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From the Minister of State for Industry

NORMAN LAMONT MP

COMMERCIAL IN CONFIDENCE

Rt Hon Peter Rees QC MP
Chief Secretary
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1

29 May 1984

Dear Peter

I wrote to Alick Buchanan-Smith on 7 March about the future of the BP rig at Scott Lithgow. At that time Graham Day was - in the light of the threatened cancellation by BP - still considering the financial and other implications of the alternatives of

(i) renegotiating the contract, as BP wished, or;

(ii) accepting cancellation, completing the rig and selling it on the open market.

As you know on 28 March Scott Lithgow was sold to Trafalgar House (TH). After the sale BP's contractual relationship remained with Scott Lithgow (under its new owners), but under the terms of sale BS remained responsible for any contract renegotiations and effectively undertook to indemnify Scott Lithgow against extra costs. You will also know that BS subsequently decided to renegotiate the contract; agreement was announced on 17 April. My purpose in writing is to let you and colleagues know the full financial basis for this decision.

A comparison of the costs of renegotiation and cancellation is set out in the Annex to this letter. The bottom line shows that, on the face of it, renegotiation works out about as costly as cancellation - each course of action means £19m in extra costs, giving a total contract loss of £58m. However, rather different risks are involved. Although the revised agreement with BP incorporates a formal delivery date of 31 July 1984, the renegotiation cost calculation assumes delivery on 30 November 1984. This is a very prudent estimate. BS' technical advisers and the new Scott Lithgow management think they might manage delivery by mid-August, in which case there would be savings of damages of £3-4m. And there is of course every incentive for Scott Lithgow to perform well on this, its first opportunity to show the market place what it can do under its new ownership.

Cancellation, however, carries opposite risks. The figures assume that, once completed, the rig could have been sold on the open market for its contract price of £78m. However, there is clearly a substantial risk of having to accept a much lower price. BS did some soundings of the market place. At worst, it was suggested that the value could be as low as £45m and the highest figure they obtained was about £60m, giving a possible additional loss of between £18m and £33m. In the circumstances Graham Day decided that renegotiation was clearly in the best commercial interests of the Corporation.

Assuming that the rig is now completed satisfactorily under the new arrangements, BS faces extra costs this year of up to £18.9m, for which no provision exists within their £137m non-warship EFL. However these extra costs will be offset by income from the sale of Scott Lithgow (£3m plus up to £6.1m in outstanding claims due in). It will be further affected (one way or the other) by any adjustments between BS and Trafalgar House which prove necessary once the completion accounts relating to the sale of Scott Lithgow are finalised in the Summer. Moreover the EFL does not take account of the proceeds of any disposal elsewhere in the non-warship part of the Corporation and we can expect some offsetting income here (eg Falmouth). At this stage I propose that we simply take note of the extra costs and of the likely offset and leave any consideration of whether adjustment of the EFL is either necessary or appropriate until the picture becomes much clearer, probably in the early Autumn.

I am copying this letter to the Prime Minister, Lord Cockfield, Alick Buchanan-Smith, Geoffrey Pattie and Alan Stewart.

Yours ever
Norman

NORMAN LAMONT

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Annex

BP RIG - COMPARATIVE COSTS OF CANCELLATION VS RENEGOTIATION

Item	Accepting Cancellation	Renegotiation
	£m	£m
Provable damages	5.8	7.25 (i)
Liquidated damages for delay (agreed with BP)		
1.2.84-30.6.84 at £28,500 per day	-	4.3
1.8.84-31.8.84 at £28,500 per day	-	0.9
1.9.84-30.11.84 at £40,000 per day	-	3.64
Additional work (ii)	2.8	2.8
Interest on instalments	10.5	-
	19.1 (iii)	18.9

NOTES:

(i) Includes agreed extra damages of £1.45m for loss of income to BP through the rig being unavailable for the 1983 drilling season.

(ii) Extra work to bring the rig up to Norwegian specification, for which BP will not be charged. This would anyway have been needed to sell the rig on the open market.

(iii) The cancellation scenario assumes (optimistically) that the rig could be sold at the contract price of £78m. If it were not, the costs of cancellation would be increased by the difference between £78m and the actual selling price.

SBP1/DTI

17 May 1984