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NOTE FOR THE RECORD

Mr. Baxendell of Shell and Mr. Laidlaw of BP called on the Prime Minister at 1700 hours yesterday. The Secretary of State for Energy and Sir Jack Rampton were also present. The purpose of the meeting was to go over the briefing on energy for the Dublin Council, and a number of points in the briefing were clarified.

But there was also a lengthy discussion of the back-to-back deal whereby BP sell Middle East crude to BNOC instead of selling 51% of their North Sea production to BNOC as they would normally have to do under the participation agreement arrangements. Mr. Laidlaw explained that the original contract had been renegotiated during the course of the summer, but the new contract still placed a very substantial financial burden upon BP. This was because BP was still obliged to supply a given value of crude to BNOC based upon official Middle East prices. But in reality, they were having to purchase much of this on the spot market. Since they were selling their North Sea crude at official prices, this meant that they were suffering a substantial financial loss on the operation. In the renegotiation, the amount of crude which they were liable to BNOC for had been reduced; but, the amounts were still excessive, given the changed market circumstances.

The Prime Minister said that she had the greatest sympathy for BP. She thought that the contract as described by Mr. Laidlaw was quite unjustifiable and since the Government was a shareholder in BP, it was damaging to the tax payer too. She wondered whether, in the changed market circumstances since the back-to-back deal was originally negotiated, it would stand up in a Court of Law. She had, it was true, approved the renegotiated deal as reported to her by the Department of Energy; but she had never seen the details, and had she seen it was as Mr. Laidlaw had explained it to be, she would not have approved it.

Mr. Howell said that BP had negotiated the back-to-back deal in their own interests, and substantial concessions had been made to them in the course of the summer. If they were buying on the spot market, this was largely to supply their overseas affiliates - rather than to fulfill their obligations to BNOC. But in any case,

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the Government and BNOC had to have regard to the security of supply argument. If BNOC were to give up its rightful 51% share of BP's North Sea production, they had to be compensated for this.

The <u>Prime Minister</u> said that she would want to see the contract and have a further discussion with the Secretary of State for Energy about it. (I have commissioned this separately).

In addition, <u>Mr. Baxendell</u> gave a very pessimistic report on the world oil scene. He thought it was unlikely there would be any agreement in OPEC on 17 December; instead, prices would continue to go up in an uncoordinated way and there could well be cut backs in supply. For example, the Saudis would almost certainly cut back production by 1 million barrels per day and shove up the price. Their attempt last year to keep prices down had patently failed, and they were likely to react accordingly. Output from Kuwait was also likely to fall, as it was also from Iran because of failure to maintain plant and equipment. It would fall much more if Saudi Arabia "blew up": the effect of this on the world economy would be frightening. The Japanese seemed likely to increase their purchasing on the spot market, and spot market prices would therefore increase.

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<u>29 November 1979</u>