Prime Minister
The position looks very much better from BP's viewpoint than Mr. Laidlaw made out. Shall I return this to your box for the weekend, and arrange a meeting with Mr Howell for you to discuss?
T 11/12

BF 21/12/79

At later weekend please

PRIME MINISTER

BP/BNOC SUPPLY ARRANGEMENTS

At your meeting on 28 November, Mr Laidlaw of BP raised with you the question of the alleged financial burden placed on BP by their obligation to supply BNOC with high cost foreign crudes. Your Private Secretary's letter of 29 November recorded your wish to consider the case for re-opening the arrangments concluded in principle on 1 November to see whether this apparent financial burden could be reduced. As I said in my minute of 30 November, Sir David Steel has in fact since confirmed that BP are not seeking to re-open these arrangements.

The existing supply arrangements, the policy underlying the new arrangement and a description of its main features are set out in the attached note. Also attached are a copy of the Principles of Understanding of 1st November, the 1977 Participation Agreement and a note on BP's present supply position. The Principles are not a contract, but a document to guide those responsible for drafting the final contracts.

As you know, OD(E) has considered the EEC aspects of these Principles and the Attorney General will be advising on possible risks under EEC law and how the contractual arrangements might best be structured to reduce these risks.

The oil flows on which Mr Laidlaw bases his comments arise from the 1977 Participation Agreement under which BP sells BNOC 51% of its UKCS production at market price. At BP's insistence an exchange arrangement was included under which the company re-acquires a large proportion of the UKCS crude, which it wants for operational reasons, in exchange for Middle Eastern oil of equal value, with volumes being adjusted to take account of quality differences. About 12 m. tonnes per year is involved in total.

BP's real difficulty arises not from the exchange arrangement with BNOC - which is financially neutral for BP - but from BP's dramatic change of fortune this year in respect to its overall supply and demand (details at annex). It is the company's shortage of supply to meet its commitments which is forcing it onto the spot market and Mr Laidlaw was disingenuous in attributing the cost of acquiring high priced crudes wholly to the commitment to BNOC. BP has, in fact, taken on new third party supply commitments this year to Svenska Petroleum and Veba.

In 1979, the only foreign crude BP has supplied to BNOC has been Kuwait crude available to BP at a modest discount from the official selling price. This supply will continue at least until the Kuwait contract terminates in April 1980, at which point BP expect to conclude another contract, albeit for a reduced volume and possibly without discount. BP should nonetheless then still have access to sufficient quantities of non-UKCS crude at or near official selling price to cover their commitment to BNOC as reduced by over half under the new arrangements now agreed in principle. The exchange arrangements between BNOC and BP provide (on BP's insistence) for exchanges to take place at term prices, a provision designed to protect BP's position as a net seller at a time when crude oil spot prices were below term prices. If, however, BP were obliged to purchase term supplies from overseas which included a proportion bearing a premium which they wished to roll into the overall market price to BNOC, this would be a point which BNOC would be prepared to consider in the price negotiations. If admitted, this cost would be passed on by BNOC to its customers.

The new arrangements with BP exhaust BNOC's supply capacity in 1980 and leave it with only a limited flexibility in 1981. BNOC cannot plead force majeure to justify disengagement from its current commitments in order to improve BP's international supply position further. One of the major purposes to which BNOC has put its oil in 1980 and 1981 is securing a reduction of the public sector borrowing requirement by forward sales.

Copies of this minute go to the Foreign Secretary, the Chancellor, the Attorney General and Sir Robert Armstrong.

DA.

SECRETARY OF STATE FOR ENERGY
11 December 1979

ANNEX

BP'S SUPPLY POSITION

(as reported December, 1979).

1980 m. tonnes

Demand

97 ... ... of which 5 Third Party Sales
(107 before new arrangements with BNOC and resale of royalty oil)
5 BNOC
87 Affiliates (67 affiliates other than BP Oil)

Supply

UK	27
Iran) Kuwait)	10 - 32
Iraq	2
Other Persian Gulf	10
Norway	0.5
Total Term Supplies	49.5 - 71.5
Anticipated Product Purchases	5 - 6
Total	54.5 - 77.5
Deficit	19.5 - 42.5

In 1979 BP has bought about 14m tonnes of spot crude or product. Similar purchases may be made in 1980, or BP may elect to reduce business where the incremental supply cost cannot be recovered in the market.