

PRESS RELEASE

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North Sea Taxation - Value Allowance Impact on Small Fields

Analysis by UK oil and gas industry consultants, Hannon Westwood, indicates that the new Value Allowance introduced by the Chancellor of the Exchequer could stimulate development of up to 45 small discoveries at an oil price of \$45 per barrel and up to 157 discoveries at \$60 per barrel.

In April, the UK Government published new tax allowances targeting certain categories of undeveloped discoveries: "Small Fields", and so called Ultra Heavy Oil and Ultra HPHT, in order to stimulate investment in indigenous resources within a low oil price environment.

Hannon Westwood maintains its own in-house database on all UKCS discovery wells, and developed commercial software to enable an NPV and "dpi" to be calculated in tandem for each discovery, in order to measure the effect of fiscal change across the whole sector. The key question asked of each discovery was: if there was an option to drill this particular discovery well in 2010 and develop within 24 months, is it likely to be commercial and therefore a candidate for drilling?

In the Hannon Westwood database there are 259 discovery wells in the "small fields" category; 235 of these discoveries have estimated reserves from near zero to 20 million barrels of oil equivalent (mmboe), and a further 24 discoveries have reserves of 20 to 26 mmboe. The Hannon Westwood analysis was run initially with a base case \$45/bbl oil price (37p/therm gas price), and the number of projects of 20 mmboe or less that could move to potential commercial status increases from 12 to 28 as a result of the £75 million Tax Allowance. At \$60/bbl (with gas at 44.4p/therm pro rata increase), further analysis shows that with a £75 million Allowance, the number of potentially commercial discoveries increases to 139.

For discoveries between 20.1 and 26 mmboe, a similar picture unfolds but on a smaller scale, and in a \$60/bbl scenario the Allowance increases the number of potential developments by only one, from 17 to 18 out of a total of 24 discoveries. In effect, the sliding scale appears to work well at the margins in ensuring that no Allowances are in place to stimulate developments that are already potentially profitable – at least in a \$60 oil climate.

Overall, the number of projects that might prove attractive in a \$60 oil climate is estimated at 157 (139 discoveries < 20 mmboe and 18 discoveries < 26 mmboe).

Commenting on the findings, Jim Hannon, Managing Director of Hannon Westwood, said;

"The Treasury appears to have pitched the Allowance at a level that reflects a medium term \$60/bbl oil price, or alternatively a reduction in capital and operating expenditure and well costs, assuming a response from suppliers to the fall in the oil price. On the other hand, if oil price falls below \$45/bbl, the new £75 million Allowance might still be sufficient to underpin an adequate (or practical) number of projects, given the limits on rig supply.

For those cash-rich companies seeking farm-ins or asset acquisitions (or corporate acquisitions) the attraction of small discoveries could have increased significantly. It is doubtful whether the capital markets are able to reflect the increased value of small discoveries in market capitalisations, suggesting that companies in acquisition mode should consider whether discoveries are more efficiently come by through corporate acquisition than piecemeal purchases or farm-ins.“

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Notes to Editors:

NORTH SEA FISCAL REGIME: INCENTIVISING PRODUCTION

Legislation will be introduced in the Finance Bill 2009 to include the measures outlined below.

The new Field Allowance will apply to fields given development consent on or after 22 April 2009.

A new 'Field Allowance' is to be introduced which will provide certain categories of new field with a fixed Allowance which can, over time, be offset against the Supplementary Charge payable by the companies involved in the field. Once that Allowance is exhausted, the field will, in effect, pay the full North Sea rate of tax. The speed of exhaustion will depend on the profitability of the company – i.e. if oil prices rise then, all other things remaining equal, the allowance will be exhausted more quickly.

SMALL FIELDS: The Field Allowance for small fields is £75 million for fields with oil reserves (or gas equivalent) of 2.75 million tonnes or less (20 mmbbl), reducing on a straight line basis to nil for fields over 3.5 million tonnes (26 mmbbl). In any one year the maximum Field Allowance (for a field with total allowance of £75 million) is £15 million.

HPHT: The Field Allowance for ultra high temperature/pressure fields is £800 million for fields with a temperature of more than 176.67 degrees Celsius and pressure of more than 1034 bar in the reservoir formation. In any one year the maximum Field Allowance is £160 million.

HEAVY OIL: The Field Allowance for ultra heavy oil fields is £800 million for fields with an API gravity below 18 degrees and a viscosity of more than 50 centipoise at reservoir temperature and pressure. In any one year the maximum Field Allowance is £160 million.