in areas like exporting and skills development is easy to access and understand. For example, the approach that SDI and Scottish Enterprise have taken towards account management of oil and gas companies in Scotland has been positively welcomed by many members and we would ask that DIT considers a similar approach. Given the significant potential to grow exports in the oil and gas industry, in particular for oilfield goods and services, we would welcome ambitious export targets from both Governments, provided these are matched by clear and funded support from both Governments.

Two good examples of positive working between the Scottish Government, UK Government and industry is the City Region Deal funding for the Oil and Gas Technology Centre and also the Scottish Government’s Energy Jobs Task Force, which included representation from BEIS.

We also welcomed the Scottish Government’s recent awards from its Decommissioning Challenge Fund, which has for example contributed £1.9million towards the OGTC’s Decommissioning Centre of Excellence in Aberdeen.

In addition to Governments working well together, we also emphasise the need for Government departments to work closely together for the sector, including regulatory agencies. The benefits of aligned working were demonstrated recently by HMRC and HM Treasury working together on the application of End Use Relief for the offshore industry.

However there are currently a number of policy developments that could have a negative cumulative impact, particularly on gas exploration and production as follows.

- The review of gas transmission charging may lead to an increase in entry charges at St Fergus which will have a negative impact on UKCS Production. The industry governance group is currently consulting on alternative proposals. There is a strong case, on MERUK grounds, for uniform postalised charges across the UK.

- If the UK remains in the EU Emission Trading Scheme (ETS), Phase IV of the ETS may, from 2021, increase costs to offshore gas producers as that sub-sector is not included on the preliminary Carbon Leakage List recently published by the EU Commission. This means that gas producers will receive a lower allocation of certificates and will need to buy the shortfall in the market. The price of Emission Certificates has recently increased to Euro15/tonne.
We would also encourage additional collaboration between governments, regulators and National Grid on gas quality standards to ensure that North Sea resources are not closed out from the market. This may occur if gas quality standards are too narrow or appropriate blending services are not made available.

5. **Does the current devolution settlement enable all stakeholders to support the sector?**

Both governments are supportive of the industry and it is important that they are aligned on key areas such as fiscal support, city region deals and regulatory change.

When using devolved powers to differentiate Scotland, for example changing the rate of income tax in Scotland, we would urge the Scottish Government to take into account that the oil and gas industry is a UK-wide industry and closely monitor the impact of such changes to avoid compromising the competitiveness and attractiveness of the basin or our members’ ability to recruit and retain highly skilled employees.

6. **How can Scotland maximise its expertise, technology and infrastructure in oil and gas industry to secure the industry’s future as reserves decline? What support is needed from Government to maximise these opportunities?**

We would like to build on the good relationship we have with both Governments to maximise economic recovery from the UKCS and also secure oil and gas’ role in the energy transition.

In support of this we believe that the UK Government should develop its own comprehensive energy strategy for the UK, which aligns with the Scottish Government Energy strategy, supporting the future investment in and recognising the longer term role of oil and gas and giving further confidence to investors.

We also ask that both governments recognise in the development of energy and climate change policies that balancing the energy trilemma of security of supply, affordability and the drive for lower CO2 are all properly considered. Within this in the foreseeable future, oil and gas is going to play a key part in the energy mix, representing two thirds of primary energy in the UK in 2035. This being the case, maximising the use of indigenous resources ensures a lower environmental impact and wider social benefit than importing oil and gas. At the same time gas plays an important role in maintaining security of power supplies alongside the intermittent renewable sources of wind and solar. A huge proportion of the reduction in UK CO2 emissions since 2008 has been due to switching from coal to gas fired power generation. This will continue as coal is phased out by 2025. Many of the companies driving the rise of lower carbon energy technology draw their expertise from the oil & gas industry. Our skills, experience and infrastructure can and should play a long-term role in enabling this transition, with exciting opportunities for our supply chain. It is important for government to recognise and support the industry in this activity.

As explained earlier, the industry has also developed proposals for a sector deal that would support our supply chain and contribute to delivering the ambition set out in Vision 2035. The deal proposal focuses on three areas – transformational technology, underwater innovation and decommissioning. Two Expressions of Interest (for transformational technology and underwater innovation) have also been submitted to the Industrial Strategy Challenge Fund and at the time of writing, we are hopeful that BEIS will look favourably at the proposals.
Finally, we are also calling for strategic management of Brexit. We have outlined four high level principles that we hope the UK Government should follow to protect the industry and capitalise on opportunities post Brexit:

1. Frictionless access to markets and labour
2. Maintaining a strong voice in Europe
3. Protecting energy trading and the internal energy market
4. Protecting our licence to operate

It is critical that UK Government Ministers understand the impact of Brexit on this industry and its supply chain both in terms of the risks and the opportunities for the sector in a post-Brexit world.

Whilst we are part of a global industry, we rely on an extensive supply chain that has significant links to Europe in terms of goods, services and people. During the transition phase European regulations and legislation will be reviewed and introduced and it is critical that the UK maintains some influence over any potential changes that could affect the industry. For example, the EU Emissions Trading Scheme Phase IV (starting in 2020) framework is set to increase operating costs by as much as 10 per cent in some cases, which significantly disadvantages offshore assets in the UKCS versus other basins by increasing operating costs. Similarly, post-Brexit we urge the Department for International Trade to work with the industry to ensure that new trade deals support the export and investment potential of the oil and gas sector.

Ends.

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