cc DP

PRIME MINISTER

SLEIPNER

The Chancellor's minute to you of 12 June requires a reasoned reply before we discuss this.

My understanding of colleagues' views was that in general they were not ready to take the risk with gas supplies involved in a total veto on the BGC deal with the Norwegians. The argument has been about the character of the export assurance to producers on the UKCS.

We could debate at length the merits of the Frigg field which is not at all as simple a matter as Nigel suggests. He does not mention that 40% of the Frigg field is British and he assumes rather readily that the 25% of our supplies from Norwegian Frigg have dominated the UK market. What is certain is that increased availability of gas to both domestic and industrial consumers in the last decade, 40% from the Frigg field, has greatly improved our oil balance and, recently, our ability to resist industrial action in the coal industry.

On Sleipner, the facts in Nigel's paragraphs 5 and 6 are simply wrong. BGC's existing contracts plus Sleipner cover only 55 to 60% of forecast demand in the mid 1990s. As I said in my minute of the 8 June, BGC needs to contract the equivalent of two Sleipners from the UKCS in order to close the gap. And a large slice of the gas in existing discoveries not yet contracted to BGC is in condensate fields where best reservoir practice may dictate oil extraction first, with delay in any gas extraction until the late 1990s or the next century.

The views expressed by oil companies naturally differ according to their interests, but the majority of them have not been prepared in informal exchanges to advise us to rule out imports, or specifically to reject Sleipner. Even BP, which is most optimistic about UKCS resources, does not go this far.

I take Nigel's point that it would be better for the balance of payments if we could do without imports of gas in the 1990s, but as his minute makes clear, what we are talking about is the continuance of an existing cost, not the imposition of a new one. Essentially, Sleipner is a substitute for Frigg when Frigg runs out and the balance of payment cost of Norwegian Frigg is, as he says, now about £1½ billion a year.

On Dutch gas, Nigel says he would feel more confident if he believed that BGC had thoroughly explored this alternative. I can assure him that, whatever BGC has or has not done, I have myself pressed the Dutch hard. They have not been willing to put on the table an offer which comes near to competing with Sleipner on price.

I agree with Nigel when he says in his paragraph 9 that it is not right that the development of our natural gas resources should be determined by BGC's use of its dominant buying power. The proposals I have made would prevent that by providing a right of appeal against BGC wherever an oil company considered that BGC was using that buying power in a way which hindered development. But I think it is a mistake to think that by simply opening up our natural gas resources to unrestricted exports we can produce a market like that which operates with oil. Unlike oil, natural gas is contracted many years ahead often in very large units and for the life of the field. Over most of the world the only economic means of transport is by pipeline, and pipeline construction is linked to individual sale transactions. At the consumer end, gas supplied now always flows from contracts made several years ago. All this means that for technical reasons the gas market is in any area a market of few sellers and very few purchasers.

Paragraph 10 of Nigel's minute warns us against confusing prices paid to oil companies for new gas with prices charged to consumers. There was no such confusion in my minute of 8 June. What I said was that if we allowed uncontrolled exports, there would be a sharper and immediate effect on prices even for those Southern North Sea developments which are already expected to be so profitable that the Inland Revenue recently proposed an extra tax on them.

Charges to consumers would rise more gradually so long as the gas levy and financial targets set to BGC permitted them to continue averaging the cost of their gas supplies as at present. Even so, I estimate that if prices for all new UKCS gas contracted rose to European levels, there would be an extra 5% increase in real terms for both industrial and domestic consumers over the next decade, in addition to the 16% increase in real terms over the same period which BGC are at present envisaging. If gas were priced immediately at the level of the most expensive gas contract, as suggested at the end of paragraph 10 of Nigel's minute, there would indeed be no effect from exports. We would simply get the whole real terms price increase to industry and domestic consumers at once in this Parliament.

These consumer price increases assume that prices paid by BGC to the oil companies do not move above European levels. However, as I said in my minute of 8 June we would under the Chancellor's proposal risk moving in one step from a virtual British Gas monopsony to a situation where the oil companies would have a potential monopoly. If they contracted considerable amounts of gas to exports and a shortfall in gas for the UK began to appear at a time when more imports were not available, they would be in a position to move prices above European levels and we cannot ignore the fact that the extent of their relations with affiliates could tempt them to organise the market. If indeed BGC has used monopsony power in the past, at least that has worked to the advantage of the UK consumer.

Paragraph 12 of Nigel's minute says that an unrestricted export regime would mean that UKCS gas was playing its full part in reducing Western European dependency on Soviet gas. I do not think that anybody outside the UK - and very few in the UK - would put much weight on that. Any UK surplus of gas would be trivial compared with European needs or Soviet reserves. On the other hand, the Americans see the purchase of Sleipner as central to their wish to limit Western European dependency on Soviet gas. Norwegian gas is the one major Western European gas deposit which the local population does not need. UK purchase of Sleipner would not only open up that particular source but would pave the way for the development of the very large but difficult Troll field further north. If we were to reject Sleipner, we would have to expect some pressure and complaint from the Americans because if we did that, it is very likely that major Norwegian gas development would be set back for a number of years.

It seems to be common ground between the Chancellor and myself that announcement of unrestricted exports could produce an interruption in development. I want to avoid such interruption, which I believe would be more serious than he thinks. I also think he exaggerates the impact of the Sleipner purchase on the gas development of the UKCS because the companies have already largely discounted it and are well aware we still have very large gas needs. Nigel talks about "current inhibitions on activity". In fact, activity is going forward at a record pace and the Southern North Sea is a highly attractive and well established area for exploration and development. So attractive is it that Nigel has agreed with me that in the Ninth Round of licensing we should use allocations of blocks in the Southern North Sea as a bait to induce companies to undertake hazardous exploration in deep waters.

The Chancellor recognises that I am in agreement with him in wishing to allow exports if this is necessaary to keep up development. I attach the outline of a Parliamentary statement which I have been discussing with the Treasury. The approach I propose does not require the Government to commit itself to particular forecasts of demand or supply or to some arbitrary "floor" of proven reserves. The Chancellor says he wants an export regime based on "clear objective criteria", but there is no objective basis on which such criteria could be defended. My proposal is unlikely to be seriously controversial and would, I believe, go fully as far as the oil industry would expect. For them, the statement, supplemented by appropriate briefing, would give an assurance of our determination to maintain development, and a right of appeal against BGC which is new and important. For industry and domestic consumers, there would be an assurance of security of supply in the 1990s and beyond, while avoiding a threat of a sharp price rise. For BGC there would be agreement to a modified Sleipner, and the opportunity to secure the UKCS supplies they need, provided they offered the right terms.

Immediate uncontrolled exports, or any move which amounted to that, would be a high risk, even aggressive step. BGC would be likely to make the most of the situation by saying they could now only be sure of carrying out their statutory obligation to supply by paying substantially higher prices and passing them on to consumers. Industry and domestic consumers would be likely to object, as Nigel foresaw when he considered such an export announcement at the time of the Oil and Gas Enterprise Act at the beginning of 1982. The move would be played up by the press as a "tit-for-tat" reaction to BGC and, because of its uncertain effect, would be seen as undermining the whole rationale of the Sleipner purchase which is to meet a large gas deficiency in the 1990s. It would not look like an independent decision to free the market, but simply a reaction to a particular import deal by BGC - as indeed it is.

I think Nigel saw all these reasons for caution when he considered this same question of exports in January 1982. His letter of 11 January 1982 to Geoffrey Howe then said the following:

> "If exploration does yield sizeable new reserves we would of course still need to ensure that exports could be managed without disrupting the supply of gas to Britain. To avoid supply difficulties in the late 1980s/early 1990s large volumes of as yet uncontracted gas will have to be landed here. (By the beginning of the 1990s barely half of projected British demand will be covered by existing contracts). New contracts to fill this gap must be signed in the next few years if the gas is to be on stream in time, and because individual gas contracts are so large it would only require a small number of export deals during the critical period to knock supply in Britain badly off balance. With no control of exports, market forces alone might not automatically lead to the right answer. Political pressures might be applied by other countries and some key North Sea companies have gas-hungry continental affiliates. So even if exploration leads to substantial new discoveries in the next few years, it will probably remain desirable to retain some control over the level of exports".

All this remains valid even with the purchase of Sleipner, except that what is relevant now is that only 55/60% of the gas needed in the mid-1990s is now contracted, including Sleipner. Remaining proven reserves are actually lower now than at the time Nigel wrote his letter. And, of course, in recognition of Sleipner, I am proposing to make a more forthcoming statement about exports and to create an effective right of appeal against BGC.

I hope therefore that it can be agreed that we should open negotiations with the Norwegians to reduce the Sleipner volume and, when those negotiations have been brought to a successful conclusion, that I should make a statement on the lines of the draft I have attached.

I am copying this minute to other ES colleagues, to George Younger and to Sir Robert Armstrong.

Secretary of State for Energy
14 June 1984

OUTLINE GOVERNMENT ANNOUNCEMENT

I have authorised BGC to enter into a contract with Statoil and its partners for the purchase of gas from the Sleipner Field. This agreement is however subject to approval by the Norwegian Parliament.

[Descriptions of the quantities and time periods of the deal, making it clear (if we are successful in negotiating it with the Norwegians) that offtake volumes above a stated minimum will be subject to HMG approval].

This contract will greatly reduce the risk of a major shortfall in supplies of natural gas to BGC to meet our requirements, both for industry and for the domestic consumer, so far as we can now foresee them. However, very large volumes of new gas from the UK Continental Shelf will still be required, over and above present contracted supplies, to meet that demand. The Government are satisfied that companies developing the gas resources of the UK Continental Shelf can proceed with exploration and development with confidence, in the knowledge that BGC is in the market for very large volumes.

However, if it should become clear that exploration and development on the UK Continental Shelf is being inhibited by lack of gas demand in Britain, the Government will be willing to waive the landing requirement for gas on new UKCS developments, provided that security of supply to the British market would not thereby be undermined. Developers in the UK Continental Shelf can move forward in full confidence in the light of these assurances.