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Scotland could be more ‘aggressive’ with UKCS natural gas

An independent Scottish government could be more aggressive in terms of extracting gas in the UK’s Continental Shelf (UKCS) than currently as energy would be a key money spinner for the country, market sources have told ICIS.

But as the gas is being extracted by private companies, the impact on wholesale gas prices could be limited as Scotland might not be able to afford the same tax cuts for gas prospectors as the UK.

The comments come in the run-up to an 18 September referendum that could make Scotland independent from the rest of the UK.

“Scotland may be inclined to take a more interventionalist view than the UK government would have, given that the imperative for maximising output and revenue might be greater for Scotland. That might lead to a different approach in terms of aggressiveness,” said Richard Power, energy litigation partner at law firm Berwin Leighton Paisner (BLP).

Nick Campbell, analyst at Inspired Energy said: “Looking at the structure of their economy they would be relying heavily on this sector [UKCS oil and gas] to generate revenue, especially given that their electricity generation is heavily weighted to renewables.”

Production from the UKCS has been in sharp decline over recent years, hitting a 35-year low in 2012, and the Scottish National Party (SNP) has accused Westminster of failing in its governance of the resources.

Member of the SNP Maureen Watt said in April: “We must not let Westminster continue to squander the remainder of this hugely valuable resource and deter further investment… Scotland has a golden opportunity to steward oil and gas for the benefit of the whole nation – and we must grab that opportunity.”

Claim to resources

Exactly how much of the tax revenues Scotland would be able to claim still needs to be negotiated by governments as part of any agreement on independence.

At present, the UKCS represents the economic region set up by the UK government which collects the oil and gas revenues.

Alexander Kemp, professor of petroleum economics at Aberdeen University, said that the most likely approach taken under independence would be the ‘median line’ principle.

This would involve a line being drawn on which all points would be the same distance from the Scottish coastline and the coastline of the rest of the UK.

Under this arrangement, while Scotland could lay claim to more than 90% of the remaining North Sea oil production and associated tax revenues, its share of gas production could be less than 50%, based on recent years.

Price impact limited

Many sources have questioned whether the regulatory framework under which companies are operating will have a meaningful impact on exploration or the wholesale price of gas.

“I don’t think that Scotland could change the pricing mechanism or the way in which the gas is sold. The EU will see to that,” said Howard Rogers, analyst at the Oxford Energy Institute.

“Any knock-on effect on UK gas production [as a result of independence] would likely be very gradual, and would be swamped by more pertinent issues of LNG supply and what the Russians intend to do with their gas,” he added.

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Andrew Hockley, specialising in competition and EU practices at law firm BLP, agreed: "Unlike Norway, so much of the UKCS assets are owned by international companies, so they are making their own investment choices. Scottish independence won't impact lower-cost extraction opportunities or the geological environment in which companies are operating."

According to the UK's Department of Energy and Climate Change (DECC), in 2013 domestic gas production in the UK accounted for about 50% of total supply, compared with 74% in 2008.

But 2012 marked a year of record investment in the UK's North Sea, and system operator National Grid expects that this, coupled with new tax initiatives, will slow or even reverse the trend of rapidly declining production in the coming years.

Tax incentives

Whether Scotland would be able to compete with existing tax incentives has been disputed, and energy secretary Ed Davey recently stated that the "broad shoulders" of the UK are of benefit to Scotland.

"Right across the energy mix, Scotland benefits from being part of the UK's strong, stable consumer and tax base," Davey said.

Among the new incentives have been new relief rules for decommissioning costs to help boost investment in and extend the production life of the UK's gas assets.

"The UK can afford to take a hit on tax revenue by providing an attractive investment framework whereas I'm not sure Scotland is in as strong a position to do this," said Inspired Energy's Campbell.

Wood Review

In a recent bid to boost production DECC announced in February that it will create a new regulatory body to oversee gas operations in the North Sea.

Along with the introduction of the new regulatory body, the review recommended that a new shared strategy between the treasury, the regulator and industry be brought in to maximise recovery.

"When the Sir Ian Wood report was rolled out, both the UK government and SNP said that they would implement its proposals. One caveat to this, however, could be whether Scotland implements them in the same way," said Power at BLP.

By Jack Elliot

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