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10 DOWNING STREET

From the Private Secretary

10 September 1981

Dear Julian.

Gas Gathering Pipeline

As you know, the Prime Minister held a meeting this morning to discuss the proposals for a gas gathering pipeline. In addition to your Secretary of State, the following were present: Chancellor of the Exchequer, Chief Secretary, Foreign and Commonwealth Secretary, Secretary of State for Industry, Minister of State, D/Energy (Mr Gray) and Minister of State, Scottish Office (Mr Fletcher). They were accompanied by officials and Mr. Ibbs and Mr. Veit (CPRS) were also present. They had before them Mr. Ibbs' minute of 8 September covering a further report as requested by the Prime Minister at the earlier meeting on 1 September, and the Chancellor's minute of 9 September.

Mr. Howell said that the CPRS report confirmed what had been known all along - that the GGP scheme would bring very substantial economic benefits, and that it was superior to the so-called multiple approach. Taking into account all the arguments that had been put forward, he remained strongly of the view that the Government should support the GGP scheme based initially on public sector finance. There was in reality no alternative scheme. Apart from the proposed Mobil line, there was no assurance that other lines would be built. Furthermore, even if they were, the multiple approach would involve greater risks of flaring, it would reduce the opportunity to bid for Norwegian gas, and there would be a substantial loss of natural gas liquids. Once launched, he believed that the private sector would soon come in to support the GGP. BP had already indicated that they would provide finance in proportion to their throughput contract, and several other companies had given similar indications. Furthermore, there was a good prospect that the private sector would help to finance the on-shore developments. For example, although they had set tough conditions, Dow Chemical had said they would finance the fractionater at Nigg Bay. The industrical implications of not going ahead with the GGP were enormous. As for the PSBR implications, these were extremely complex. But the CPRS report showed that, assuming the GGP was in due course privatised, it would result in a lower PSBR cost than multiple developments. In short, he believed the economic arguments strongly favoured the GGP. The political arguments were equally powerful. The public would find it inexplicable that the Government was not prepared to support such a good project.

/ The Secretary of State

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The Secretary of State for Energy went on to say that he strongly disagreed with the arguments in the Chancellor's latest minute. It ignored the fact that Ministers had already decided that an integrated line was in the public interest. He disagreed with the assertion that it would be necessary to hold back the development of Southern Basin gas in order to provide sufficient throughput for the integrated line. It was no longer true that the BGC Chairman was unwilling for BCG to accept financial responsibility for the scheme if their monopsony was removed. He was still insisting on first access to the gas fields that were essential to the success of the project, but he had dropped his reservations about the ending of BGC's monopsony position in general. He also disagreed with the argument that going ahead with an integrated line would make the UK more vulnerable to interruption of gas supplies: the amount of gas coming through the line would be considerably less than the amount already flowing through the Bacton system.

The Chancellor said that the balance of argument had changed since Ministers had first considered the GGP scheme. The crucial element in the arguments supporting the scheme had been the Department of Energy's assurance that it would not be difficult to obtain private sector finance for it. Over the summer, it had become clear that private sector financing would not be forthcoming except on terms that would be unacceptable to the Government. The prospects of the private sector joining in to finance the project following a public sector launch were not, in his view, at all good. If an integrated line, albeit financed by the public sector, was the only way of obtaining the gas from the Northern Basin, he would be prepared to go along with it: the PSBR arguments, although in his view they favoured the multiple approach, were not decisive. But the multiple approach provided a perfectly satisfactory alternative. It was on this basis that North Sea oil had been developed. This had had the advantage of bringing in the investment as and when it was necessary, and it involved less concentration of risk. It would be better to follow the same approach with Northern Basin gas. The Chief Secretary added that the greater flexibility of the multiple approach, as described by the C.P.R.S., was very important. He was also concerned that our depletion policy would have to be badly distorted in favour of Northern Basin gas if the GGP were to go ahead.

The Secretary of State for Industry said that he had earlier been a supporter of the integrated scheme. But he was now persuaded by the Chancellor's arguments in favour of the multiple approach: in particular, he was impressed by the greater flexibility that the latter would involve. He also believed that, with the multiple approach, there might well be more development of potential gas fields. However, from an industrial standpoint, there would be some substantial disadvantages. Less ethane would be available, and this would put at risk petro-chemical development in the UK. Grangemouth would be at risk, and we would probably lose one potential new petro-chemical complex. There would be criticism from the chemical industry and from the processed plant industry.

/The Foreign and Commonwealth

The Foreign and Commonwealth Secretary said that the decision on the GGP did not have significant international implications. There would be some embarrassment with the French if it was decided not to go ahead with it because they had been prevented from obtaining seventh round licences in order to conserve gas for the pipeline; but it should be possible to handle this problem. As for the merits of the two approaches, based on his reading of the CPRS report and in particular the points set out in Annex 1, he had concluded that the GGP was preferable to the multiple approach. He was especially impressed by the point that no multiple scheme as such existed, and by the fact that it would mean a significant loss of ethane. Furthermore, it was widely believed that the Government favoured the GGP, and if it was decided not to proceed with it, there would be enormous criticism in the country. He wondered whether it was possible at this late stage to revise the conditions for private sector involvement in it so that it could go ahead on a private financed basis.

Mr. Ibbs said that it should have been possible to arrange matters so that the private sector would support the GGP. It was now apparently too late, but it might be worth making one final effort to bring the private sector in. It was a great pity that the problems of persuading the private sector to participate had not been foreseen earlier. If the only way of proceeding with the GGP was to do so as a public sector project, he believed that it should be dropped in favour of the multiple approach. An integrated pipeline would require conditions necessary to ensure an adequate return on investment - for example, relating to gas prices and depletion policy - that would in any case have damaging side effects; but if it were to be owned and financed by the public sector, it would also involve some very substantial risks. For instance, there was ample evidence that it was more difficult to achieve successful management of public sector than of private sector projects. He disagreed with the Secretary of State's view that it would be easy to privatise the project after launching. If the public sector built the pipeline, the private companies would have no incentive to join in at least until it had been shown to be a commercial success; and this could take a number of years.

In discussion, the following points were made:

(i) It was pointed out that the BGC Chairman was still insisting on BGC retaining its monopsony position in the northern basin. If this had been broken, then it should not have been difficult to obtain private sector finance for the GGP. Its continuation was likely to put at risk development of the gas fields in the area. Against this, it was argued that it was unlikely that the complete ending of BGC's monopsony would have been sufficient to bring the private sector in. Furthermore, BGC was only able to make a "first offer" for the gas. If their price was unacceptable, the gas producer could always appeal to the Secretary of State to obtain a reasonable price. BGC had every incentive to offer a reasonable price because, if they were to build the GGP, they would want it to be fully utilised; and they would want to avoid unnecessary flaring or sales of gas to Norway.

 /(ii)

(ii) It was suggested that too great a distinction was being made between public sector and private sector financing of the GGP. The banks were still interested in financing the project, and the guarantees they were asking for would only be against contingent liabilities that were unlikely to arise. The scheme would in essence be financed by the private sector. The guarantees that the banks and the companies were looking for were more of a political than a financial nature. Against this, it was pointed out that the banks were not planning to take any equity in the project, and they were only prepared to lend at a higher rate than the Government was able to borrow at, even though their lending would be the equivalent of gilt edged. Their proposals came within the definition of public sector borrowing, and they were expensive.

(iii) It was argued that it would be electorally disastrous to forgo the GGP. The Government would be abused from every quarter. The public would find it inconceivable that Ministers had turned down such a challenging project. On the other hand, it was suggested that it would be hard to defend a project that the private sector was unwilling to support.

(iv) As regards the Foreign and Commonwealth Secretary's suggestion that one more attempt should be made to bring the private sector in, it was pointed out that this was what Mr. Liverman had been asked to explore; and his report had concluded that it would not be possible to reach an accommodation with the oil companies in time for the project to go ahead on the required time scale. There was no reason to believe that it was worth reopening this again. Any further delay in reaching a decision would mean continuing uncertainty for the oil companies and would delay the start-up of individual schemes such as those proposed by Mobil.

Summing up, the Prime Minister said she concluded, on balance, that the multiple approach was preferable to a public sector integrated line. It now seemed too late to persuade the private sector to finance an integrated line, and in any case there were serious doubts as to whether they would be prepared to do so except on conditions unacceptable to the Government. Serious doubts had also been expressed as to whether the private sector would be prepared to join in the financing of an integrated line once it had started as a public sector scheme. The multiple approach would therefore almost certainly involve less public money. It would also have a number of other significant advantages over the integrated line. These, in her view, more than outweighed its disadvantages. Accordingly, an announcement should be made that the Government had decided against the GGP, and Mobil should be given the go-ahead for their individual scheme. The Government should also take action as soon as possible to break BGC's monopsony in order to ensure that the gas fields in the northern basin were developed. Further consideration would have to be given to when this could be fitted into the legislative programme.

/The Prime

The Prime Minister invited the Chancellor, the Secretary of State for Energy, the Secretary of State for Industry and Mr. Fletcher to meet again that afternoon to discuss the terms of a possible statement. This meeting took place and considered a draft prepared by officials; in the event, it was decided that a new draft should be prepared within the Department of Energy for subsequent clearance by other Departments.

I am sending a copy of this letter to John Kerr (HM Treasury), Brian Fall (Foreign and Commonwealth Office), Godfrey Robson (Scottish Office), Ian Ellison (Department of Industry), David Wright (Cabinet Office) and Gerry Spence (CPRS).

Yours ever,

Tim Lankester.

J.D. West, Esq.,
Department of Energy.