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FCS/85/67SECRETARY OF STATE FOR ENERGYBNOC Prices

with TF??

1. I have now seen your letters of 18 and 19 March to Nigel Lawson about BNOC's prices, and his letter of 18 March to you.
2. I agree BNOC should move to market pricing for the second quarter. I would also see advantage, as Nigel argues, in handling March prices on the same basis. The change to market pricing is the main message OPEC will pick up from BNOC's telex, and whether or not it is applied to March is unlikely to affect their reaction significantly.
3. Most OPEC governments have so far reacted with understanding to the announcement of BNOC's abolition. I see advantage in completing the change in arrangements while they are still digesting the announcement, and before they can have second thoughts. Moreover, the spot market is at present fairly strong. If it were to decline by the end of the month, a move to market related pricing at that point would seem that more significant to the market, as well as to OPEC. And the postponement of a change would imply to OPEC that we and BNOC might be open to pressure to hold prices even into the second quarter.
4. As to the timing of BNOC's telex, I hope it will wait until the current OPEC meeting in Geneva is over. To act while it is under way would seem unnecessarily

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provocative. Our understanding is that it will finish today, unless it finished late last night.

5. I am copying this minute to the Prime Minister and to Nigel Lawson.

A handwritten signature in black ink, appearing to be 'G. Howe', written in a cursive style.

GEOFFREY HOWE

Foreign and Commonwealth Office  
20 March, 1985

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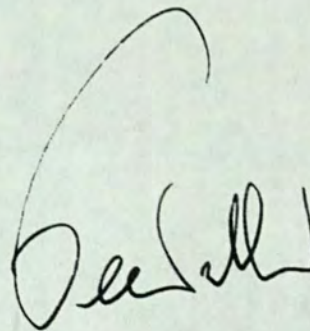
BNOG

Thank you for your minute of 11 March.

I have looked at a copy of the draft telegram to posts, which your officials left with mine. I believe a number of amendments are required, particularly to bring out the point for OPEC Governments that far from contributing to stability of oil prices, continued existence of BNOG would have exactly the opposite effect. I therefore attach a draft of the telegram.

You will see that I have added personal messages to Shaikh Yamani and David West. I do not, however, believe special messages to my Venezuelan and Mexican counterparts are necessary.

I am copying this minute to the Prime Minister, the Chancellor of the Exchequer and Sir Robert Armstrong.



SECRETARY OF STATE FOR ENERGY

March 1985

## FUTURE OF BNOC

The Minister of State for Energy is to announce to Parliament at 3.30 pm tomorrow, 13 March, that the British National Oil Corporation is to be abolished. Legislation to this effect will be introduced as soon as possible. The text of the statement will be telegraphed to you as soon as it is finalised.

In his Statement to Parliament, Mr Buchanan-Smith will explain that, since the BNOC Review was completed last Summer, there has been a major change in the structure of the oil market away from term contracts and towards spot and similar short-term transactions. This structural change means that BNOC can no longer operate in its traditional way of purchasing and selling oil under term contracts at prices fixed for a period of months ahead. If it had continued to exist, BNOC would be forced to link its prices more closely to spot prices and be prepared to move its prices frequently. It would therefore have been in danger of increasing instability.

Before BNOC is wound up, the volumes of oil it purchases under participation agreements (under which it acquires most of its oil) will be run down rapidly. However, the agreements themselves will be retained for use if there was a danger to security of supply. Custody of the agreements, together with some residual functions of BNOC (handling royalty oil, management of the Government pipeline and storage system and certain contracts prior to complete disengagement) will be transferred to a small, specially created public agency, the Oil and Pipelines Agency.

For posts in OPEC countries, Mexico and Norway. On receipt of a trigger telegram, you should hand over a copy of the statement to your host government as soon as possible after 15.30Z on Wednesday 13 March. You should not, repeat not, arrange meetings in advance. In handing over the text, you should lay particular stress on the points made in paragraph 2 above and draw on the line set out in paragraphs 7 to 9 below.

For Washington. On receipt of the trigger telegram, please hand a copy of the statement to the US Government. You may draw on the points at paragraph 7 to 9 below. We would expect the US Government to welcome this decision.

For UKRep Brussels, UKDel Paris and other OECD posts. You may act as in paragraph 5 above.

Line to Take

HMG's concern remains to avoid destabilisation of the oil market. BNOC has consistently handled its pricing proposals accordingly.

However, it has become increasingly clear that the Corporation cannot change its purchase prices without risking the destabilisation of the market. When the market has weakened other producers have tended to match or exceed BNOC's price cuts. In anticipation of this the market has reacted by drawing on stocks and postponing purchases. This has reduced demand and exacerbated the existing weakness of the market. (For Lagos. You may wish to refer to David West's remark in a recent Financial Times interview that in BNOC we have built a Frankenstein monster).

North Sea spot prices have been almost invariably below BNOC's purchase price of \$28.65 since it was set last October. At times spot prices have fallen to levels up to \$2 below term. Since the spot market is a ready alternative source of oil to BNOC's customers, the Corporation has lost its term sales and with them the power to contribute.

[To Riyadh only]. When handing over the text of Mr Buchanan-Smith's Statement you should also pass on the following personal message to Shaikh Yamani from Mr Walker: Quote: Further to our conversation at lunch at Cowley Street last month, we are today announcing that BNOC is to be abolished and that consequently it will be ending the selling of participation oil. We agree with your view that in changed circumstances in the oil market BNOC would increasingly become a force

for instability rather than stability. I am setting up a small agency to carry out some of BNOG's secondary residual functions, notably those relating to our security of supply.

[To Lagos only]. When handing over the Statement to David West, please also pass the following personal message from Mr Walker. Quote: Since we met in Geneva in January I have been considering how the UK can contribute best to the stability of the oil market, to which both our countries attach great importance. You will have seen that BNOG maintained their term price at \$28.65 for January and February, despite the fact that the spot price was normally well below this level. With the structural change from term prices to spot transactions throughout the world oil market, BNOG became ever less able to make a contribution to stability. Increasingly BNOG seemed in danger of undermining stability, especially if it had been forced to move to market-related prices like Statoil. I therefore believe abolition of BNOG will now make a significant contribution to stability.