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Energy

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PRIME MINISTER

*A more detailed
report, foreshadowing
public (guarantee)*

*involvement in financing
the pipeline.*

3 April 1981 MS

3/4

Dear Tim,

MS

GAS GATHERING PIPELINE

I attach the note on the gas gathering pipeline that you requested for the Prime Minister, following the "North Sea pipeline plan shelved" article in the Financial Times on 1 April. Following your letter of 6th January we were anyway about to put forward a quarterly progress report on the project; the attached note will, I hope, serve that purpose also.

Technical progress remains good but there are problems in financing. We would therefore draw the Prime Minister's attention to paragraph 11 of the note — *and para 12!*

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Yours ever,

MS

J D WEST

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GAS GATHERING PIPELINE

PROGRESS REPORT FOR THE PRIME MINISTER

Introduction

- 1 A year ago a BGC/Mobil study reported in favour of a new gas gathering pipeline in the northern North Sea (see attached map). The study was made public in June, and the Secretary of State for Energy, following a decision by "E", announced that the Government considered a pipeline system along the general lines recommended would be in the national interest and should be constructed as quickly as possible. He' announced the formation of an Organising Group comprising BGC, BP and Mobil to develop proposals for a private utility transmission company outside the public sector to build and operate the line. It was envisaged that BGC would hold 30% of the equity, the remainder being offered to financial institutions, licensees, customers for the natural gas liquids (NGL) and perhaps the general public; the pipeline company would be financed substantially by loan finance raised from the markets, and without Government guarantee.

Technical Work

- 2 The Organising Group is making good progress on technical work:
 - offshore BP has completed conceptual design work on the pipeline itself; surveys of the pipeline route are in hand. BP are in close touch with British Steel as the final specification for pipe emerges. While the tight timetable will prevent the entire order being placed with one supplier, the Organising Group is well aware of our hope that British Steel could win the major part of the work.
 - for the St Fergus terminal, land has been acquired, planning permission obtained, and conceptual design completed. Work

is now in hand on prequalification of contractors who might be invited to tender for the construction contract.

- although the final onshore disposal pattern for NGL will not be clear until commercial negotiations are complete (see para 7), the Organising Group is advancing planning for facilities which may be required.

Completion Target Date

- 3 The original target date mentioned in the Secretary of State's June announcement was 1984/85. In the light of the detailed engineering design work now completed the Organising Group has now adopted 1985 as its target. As expected, the critical item is not the offshore pipeline itself but the St Fergus terminal.

Gas Availability

- 4 The Organising Group after consulting the field operators has updated the gas availability figures used in the BGC/Mobil study. The results show gas availability at least as high as in the previous figures. For the critical early years this result depends on including gas from North Alwyn, whose licensees (Total and Elf) are now preparing to seek development approval. Total and Elf wish to put North Alwyn gas into their Frigg pipelines, but this would involve a 110 km pipeline duplicating part of the gas gathering pipeline's route. We are pressing them to commit North Alwyn gas to the gas gathering line; meanwhile we are holding back award of Seventh Round licences for which they had applied.

Norwegian Gas

- 5 There had been hopes of attracting into the line Norway's 84% share of gas from the Statfjord field, and BGC put in a fully competitive purchase offer. However the Norwegian Government has recently decided that the gas should be landed in Norway (political pressure to land hydrocarbons in Norway for the first time is immense). Norwegian Statfjord gas would have helped the UK line reach full utilisation more

quickly. But its loss is not critical - the line is economic on the basis of UK gas alone, and we have made clear that the UK share of Statfjord gas will be coming to the UK.

Costs

- 6 The detailed engineering design work now completed has produced a revised cost estimate of £1.5 billion at January 1981 prices. This compares with the original estimate in the BGC/Mobil study of over £1.2 billion on the same price basis. £150m of the increase is accounted for by the inclusion of a new item, an ethane pipeline from St Fergus to Teesside which could be constructed if the final NGL disposal pattern so required.

NGL Disposal Onshore

- 7 The NGL which the line will bring ashore has considerable potential as a petrochemical feedstock and a number of companies are seeking supplies to feed new plant or improve the economics of existing plant. To identify a major seller with whom these companies can negotiate and get the disposal arrangements settled speedily BNOG and BGC have, at the Secretary of State's invitation, formed a joint venture to market those NGLs which will fall to the public sector (notably as a result of BNOG's participation rights). Negotiations are now beginning. The uncertainty meanwhile as to the final disposal pattern does not threaten delay; if the offshore line and St Fergus are ready to accept gas before final NGL facilities are completed, interim NGL outlets are possible.

Southern Leg

- 8 The BGC/Mobil study envisaged the southern leg of the line running as far south as the Fulmar field. Shell/Esso subsequently suggested that much more gas might be available in the southern area, so that a separate line to shore might be needed. The Organising Group decided to defer a decision on how best to collect gas south of Lomond until further exploration had given a better picture of the gas likely to be available. A garbled report in the Financial Times on 1 April presented this as in some way a step back. It is not. In fact it permits a better informed decision and does not delay the main line.

Financing

- 9 This is currently the biggest challenge facing the Organising Group and their financial adviser, Sir Jasper Hollom (formerly Deputy Governor of the Bank of England). Financing discussions are not however holding back technical work, because the Organising Group itself is providing the necessary funds - over £8m has already been committed.
- 10 The long term objective is to raise project finance secured on gas throughput contracts, and to involve a wide range of equity holders as envisaged by the Secretary of State. By last autumn the Organising Group had concluded that an interim company would be required to undertake the initial stages of the project - merchant bank advice was that potential public and institutional shareholders would at this stage perceive the risks as too great and the prospect of reward as too distant. The Organising Group set itself the target of forming an interim company by 31 March. The Bank of Scotland then suggested that banks might provide interim finance, and formed a study group comprising Barclays, Lloyds, National Westminster, Morgan Guaranty and Citibank to examine the project in detail. In mid-March the banks submitted a modified idea: interim bank lending would require not only non-financial assurances on exercise of Government powers over North Sea development (where we believe we can meet banks' needs) but also a completion undertaking to take effect if the expected long-term finance did not materialise. This latter requirement arises because a main purpose of the integrated gas gathering line is to serve fields not yet under development, whereas banks are prepared to lend project finance only on gas from fields already under development. Those fields under development today do not have enough gas to support bank lending of the entire project cost. There is thus a gap which will decline through time as more fields begin development but which initially must be covered by some other contingent security, to be invoked if new field developments are not in step with financing needs.
- 11 The Banks, led by the Bank of Scotland, (unlike the City) have shown imagination in their approach to this problem and the guarantees they are seeking are not unreasonable. This is also the view of the Governor
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of the Bank of England with whom the Secretary of State had discussed the problem. The Organising Group are discussing with the Banks the various means by which credit-worthy shareholders in the interim company could provide a satisfactory guarantee or security. Potential shareholders are the present members of the Organising Group (BGC, BP, Mobil) and other oil companies, and perhaps companies seeking larger supplies of NGLs from the line.

12 However, it is vital that the project should not be delayed and we must now face the fact that sufficient support may not be mustered in time. To bridge this 'time gap' there is probably no alternative to some kind of limited - and reducing - guarantee or security being given either by HMG or preferably BGC (with Government approval). Officials have therefore been instructed to discuss with the Treasury the probable need for BGC to provide the sort of guarantee indicated. The chances of it being called are on present estimates small. An early paper will be submitted to Ministers.

NORTHERN NORTH SEA BASIN

