

MEMORANDUM FOR CABINET
BY THE HON. PRIME MINISTER

Exploration and Exploitation of the
Continental Shelf

In 1965, following the receipt of three applications for the exploration of the Continental Shelf, Government asked for and obtained the services of a U.N. Expert on oil matters, Mr Fuad Rouhani.

2. Mr Rouhani proposed that (a) a general exploration of the Continental Shelf be carried out under Government direction at the expense of oil-companies interested in the exploitation of the area; (b) the regulations be published and the rate of royalties and other cash benefits be determined when the results of the survey become available and (c) the area be divided into several blocks to be given out by tender. Such a procedure had been adopted successfully in Iran in 1961. Mr Rouhani also undertook to draft a Continental Shelf Bill and Regulations to control both on-shore and off-shore drilling.

3. Though wide publicity was given to the relevant notice only six companies expressed a firm interest in the collective survey. Two of these withdrew at the very last moment and only Shell, Agip, Sinclair (U.S.A.) and ERAP (France) attended the discussions with the Oil Committee during the week commencing 21st March. ESSO refused to participate because the regulations were not published and Shell made their participation conditional upon Government's willingness to discuss both the survey and the regulations. The Committee was assisted by Mr Rouhani and Dr. P. Mina, an expert in continental shelf operations.

4. The companies made it clear that since the oil-prospects of the continental shelf were not comparable to those of the Middle East they were not prepared to join in an expensive general survey of the area (estimated cost \$1.5 million) if the number of companies was, say, less than ten and if they were not given assurances that eventual bidding would be restricted to companies subscribing towards the cost of the survey. The companies, however, showed a marked preference for a short-term licence for an area of not less than one-fourth of the total area of the Shelf (3,300 sq. mls.) to carry out reconnaissance survey work on their own, with the option of giving up the licence should the reconnaissance work give negative results.

5. As regards the draft regulations their first reaction was that these followed the standard Middle East pattern and that the terms were too high by European standards. They insisted that the royalty rate (12~~1/2~~^{1/3}%) be reduced to bring it more in line with rates obtaining in Europe, where oil-bearing structures are smaller and off-shore drilling a difficult and expensive proposition. They made certain other suggestions and, as they did not have the material time to study the regulations in detail, they undertook to post their final views at an early date. Some of the suggestions were agreed to and Mr Rouhani amended the draft regulations accordingly.

6. In view of the small number of interested companies and as the area is very small (at the most it could embrace from one to three oil-bearing structures) the Oil Committee recommends, on the advice of both Mr Rouhani and Dr. Mina, that the original plan for a collective survey be abandoned in favour of the standard system of issuing combined exploration and exploitation licences. The Oil Committee cannot agree to the companies' suggestion for a reconnaissance survey since negative results will prejudice the chances of further exploration of the area.

7. The Oil Committee now proposes that:

- (i) the Continental Shelf area, exclusive of the land of Malta and Gozo and the territorial waters (3 miles), be divided into two Blocks A and B equally attractive as regards size, accessibility to the Islands and depth of water;
- (ii) companies be allowed to bid either for Block A or Block B or for both Blocks A and B together (maximum of three bids);
- (iii) the selection of the bids be based on the following competitive elements: cash bonus, production bonus, scale of rental, cash prepayment in lieu of rental, minimum expense obligations and scale of royalties;
- (iv) royalties be reckoned on the posted price of crude oil i.e. on the published price at which the company is willing to sell in the open market, and that such royalties be treated as an expense by the company and not as a payment to Government deductible from income-tax payment;
- (v) income-tax be reckoned on the posted price reduced by a negotiated allowance the rate of this allowance being related to the cost of production and the size of the oil-field;
- (vi) the duration of a combined exploration and exploitation licence be as follows: ten years exploration phase or less if commercial production is achieved earlier; production period of 25 years from date of commercial production with an optional extension of 5 years and two further extensions of 5 years each though the last two periods on terms to be negotiated;
- (vii) the licensee be required to surrender 50% of the area at the end of the third year and 50% of the remaining area at the end of the sixth year;
- (viii) the licensee be given the option to give up the licence at the end of the third year, if it is concluded that there is no reasonable chance of finding petroleum, provided that the amount of expense obligations due up to the end of the tenth year shall be forfeited to Government;
- (ix) all other terms be fixed and provided for in the regulations which should be published prior to the bidding;
- (x) the regulations should provide for the negotiating of some items prior to their inclusion in the licence proper.

8. The formulae at (iv) and (v) relating to royalties and income-tax are current in most Middle East Countries and in North and South America. They were adopted in Libya in November, 1965.

9. The above proposals were outlined to the companies making it clear that they were still subject to Government approval. The proposals were considered to be reasonable except by Agip, which was against any system of competition which would involve the company in extra expense. The proposed system, however, will undoubtedly attract more companies.

10. As a result of discussions between Mr Rouhani and the Deputy Crown Advocate General, the latter is now recasting the draft regulations and dividing them as follows: (a) certain chapters for inclusion in the regulations proper; (b) certain chapters for inclusion in both the regulations and the licence and (c) certain chapters to be omitted as there are already similar provisions in existing legislation (land, company law, etc.).

11. It will also be necessary to re-introduce in Parliament the Continental Shelf Bill.

12. Hon. Ministers are invited to advise whether they agree that the Continental Shelf Bill should be re-introduced in Parliament and whether the exploration and the exploitation of the Continental Shelf should be effected under the system outlined at paragraph 7 above.

18th April, 1966.
