Would it be bad tactics if we were taken to arbitration? — [initials]

2

PRIME MINISTER

To see. You will want to have colleagues' reactions to these proposals. D. Energy tell us that the Observer will be running a story that the price is to be fixed at $33.

MS 4/1

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402


Tim Lankester Esq
Private Secretary to the
Prime Minister
No 10 Downing Street

4 January 1980

Dear Tim,

Since writing the attached minute of 3 January to the Prime Minister, my Secretary of State has been giving further consideration prior to his departure this morning for the Middle East to the BNOC proposal for a 2-tier price if all the African producers increase their prices to around $34 per barrel.

He has asked me to say that he remains of the view that if Nigerian prices do not rise above $30 per barrel BNOC should seek to establish a single UKCS marker price at $30 per barrel.

If Nigeria does move to $34 per barrel, however, he believes that while a UKCS price of around $32.75 per barrel would be defensible, there are attractions in allowing BNOC to pursue the idea of retaining a basic marker price of around $30 per barrel with the addition of a temporary supplementary payment or surcharge to be reviewed monthly. If BNOC could secure acceptance of this idea it would:

(a) combine the virtue of a lower basic price while at the same time ensuring that the UK did not lose the balance of payments and revenue benefits of higher market prices; and

(b) by making the surcharge a temporary payment, subject to review each month, help to reinforce growing market sentiment that the very large surcharges and premia of recent months may not be a permanent feature of the scene particularly if the oil market slackens in the Spring.

My Secretary of State recognises that there could be criticism if the UK appeared to be adding to the recent welter of OPEC price premia and surcharges, but feels that the balance of advantage lies in allowing BNOC to act in a way which, while enabling it to meet its obligation to pay market prices, would nevertheless help to confirm the logic of and reinforce current market expectations by sticking to a low basic price and giving itself the flexibility to review any surcharge payment on a month-by-month basis.

My Secretary of State has accordingly asked me to suggest to the Prime Minister and to other ministerial colleagues that BNOC should be authorised to go ahead next week on this basis.

I am sending copies of this letter to Paul Lever (FCO), to Martin Hall (Treasury) and to Martin Vile (Cabinet Office).

Yours ever,

Denis

Denis Walker
Private Secretary

conqueror

PRIME MINISTER

Following the failure to reach agreement on prices at the OPEC Ministerial Conference in Caracas the Algerians and Nigerians followed the Libyan lead by raising their official selling prices to $30 per barrel from the middle of December. Since then the Libyans have increased their prices from 1 January by a further $3 surcharge, plus a retroactive premium of $1.72 to apply during the 1st Quarter of 1980. The Algerians have also announced a $3 surcharge for the 1st Quarter which may be returnable later to those engaging in approved exploration work. It was reported in the press yesterday that the Nigerians were also intending to raise the selling price to more than $34 for the 1st Quarter. But in spite of enquiries there is no confirmation of this. There are therefore still considerable market uncertainties which we must allow for in agreeing on BNOC prices for North Sea oil. There is also a possibility that later in the year the oil market may slacken.

The light African crudes effectively establish the market price for North Sea crudes. BNOC, which is required to pay the going market rate for the oil it purchases under participation agreements, is now coming under very strong pressure from supplying companies to adjust its prices to new market levels. If the Nigerian move is not confirmed then it would be difficult to agree a price for UKCS crude in excess of $30 although this could involve a risk of challenge at arbitration. If a Nigerian move to around $34 is confirmed, then it could justify a figure of about $32.75 which we might be able to hold for some time without challenge. It would be intended to be slightly under the average African term price and the figure an independent valuer might set at arbitration.

BNOC believe in the present very uncertain outlook for oil prices and assuming a Nigerian price increase that there could be both presentational and practical advantages in quoting a basic price of around $30, but to propose in addition a temporary supplementary payment or surcharge to be reviewed monthly. On the whole however I think that there would be an advantage in sticking to a single price for the time being.

This would avoid complaints that we were following recent OPEC practices which have aroused so much criticism.

BNOC has notified all its suppliers and customers in the usual way of a price change to be effective from 1 January and there can be no complaints that the 1st Quarter price determination will be retrospective in an OPEC sense.

Given all the present uncertainties it is not possible to come to a firm view on what North Sea price we should seek to establish or precisely when we should move. But if there are no other new factors, and if you and other colleagues see no objection, I suggest we authorise BNOC to go ahead and reach agreement next week on one of the two following bases:-

(a) if Nigerian prices do not rise above $30 per barrel, BNOC should seek to establish the basic North Sea price at $30 per barrel. This would be clearly defensible as showing moderation in the face of the significantly higher prices being charged by Libya and Algeria. There would however be a risk of BNOC being taken to arbitration (which might take two or three weeks) and the price being forced up as a result.

(b) If Nigeria does move to $34 then the UKCS prices should be based on $32.75. Again this would be defensible as moderate, given that the average market level for relevant African crudes would be above this, but it should not attract challenge at arbitration and would help to ensure that the UK did not lose the balance of payments and revenue benefits of higher market prices.

I have taken into account the views likely to be expressed by our EEC partners and by the USA on what is both a problem and a very sensitive issue: but I am confident that on either basis we can make a good case for saying that we have acted with moderation and consideration for their views if that is the line of general policy we want to pursue.

I am sending copies of this letter to the Foreign Secretary, the Chancellor of the Exchequer and to Sir Robert Armstrong.

DH.

SECRETARY OF STATE FOR ENERGY
3 January 1980

-4 JAN 1980

CONFIDENTIAL

10 DOWNING STREET

*From the Private Secretary* 9 January 1980

NORTH SEA OIL PRICES

The Prime Minister has now considered your letter of 4 January and your Secretary of State's minute of 3 January which you enclosed with it. She has also seen Martin Hall's letter of 7 January and Paul Lever's letter of 8 January.

Since the Nigerians have apparently not raised their prices above $30 a barrel, the Prime Minister agrees that BNOC should be authorised to establish a UKCS marker price at that level. The question of whether there should be a temporary surcharge on the $30 price is now hypothetical, and the Prime Minister does not wish to take a decision on this for the moment. Instead, she would like early advice on the pros and cons of the arbitration approach. She believes that there would be political advantage if North Sea prices were established under the terms of legally binding commercial contracts by recognised and independent arbitration procedures. On the other hand, the economic and financial implications of this approach need to be thoroughly considered.

I am copying this letter to Paul Lever (Foreign and Commonwealth Office), Martin Hall (H.M. Treasury) and to Martin Vile (Cabinet Office).

T. P. LANKESTER

Denis Walker, Esq.,
Department of Energy.

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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

7th January 1980

Dear Tim,

NORTH SEA OIL PRICES

The Chancellor has seen a copy of the letter of 4th January from the Private Secretary to the Secretary of State for Energy about North Sea oil prices. The letter reported the Secretary of State's view that if Nigerian prices do not rise to above $30 per barrel, BNOC should seek to establish a single UKCS marker price at $30 per barrel. But if Nigeria moved to $34 per barrel, a UKCS price of around $32.75 per barrel would be defensible with perhaps the extra $2.75 being treated as a temporary supplementary payment or surcharge to be reviewed monthly.

The Chancellor understands that the Nigerians have in fact decided on a price of $30 per barrel and in these circumstances he would agree that BNOC should seek to establish a UKCS marker price at the same level. A higher price would increase PRT, etc. receipts and the PSBR would be reduced if our decision on oil prices did not affect world oil prices. But any price above $30 would be difficult to justify internationally in view of the Nigerian decision to stick at that price and it could well provoke the Nigerians into raising their prices to our level using our decision as an excuse. This would be embarrassing.

But if the Nigerians increased their prices above $30 within the quarter, we ought to reconsider UKCS prices. The Chancellor thinks that in those circumstances the Secretary of State's suggestion for a temporary supplement might be helpful presentationally.

The Chancellor has therefore concluded that this is not the moment to go for the highest possible price, for example in reply to the failure so far of the Community to meet us on our contribution to the Community Budget. If we wanted to consider that step, the time to do so would be after the next European Council if no progress was then made on the Budget.

/Finally,

T. Lankester, Esq.,
No.10, Downing Street

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Finally, the Chancellor thinks it most important that posts abroad and the press are given firm guidance about the reasons for and the reasonableness of our line.

I am sending a copy of this letter to Paul Lever (FCO), Denis Walker (Department of Energy) and to Martin Vile (Cabinet Office).

Yours ever,

(M.A. HALL)

Ref: A01088

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MR. LANKESTER

The Price of North Sea Oil

You asked for advice on the Secretary of State for Energy's minute of 3rd January to the Prime Minister, as supplemented by his Private Secretary's letter to you of 4th January, about the price of North Sea oil.

2. The Chancellor of the Exchequer has of course since commented through a letter from his Private Secretary to you dated 7th January. Sir Robert Armstrong has no reason to dissent from the joint view of the two Ministers that, given what appears to be the Nigerian decision, $30 a barrel is an acceptable price for the time being.

3. At the same time Sir Robert wonders whether it makes sense for the Government to get, or appear to get, involved in the price-fixing process. Not only does this attract unnecessary political flak from our European partners, but the cost of interference to restrain prices is potentially high (every cent on a barrel of North Sea oil raises the annual value of North Sea output by about $7 million, of which about three quarters ultimately comes to the Exchequer). Of course we can and do say that the British Government does not set the price of North Sea oil and that it simply follows the market. But our protestations would carry more conviction if it were clear that the price was established under the terms of legally binding commercial contracts by recognised and independent arbitration procedures.

4. Before deciding whether the political benefits of the arbitration approach are worth having, we should need to know what price tag, if any, might attach to them. How would an arbitrator's price be likely to compare at the margin with an administered price - particularly in the present confused state of the market? A judgment here must turn on detailed knowledge of the arbitration procedures and ground rules which we do not have. Sir Robert suggests that in replying to Mr. Howell's minute the Prime Minister should ask for considered advice on what the likely effect on our oil prices would be if we set out positively to encourage recourse to arbitration rather than, as at present, sought to avoid it.

M.J.V.

(M. J. Vile)

8th January 1980

Prime Minister

See Treasury and FCO comments at Flags A and B. Since the Nigerians have not increased their prices above $30, BNOC should stick at this level. Before deciding on possible supplements for the future, it would seem worth examining the arbitration option as suggested below. Agree?

R 8/1

Agreed. As this would take time - we should go ahead with $30 - but more North Sea producers may think that is not enough. Perhaps advice on arbitration procedure could i.e. prepared. Flag A ref.

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Foreign and Commonwealth Office

London SW1A 2AH

8 January 1980

Dear Michael,

North Sea Oil Prices

The Foreign and Commonwealth Secretary has seen the Secretary of State for Energy's minute of 3 January to the Prime Minister and Denis Walker's further letter to you of 4 January about North Sea oil prices. He agrees broadly with the approach that Mr Howell has proposed. We understand that there is still no hard evidence that the Nigerians have increased their prices above $30 per barrel. In these circumstances, Lord Carrington assumes that the authorisation to be given to BNOC will be on the lines of (a) in the Secretary of State for Energy's minute of 3 January.

If the Nigerians subsequently increase prices to around $34 per barrel, Lord Carrington sees some attraction in Mr Howell's suggestion that BNOC should pursue the idea of retaining a basic market price of around $30 per barrel, but adding on a temporary surcharge to be reviewed monthly. He attaches particular importance to the arguments set out in (b) of Denis Walker's letter of 4 January, and hopes that if we follow this course we can make it clear publicly that the surcharge is temporary and subject to regular review, and would be reconsidered if demand for oil falls this spring. We could present this internationally as evidence that the Government were seeking to influence market trends in a moderate direction.

Denis Walker's letter does not state explicitly that the temporary surcharge which his Secretary of State has in mind would be in the order of $2.75, to take the effective price up to the proposed ceiling of $32.75. No doubt the Department of Energy will confirm that that is what Mr Howell has in mind. A higher surcharge, even if labelled temporary, would be exceedingly difficult to defend internationally.

I am sending copies of this letter to Denis Walker (Energy), Martin Hall (Treasury) and Martin Vile (Cabinet Office).

Yours ever

Paul

(P Lever)
Private Secretary

M O'D B Alexander Esq
10 Downing Street

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