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cc: Hammer set.

SUBJECT

NOTE OF A CONVERSATION BETWEEN THE PRIME MINISTER AND DR. HAMMER  
AT 10 DOWNING STREET ON THURSDAY 5 FEBRUARY 1981 AT 1800 HOURS

Present: Prime Minister  
Chancellor of the Exchequer  
Secretary of State for Energy  
Mr. M.A. Pattison

Dr. Hammer

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The Prime Minister met Dr. Hammer of the Occidental Oil Corporation last night. Your Secretary of State and the Chancellor of the Exchequer joined her for part of the discussion.

Occidental's investment proposals

Dr. Hammer said that the three projects which he had announced during the Prime Minister's September visit to Flotta were all proceeding on schedule. But he was disappointed by British delays on the Peterhead project. In respect of Canvey Island, he was confident that Occidental could work with the local people, and the company was establishing a good working relationship with Sir Bernard Braine.

Referring to Occidental's intention to order a semi-submersible rig, Dr. Hammer said that the price quoted by British Shipbuilders had now risen to \$160 million, which represented a 100% increase on the initial quotation six months ago. Finnish and Japanese bids were about 60% lower. Dr. Hammer said that he was prepared to allow as much as a 20% preference for British purchase but his shareholders and partners would not accept 60%. The Chairman of the British Steel Corporation was an old friend of his. Mr. MacGregor had told him that if Occidental were to announce its intention to place all its future steel orders for North Sea oil operations in the UK, it would have a tremendous positive effect on morale. Dr. Hammer said that he was willing to do this, but he would have to wait until the price differential for the semi-submersible rig had been narrowed to the point where he could deliver on such an undertaking. The Secretary of State for Energy said that he was desperately trying to get the Chairman of British Shipbuilders to operate competitively so that he could get contracts of this kind.

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BS were building a rig for BP at Scott Lithgow. He understood that the Cammell Laird yard was quoting about 20% above South Korean tenders for other contracts. The Prime Minister undertook to make inquiries.

#### Taxation

Dr. Hammer said that he was concerned about proposals for a change in the North Sea tax regime. He recognised that petroleum revenue tax had not been operating satisfactorily. In practice, only Occidental and BP were paying. Occidental were the second largest tax payer. In the last year, they had paid about £600 million and their liability for the current year would be similar. He recognised that the Chancellor was looking for ways of raising tax revenue from those companies who still avoided PRT because they could write off depreciation on major investment projects against liability. The Chancellor still seemed to be looking for additional revenue of £1 billion. But the other North Sea companies would eventually have to pay, and their liability would be increasing as the price of oil went higher. Dr. Hammer therefore argued that the Government should require further advance payment now, raising the required £1 billion, as an advance against future liability. It would also be open to the Chancellor to raise the rate of PRT above the present 87% figure, because the rising price of oil gave the oil companies a greater cash margin. Even if the percentage figure was raised, the companies could not legitimately complain because the tax was levied on profits. But the proposed new royalty came off the top of revenue and would certainly discourage new development. He entirely agreed that it was wrong that a company like EXXON should be paying nothing. Occidental brought its investments on line fast, and therefore paid PRT in the way in which the tax had been designed. He did not want to see others escape. By 1982 and 1983, many of the projects where investment had been offset against PRT liability would have come on stream, and PRT would also start to flow. The UK problem was therefore one of timing, and the principle of a second royalty unrelated to profit was scary to companies like his. He advised the Government to consider the issues further. Perhaps they could try his suggestions for advancing PRT, and raising the rate, for a year, and then judge whether a further tax was necessary.

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/ The Chancellor

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The Chancellor said that Dr. Hammer had acknowledged that the Government was entitled to more North Sea revenue, and that the Government was looking for a further £1 billion contribution next year, whilst preserving future tax income. Their differences, therefore, were over the argument between a profit-based and a revenue-based source of income for the Government. He and his colleagues had been into these issues with great care, but had found their proposal to be the most feasible option. They had had to design a supplementary tax to provide both current and future revenue. In his judgement, Dr. Hammer's proposal was not so likely to raise £1 billion next year and offer rising revenue thereafter. But, in view of representations like Dr. Hammer's, Ministers might well decide to try the new arrangements for one year, and to review them in the course of that initial year.

The remainder of the conversation was dominated by Dr. Hammer's reflections on OPEC as the greatest threat to the world. He regarded it as particularly important to develop energy sources which would allow the West to deal with OPEC from a position of strength. Coal conversion and shale oil programmes were therefore crucial. Occidental had a 5,000 acre block in the US containing 1,200,000,000 barrels of oil. Their research showed that the extraction was simple when the shale was heated to 900°F. Occidental would go ahead, if necessary, even without Government help. He was confident that they could handle the conversion cheaply enough to deal with imports. Similarly, coal liquification would be possible at a cost of around \$35-50 a barrel. Sheikh Yamani was already predicting an OPEC price of \$50 a barrel this year.

MA

6 February 1981

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